

By email

16 September 2021

Dear Chief Executives

## Reviewing incumbent company support for effective markets (RISE)

Following taking up my role as Interim Chief Executive, I wanted to take this opportunity to write to you to reaffirm Ofwat's commitment to monitor incumbent company support for effective markets and, consistent with our strategy, to improve company performance.

This letter sets out how we are supporting work in the business retail and developer services markets to improve incumbent company support for effective markets in order to deliver improved outcomes for customers, society and the environment. I would like to see all incumbent companies work constructively and – in some cases – step up their efforts to support these markets.

- **Project RISE**

It's now been over two years since Rachel Fletcher [wrote](#) to incumbent companies in England to say that levels of support for effective markets were – at that time – unacceptable. Following analysis of evidence submitted by incumbent companies and other stakeholders, we [concluded](#) in 2020 that despite some improvements (and including the liquidity support provided to business retailers during Covid-19) overall, incumbent companies needed to play a more active role in supporting the business retail and developer services markets. We recognised – as illustrated in the [bespoke letters](#) to company CEOs – that some companies performed better than others.

Based on our on-going market monitoring activities, this remains our view. There are a number of initiatives currently underway in the business retail and developer services markets aimed at improving incumbent company support for effective markets and I would like to see incumbent companies fully support these. For example:

- **Business retail market**

Following an initial [study](#) exploring the feasibility of a B-MeX<sup>1</sup> incentive that was commissioned by Ofwat, market participants are now leading work to design and implement a new B-MeX incentive. Market participants are also leading work to reform the current market performance framework (MPF), including to sharpen incentives on

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<sup>1</sup> A B-MeX incentive focuses on the experience of (end) business customers in consuming wholesale services.

incumbent companies to support the business retail market and deliver improved outcomes for business customers. We fully support these initiatives and are pleased to see some incumbent companies stepping up to drive progress on these important workstreams. If we see companies failing to support this work and/or attempting to delay progress, we will call this out and take further action if appropriate.

We have recently [consulted](#) on our investigation into Thames Water, which concluded that this company failed to meet its licence conditions and code obligations relating to the quality of its market data. This demonstrates that we are willing to use our full range of our regulatory tools if necessary. I encourage all incumbent companies to carefully reflect on our findings, including the actions that Thames has committed to in order to improve the quality of its market data.

- **Developer services market**

Following publication of the RISE report, a number of incumbent companies have engaged with us on their work to substantially improve their support for developer services markets. I encourage other companies to reflect on the improvements they can still make, and welcome companies' engagement, including by inviting us to attend their developer services events.

We are also supporting industry to further improve bulk charges for NAVs through the new industry working group; and we have published a report by SIA partners on the variance in companies' developer charges which allows incumbents to examine how they might improve the cost-reflectivity of their new connection charges for 2022-23.

Appendix 1 of this letter highlights recent positive examples of incumbent companies stepping up to support effective markets, including in response to our challenges through project RISE. Appendix 2 highlights additional areas where we expect to see further support, including as companies begin to prepare their business plans for PR24.

I look forward to hearing about the steps you are taking to support effective markets in our regular CEO catch ups.

Yours Sincerely



David Black  
**Interim Chief Executive**

## Appendix 1: Positive action from incumbent companies to support effective markets

- **Business retail**

In project RISE we concluded that the **market-led approach to governance** in the business retail market could be improved to further strengthen the customer voice and better facilitate innovation. This led to the Panel commissioning an independent [review](#) of its effectiveness and subsequent changes to the market codes to replace the existing Panel with a more strategic Panel. We are very supportive of the changes to both: the Panel's composition – to make it more customer centric; and to the Panel's purpose – including to operationalise [our vision](#) of a market that creates value for society. We have been clear that we think the Panel needs to be more strategic, including by prioritising changes that will deliver the greatest benefits to customers. We look forward to seeing incumbent companies support a reformed and more strategic Panel, including by nominating suitably senior staff as wholesaler representatives<sup>2</sup>.

Inefficient and cumbersome interactions between retailers and wholesalers lead to poor outcomes for end customers and unnecessarily increase retailer costs. Project RISE called out some positive examples of market participants working collaboratively to improve the interactions between trading parties – including the development of the 'bilaterals' solution and improved harmonisation of some wholesaler policies. Since publication of the RISE report we have been pleased to see the Retailer-Wholesaler Group (RWG) establish a group to explore **simplification of wholesale tariff structures**, which includes excellent wholesaler representation (including its Chair). We look forward to seeing the outputs of this important work. We are also pleased to see the 'bilaterals' programme continue to deliver under collaborative leadership from MOSL.

A common theme in project RISE was wholesalers – in our view wrongly – using competition law as a reason not to collaborate or to be more responsive to the needs of individual Retailers. Compliance with competition law is a matter for companies but we have been very clear that competition law is not in and of itself a barrier to wholesalers working with retailers – for example to deliver improved levels of water efficiency. In relation to **credit support requirements**, project RISE noted a range of alternative credit agreements in place. However, we found less evidence that wholesalers have responded positively to retailer-led proposals for alternative credit arrangements or

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<sup>2</sup> More information on nominations for trading party Strategic Panel Members can be found [here](#). The deadline for nominations is 1 October 2021.

tailored their offerings to the circumstances of particular Retailers or sub-sets of Retailers. Since then, we have noted some positive examples of individual wholesalers tailoring their credit support requirements to reflect levels of risk posed by different retailers and have received positive feedback from some retailers. We have now published [guidance](#) and look forward to seeing wholesalers take further action here.

- **Developer services**

Following publication of our findings on RISE, we have seen individual incumbent companies increase their support for effective developer services markets. We have been pleased that a number of companies have engaged with us to explain the work they are doing to **substantially improve their services** to self-lay providers (SLPs) and new appointees (NAVs). And that we have been able to trace this through, for example in improved overall D-MeX scores. We understand that there has been a widespread reduction in the time taken to reach agreement with NAVs on bulk supply / discharge, supported by the standardised agreement that industry has established. We recognise there are other good examples of incumbents supporting NAVs in their areas of appointment. We encourage other companies to reflect on the improvements they can still make, and welcome companies' engagement, for example by inviting us to attend their developer services events.

We have seen **companies collaborating to support more effective developer services markets**. Incumbents have shown a strong commitment to Ofwat's new industry group on bulk charging for NAVs, with companies driving forward individual areas of work. Companies have worked together to prepare a list of standardised terms for developer services charges, and agreed a consistent format for presenting worked examples to explain their charges, and have engaged with stakeholders to improve these further. Subsequent to our work on RISE, both the water and sewerage panels for Codes of Adoption Agreements are now established and processing change proposals.

We have seen evidence that this support has **strengthened developer services markets**. Since publishing our RISE report, some companies have reported substantial increases in SLP activity in their areas, and we estimate SLPs now account for around 34% of all water new connections. We continue to see record numbers of NAV applications and licences granted since publication of our updated guidance on bulk charges for NAVs earlier this year.

## Appendix 2: Areas where we would like to see further support from incumbent companies

- **Business retail**

Project RISE recognised the ways in which wholesalers can influence the end customer experience and concluded that incumbent companies need to be more proactive in **understanding and responding to the needs of their non-household customers**. Customer engagement is an ongoing activity but the development of PR24 business plans provide incumbent companies with an opportunity to demonstrate they understand the needs of their business customers and are tailoring their wholesale services accordingly. For example, accurate and timely meter reads are a crucial underpinning of an effective business retail market and as owners of this essential metering infrastructure wholesalers have a crucial role to play in facilitating more accurate and timely consumption data. This is an important enabler of business customers using water more efficiently, which should also benefit incumbent companies by saving them money and helping them to balance their demand.

Project RISE also recognised the importance of well-designed, targeted incentives on wholesalers to deliver improved outcomes for business customers and strongly supported **reform of the Market Performance Framework (MPF)**, including to reflect the principles agreed in the [MPF roadmap](#). We were disappointed to see this important work delayed as a result of Covid-19 and would like to see market participants focus on reform of the MPF as a priority in order to improve Trading Party performance for the benefit of customers.

- **Developer services**

We continue to see instances of poor support for effective developer services markets that require addressing. We are concerned that a number of incumbents are **not meeting target service levels for SLPs and NAVs**, for example resolving point of connection/discharge applications for NAVs within the target of 28 days. There is scope for incumbents to be more proactive and work with NAVs across boundaries, to prepare for emergencies and planned responses to incidents in the interests of all customers. Where novel issues have arisen in the negotiation of bulk supply/discharge agreements, there are examples of incumbents not seeking to resolve these issues.

We would like to see further improvements to charging practices so that SLPs and NAVs can have confidence that new connection charges are cost reflective, allowing them to compete on a level playing field. Earlier in 2021, incumbent companies engaged with us and [SIA Partners](#) to investigate reasons for large differences in incumbents' charges. We expect incumbents to **review the findings of the Sia Partners' report** to establish how they might improve the cost-reflectivity of their charges for 2022-23, consistent with the principles in our charging rules. We are also examining the impact of different approaches to cost allocation between developer services and other wholesale activities as part of our

preparations for PR24. We are looking to improve allocation of overhead costs through changes to our Regulatory Accounting Guidance.

Our updated 2021 guidance on bulk charges for NAVs allowed a period of transition for incumbents to review their current approaches for charging NAVs. Work has begun through the industry group to make sure approaches for 2022-23 charges are in line with guidance, but companies (particularly smaller ones) need to ensure they are in a position to comply with the updated guidance. In addition, there is insufficient consistency of approach to cost estimation that could be leading to wide variations in NAV tariffs across the country: we expect continued support at the bulk charging industry group to address this.

While SLP (and NAV) market shares have increased, there are still some incumbent areas where they are low. We are keen to understand the reasons for this, particularly the level of competition in different segments of the developer services market and the drivers of SLP growth. As part of PR24, we will consider whether an alternative form of regulation might apply, and what further interventions might be appropriate.