

Information notice

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Payment terms between wholesalers and retailers

This information notice confirms our decisions on the form of payment terms which are to apply between wholesale businesses ('wholesalers') and retail businesses ('retailers') in the water and wastewater markets in England and Wales. These payment terms will apply from 1 April 2015.

We consulted on our proposed approach in '[Payment terms between wholesalers and retailers – a consultation](#)', which we published on 11 October 2013. The consultation closed on 28 October.

Background

Most people in England and Wales receive their water services from one of 19 private monopoly suppliers and their wastewater services from one of ten suppliers. These companies provide both customer-facing ('retail') services and less customer-facing ('wholesale') services. Only non-household customers using more than five million litres of water a year (50 million a year in Wales) are currently able to choose their

supplier. They are able to choose a company that provides water-only services (a 'water supply licensee') or to choose a licensed company to become their monopoly supplier for a specific area (a 'new appointment and variation').

The UK Government has proposed in its Water Bill to, among other things, allow all non-household customers in England to choose their retail supplier for water and wastewater services. They have also proposed to allow competition to provide wholesale services. The UK Government has set up a group of stakeholders – including Ofwat – to prepare to implement the Water Bill once it becomes law. The work of the group (the '[Open Water programme](#)') includes proposing the rules – set out in published documents ('market documents') – that everyone in the markets will need to stick to.

We are currently considering the price and service package ('price controls') that the monopoly water and sewerage and water only companies must deliver for each

of the five years between 2015 and 2020. We call this the 2014 price review. For the first time we are setting up to four price controls for each company – retail household services, retail non-household services, wholesale water services and wholesale wastewater services. Each monopoly company is expected to send us a business plan, setting out how it plans to deliver services during 2015-20, by 2 December 2013.

It is important for the 2014 price review and for the expansion of markets for water and wastewater services that we establish the payment terms that exist between retailers and wholesalers. This is so we can make sure we protect both the interests of customers that that cannot choose their supplier and those that can.

In 'Payment terms between wholesalers and retailers – a consultation' we set out our 'minded to' proposals on payment terms, including the details of billing, settlement and credit requirements. In particular, we proposed:

This is a formal document that alerts our stakeholders to a change in the way that we regulate the water and sewerage sectors in England and Wales.

- how prescriptive the payment terms will be;
- what products and services the payment terms will apply to;
- the period of time that is charged for each time an invoice is issued (the 'billing period');
- how long the participant receiving goods has to pay for them (the 'payment period');
- what credit requirements will be associated with the payment terms; and
- the minimum period for which traded services can be purchased ('settlement period').

We have received and reviewed 14 responses to our consultation from wholesalers, retailers and customer representatives. Most of the responses support our proposals. Where stakeholders have suggested changes or clarifications to the terms we proposed, we have considered these and reflected them in our final position below. These payment terms will apply from 1 April 2015.

Application of payment terms

Before the Water Bill is enacted and the relevant sections of the legislation are implemented, we will do the following.

- We will update our access code guidance under section 66D (4) of the Water Industry Act 1991.
- We will require the existing monopoly water and sewerage and water only companies to offer other licensed water suppliers these payment terms. The monopoly companies should

Decisions at a glance	
Setting of payment terms	<p>Wholesalers must offer standard terms to everyone.</p> <p>Non-standard terms can be used where a wholesaler and retailer agree with each other to do so.</p> <p>Wholesalers must publish any non-standard terms they agree and make these terms available to all retailers.</p>
Scope of products and services	<p>Payment terms apply to all products and services provided between wholesalers and retailers.</p> <p>Services provided directly by the wholesaler to end customers are not covered by these payment terms.</p>
Settlement period	One calendar day
Details of payment terms	
Billing period	Standard term: One calendar month
Payment period	Standard term: 30 days from the last day of the billing period, or 15 days after the invoice is deemed to be received, whichever is the later.
Credit requirement	<p>Standard term: a retailer needs to have either:</p> <ul style="list-style-type: none"> • a letter of credit from a guarantor with a minimum credit rating that will be set out in the market documents; or • an agreement with a wholesaler to use an escrow account. <p>Additional safeguard for deviation from standard term: a wholesaler needs to:</p> <ul style="list-style-type: none"> • offer proportionate credit and collateral arrangements; and • explain clearly the rationale for credit decisions.

also assume in their business plans that their wholesale businesses will use these terms with their retail businesses.

This would not apply to business plans for small companies (Cholderton and District Water and new appointments and variations) for whom we are not setting separate retail and wholesale price controls.

After enactment and implementation of the relevant sections of the Water Bill:

- water companies will be required to offer these payment terms to water supply licensees; and
- sewerage companies will be required to offer these terms to sewerage licensees.

We intend to do this by setting the terms out in the market documents, and making compliance with those market documents a licence obligation for market participants.

Setting of payment terms

Some respondents stated that they would prefer wholesalers to have fixed payment terms. We think that this could potentially inhibit competition and the development of innovative products. So we confirm that there will be standard payment terms.

One respondent argued that allowing wholesalers to offer non-standard terms creates the potential risk that they could offer overly generous terms to their own retailers and so inhibit competition.

To limit this risk, we confirm that any non-standard payment terms agreed between any two parties, including between a wholesaler and its own retailer, **must** be published, and made available to any other party.

In addition, we confirm that all market participants **must** offer the standard terms. Non-standard terms can only be used if both parties agree that they want them. When such non-standard arrangements are agreed, wholesalers are required to publish their non-standard payment term agreements and make these terms available to all retailers.

Some respondents queried what would happen in the event that payment terms were breached by any party. The details of payment terms will be included in the market documents – such as market codes. Compliance with the market codes will be a condition of both retailers' and wholesalers' licences. Failure by any party to comply with the payment terms could be a breach of their licence conditions and would be addressed accordingly.

Products and services

We confirm that the same payment terms will apply for all products and services provided between retailers and wholesalers, and not just those for which the market operator calculates charges.

Services provided directly by wholesalers to end customers –

for example water and wastewater connections for household customers – are excluded from these payment terms.

Settlement period

We confirm that the settlement period in water and wastewater will be one day. Our working assumption is that the settlement period will be defined as a calendar day (from midnight to midnight).

Standard billing period

The standard billing period will be one calendar month.

Standard payment period

The standard payment period will be 30 days from the last day of the billing period, or 15 days after the invoice is deemed to be received, whichever is the later.

Credit requirements

Respondents to our consultation recognised that allowing wholesalers to require a letter of credit from an investment grade rated company could act as a barrier to companies entering the water and wastewater markets and offering their services. They also recognised that allowing an alternative, such as an escrow account – an account managed by a third party – to be set up could alleviate this problem, as in the Scottish water market.

It was also noted that eligibility for standard terms could become

fragmented across the sector if a minimum credit rating was not specified. For example, one respondent recommended that a minimum investment grade credit rating from one of three widely recognised credit-rating agencies should be specified. These were:

- Standard & Poor's (BBB-);
- Fitch (BBB-); or
- Moody's (Baa3).

However, this is the view of one company. So while we agree that it is sensible to set out specifically the credit requirements, we think that the details of this are for the sector to agree, not us.

So we confirm that the standard credit requirement will be that the retailer needs:

- to have a letter of credit from a guarantor with a minimum investment grade credit rating; or
- an escrow account set up between the wholesaler and the retailer.

The details of the minimum investment grade credit rating requirements and escrow accounts in payment terms will be specified in the market documents.

We confirm that in cases where market participants agree non-standard terms that include alternative credit requirement, wholesalers must:

- offer proportionate credit and collateral arrangements; and
- explain clearly the rationale for their credit decisions.

Resettlement and dispute process

We recognise that the details of the resettlement timeline – the points in time at which settlement payments are corrected for more up-to-date information – and the dispute process for settlement are not set out here. We confirm that these will be set out in the market documents when they are developed for our consideration by the Open Water programme.

Access code guidance

The terms and conditions of access agreements between monopoly water and sewerage and water only companies and water supply licensees must be made in accordance with our access code guidance. Several respondents queried how the proposed payment terms relate to our access code guidance. In particular, the proposed approach would lead to inconsistency with existing retail market payment arrangements.

We will update the access code guidance to reflect the new payment terms in this notice. We will do this at the same time as we implement other updates to the

guidance. However, water supply licensees will not have to change their existing agreed payment terms unless their customers want to change their terms.

Next steps

The payment terms in this notice will take effect from 1 April 2015.

These payment terms should be used by monopoly companies to form the basis for their assumptions on payment terms for their household and non-household retail price controls in their business plans.

We will update our access code guidance and other market documents in conjunction with the Open Water programme by 1 April 2015.

Enquiries

If you have any questions about our approach to payment terms between wholesalers and retailers, please send them to jacob.wood@ofwat.gsi.gov.uk.

More information

[Payment terms between wholesalers and retailers – a consultation](#), October 2013

[Responses](#) to 'Payment terms between wholesalers and retailers – a consultation', November 2013

[Setting price controls for 2015-20 – final methodology and expectations for companies' business plans](#), July 2013

Choosing your supplier [web pages](#)

[Open Water](#) website

2014 price review [web pages](#)

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