
Wholesale-Retail Code Change Proposal – Ref CPW021

Modification proposal	Negotiating Alternative Eligible Credit Support reasonably and in good faith
Decision	Ofwat has decided to accept this change proposal
Publication date	Thursday 13 July 2017
Implementation date	Friday 14 July 2017

Background

The Wholesale-Retail Code (WRC) sets out the relationship between Wholesalers and Retailers, and how the market operates. Credit arrangements are an important aspect of any market arrangement. Any disproportionate, discriminatory or unclear credit arrangements could act as a barrier to entry for new entrants, resulting in a chilling effect on the levels of rivalry and choice in the new market to the detriment of customers. Similarly, if credit arrangements do not adequately address the risks that wholesalers are exposed to under the new arrangements then they could potentially impact on the financeability of the wholesaler.

Following lengthy consultation and engagement with the industry prior to market opening, the credit arrangements to open the business retail market were included in the WRC. These arrangements include a suite of six regulated credit options which retailers can use to provide the required credit support, along with a seventh option which allows for eligible credit support to be provided on an alternative, negotiated basis between retailers and wholesalers. Each of the six regulated options included within the WRC were complemented with key terms and, where appropriate, templates that could be used by retailers to provide the required credit support to wholesalers.

The issue

We are aware that retailers across the industry are providing the required eligible credit support using a variety of the credit options included in the WRC. This is positive and something we would expect to see in a dynamic, competitive environment. However, concerns have been raised that some of the key terms and templates associated with some of the credit options may not be practicable in some

instances and might prevent retailers from entering and operating in the market. Some retailers have therefore approached wholesalers in an attempt to negotiate and agree Alternative Eligible Credit Support in line with Schedule 3 of the WRC, but so far without success. The main cause of this appears to be ambiguity within section 9 and Schedule 3 to Part 2: Business Terms of the WRC, as to the extent of Wholesalers' obligations in considering and responding to Alternative Eligible Credit Support.

Schedule 3 currently states *“where a Contracting Retailer seeks to establish arrangements for Alternative Eligible Credit Support with the Contracting Wholesaler, the Contracting Wholesaler shall be obliged to give due and proper consideration to such proposals”*. The circumstances referred to above have demonstrated that it is not clear what is meant by “due and proper consideration”. In particular, there is a lack of detail on the principles which a Wholesaler should apply in considering and responding to such proposals, other than that as a minimum any resultant agreement should comply with the basic features of such credit prescribed by Schedule 3.

Ofwat is particularly concerned that the lack of clarity described above is an unnecessary barrier to Retailers and other trading parties, because it limits access to and the scope for parties to develop new and innovative credit support options.

The Modification Proposal¹

Ofwat submitted this change proposal as an Authority Timetabled Change Proposal. This proposal seeks to amend section 9.11.5 of, and Schedule 3 to, Part 2: Business Terms of the WRC to clarify the obligations on Contracting Wholesalers and Contracting Retailers to one another to negotiate Alternative Eligible Credit Support reasonably and in good faith, having due regard to the Principles of the Code.

Ofwat set its timetable for assessment of its proposal in recognition of the timescales for certain ongoing negotiations as to Alternative Eligible Credit Support.

Panel recommendation

The Panel met by teleconference on 10 July. At this meeting, the Panel voted by majority decision to recommend implementation of Change Proposal CPW021 to Ofwat on the basis that this proposal improves the principles of efficiency and

¹ The proposal and accompanying documentation is available on the MOSL website at <https://www.mosl.co.uk/market-codes/change#scroll-track-a-change>

transparency. The Panel submitted its recommendation report to Ofwat on 11 July 2017.

In its recommendation report, the Panel states that in its view this Change Proposal reinforces Wholesalers' obligations to act reasonably, without delay and in good faith in relation to considering the terms for Alternative Eligible Credit Support. The current obligations on which Wholesales agreed Alternative Eligible Credit Support are not specific and can lead to inefficient and drawn out negotiations. The reinforcement of the obligations should address some of the inefficiencies in how Wholesalers and Retailers agree arrangements in Alternative Eligible Credit Support. The Panel also adds that the Change Proposal potentially broadens the options available to Wholesalers and existing and prospective Retailers in relation to proposals for Alternative Eligible Credit Support. The reinforcement of the principles of Schedule 3 means that the approach to Wholesalers and Retailers agreeing terms is more clearly expressed.

In reaching its recommendation the Panel noted that Ofwat, as the proposer of the change, put forward in the change proposal form that CPW021 also improves the Principles relating to barriers to entry and proportionality. The Panel believes that CPW021 clarifies requirements on Trading Parties to act reasonably and negotiate in good faith in accordance with the Principles of the WRC. Consequently, Panel Members concluded that, on balance, CPW021 had neither a benefit nor detriment on the Principles relating to barriers to entry or proportionality.

Our decision

Alongside the issues raised by us in the modification proposal, and given the tight timescales, we have paid particular attention to the responses received to the industry consultation and the Panel's recommendation report. We have concluded that the implementation of CPW021 will better facilitate the principles and objectives of the WRC² detailed in Schedule 1 Part 1 Objectives, Principles and Definitions and is consistent with our statutory duties.

Reasons for our decision

We set out below our views on which of the applicable Code principles are better facilitated by the modification proposal.

² Available at <https://www.mosl.co.uk/market-codes/codes>

Efficiency

In our view this proposal promotes the efficient, economic and innovative operation of the water and wastewater sector by removing ambiguity around the nature of trading parties' obligations to each other in relation to proposals for Alternative Eligible Credit Support. In turn, this could assist parties by expediting negotiations so that mutually acceptable solutions can be reached in a more efficient and timely manner.

Proportionality

We think that the proposal is proportionate to the problem it seeks to address. Currently there is ambiguity as to the extent of Wholesalers' obligations in considering and responding to Alternative Eligible Credit Support. It proposes a principles-based solution to questions around the nature of such negotiations which addresses the uncertainty without being overly prescriptive. However, we also note that this obligation should also apply to Retailers when entering into discussions around Alternative Eligible Credit Support. This is discussed further under 'Transparency' below.

We have considered whether to make explicit reference to particular credit options in Schedule 3. However, we think that Alternative Eligible Credit Support would be used where use of any of the regulated credit options was not possible, and as such we think making provision for any of the regulated credit options in Schedule 3 would create unnecessary duplication with parts of Schedule 2 and is contrary to the principles-based approach that allows the market to reach the best solution.

Transparency

We agree with the Panel that this change proposal is consistent with the principle of improving Transparency. We consider that the introduction of the revised wording will provide greater transparency and clarity as to the obligations of wholesalers and retailers to each other in negotiating Alternative Eligible Credit Support. We also want to send a clear message to the industry of our expectations with regard to the behaviours of both Wholesalers and Retailers.

This proposal improves the clarity around Wholesaler's obligations in relation to considering proposals for Alternative Eligible Credit Support and makes the arrangements under the WRC more readily accessible to Retailers, by removing ambiguity as to how such proposals should be dealt with. However, we also recognise that it should be the case that Retailers must also take their responsibilities in relation to making proposals for Alternative Eligible Credit Support transparent and cogent such that Wholesalers can engage constructively in

negotiations and consider proposals reasonably. Without this obligation applying to both parties we think there would be a risk of Retailers submitting spurious proposals and we think that Retailers, when proposing Alternative Eligible Credit Support, should be incentivised to ensure that their proposals are sufficiently developed.

Barriers to entry

We go further than the Panel and consider that this proposal reduces a barrier to entry by providing greater certainty on Wholesalers' obligations to negotiate Alternative Eligible Credit Support and increases the scope for Retailers to provide the required eligible credit support via a mechanism which suits their particular circumstances. The proposed obligation also helps to address the differences in bargaining power between Wholesalers and new entrants by requiring Wholesalers to act reasonably, in a timely manner and negotiate in good faith. In absence of this proposal, Wholesalers may not always have an incentive to do this and that could restrict the ability of Retailers to enter and expand in the market.

Non-discrimination

In our view, the proposal expressly requires the parties to negotiate having regard to the Principle of Non-Discrimination. We do not consider that this proposal creates any duplication with the Objectives, Principles and Definitions of the Wholesale Contract. We think it is appropriate, given the importance to both parties that credit support arrangements are in place, to make an explicit provision via this change proposal in Schedule 3 that is consistent with the principle of non-discrimination.

Decision notice

In accordance with paragraph 7.2.8 of the Market Arrangements Code, Ofwat approves this change proposal.

Cathryn Ross,
Chief Executive