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## Wholesale-Retail Code Change Proposal – Ref CPW057

<b>Modification proposal</b>	Wholesale-Retail Code Change Proposal – CPW057 – Improving the transparency of Credit Guarantee Arrangements
<b>Decision</b>	Ofwat has decided to approve this change proposal
<b>Publication date</b>	13 September 2019
<b>Implementation date</b>	30 September 2019

### Background

The [KPMG review of credit arrangements for the non-household retail market](#) (“the KPMG Report”) was commissioned by Ofwat to review the effectiveness of the credit arrangements for the non-household retail market.

The KPMG Report refers to the Parent Company Guarantee (“PCG”). The PCG, as well as other similar forms of credit, is an intra-group credit arrangement between a Wholesaler and its Associated Retailer. These arrangements are referred to as “Guarantees” in the Wholesale-Retail Code (“WRC”).

Ofwat stated in its [narrative](#) to the KPMG Report “The responses to our formal information request revealed that Associated Retailers of incumbent wholesalers are primarily accessing PCGs, at zero or low cost and these associated retailers are using PCGs in areas previously served by the incumbent.”

### The issue

Retailers have raised concerns that the way in which PCGs and other forms of credit between Wholesalers and Associated Retailers are facilitated are not transparent and may provide an unfair competitive advantage to the Associated Retailer over any other Retailer.

An example of the concern is that the availability of low credit costs through Guarantees (including PCGs) may create an opportunity for Associated Retailers to

price below the efficient costs of a new entrant and prevent the new entrant from competing fairly in the market.

The proposal is seeking to improve the transparency and oversight of the Guarantee arrangements used in the market place, in order to identify unfair competitive advantage without making commercially sensitive information available.

## **The modification proposal<sup>1</sup>**

The proposal is that the existence of the Guarantee will be published on the Market Operator (MOSLs) website, and that items which form part of the Guarantee will be made transparent. The publication of this information on MOSL's website is considered to provide sufficient transparency without the need for publication on the websites of the Wholesaler or the Retailer. The full value of the Guarantee will not be published. Concerns were raised in the public consultation that publication of the full value and terms of the Guarantee was undesirable as some Guarantors might otherwise be dissuaded from offering credit.

If approved, the following obligations will be created:

Retailers will be obliged to provide MOSL with:

- Guarantee Details: including details of the Guarantor, Counterparty (Contracting Wholesaler) and Obligor (Contracting Retailer); and
- A Declaration of Assurance that the Guarantee has been provided on an arm's length basis and that the Retailer has provided Ofwat with the requisite information related to the Guarantee

Retailers will be obliged to provide Ofwat with:

- Confirmation that the Guarantee has been provided on an arm's length basis, and;
- Evidence to determine the commercial consideration of the Guarantee including the costs and other relevant terms of the Guarantee.

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

Ofwat will apply a risk-based approach to the evidence provided under the proposed solution. Ofwat reserves the right to request further information to that provided where appropriate.

Wholesalers will be obliged to provide consent to the Contracting Retailer to release the items in the Guarantee Details following the execution of the Guarantee.

MOSL will be obliged to publish the Guarantee Details and Declaration of Assurance on its website.

## **Industry consultation and assessment**

The current modification proposal is a revision of a previously proposed solution set out in DCP016. This proposal placed obligations on Wholesalers and Retailers to notify Ofwat and MOSL of any Guarantees either still in effect, or which had been put in place, and to publish the Guarantees on their website. DCP016 was the subject of an industry consultation and although respondents in the main saw the benefits of increased transparency of intra-group Guarantees, it was considered by the majority that the nature of the obligations on Trading Parties set out in the proposals are onerous and, together with concerns relating to revealing commercially sensitive information online, led to the proposal being revised. A summary of the responses to the industry consultation is set out in Appendix 1.

The current Change Proposal continues to be aimed at increasing the transparency of Guarantees (including PCGs), but addresses the concerns raised by Trading Parties in response to the industry consultation. It creates obligations on Wholesalers and Associated Retailers which are less onerous than those contained in the original proposal and will require Retailers to make available to Ofwat evidence relevant to the commercial arrangements of each Guarantee. The requirement placed on Trading Parties to publish the details of the Guarantee arrangements on their websites has been replaced by the requirement to provide Ofwat with evidence related to the details of the Guarantee.

It is considered that the concern related to revealing commercially sensitive information by publishing the full detail of Guarantees on websites will be avoided with this modification.

## Panel recommendation

The Panel considered this Change Proposal at its meeting on 28 May 2019. It decided unanimously to recommend that Ofwat approve this proposal, whilst noting that some Panel Members were disappointed that the proposal did not go further to recommend that full Guarantees, including costs, to be published. The Panel has made the recommendation for approval on the basis of improving the principles of efficiency, non-discrimination and transparency. The recommended date of implementation is 30 September 2019.

## Our decision

We have considered the issues raised by the modification proposal and the supporting documentation provided in the Panel's Final Report. We have concluded that the implementation of CPW057 will better facilitate the principles and objectives of the Wholesale Retail Code detailed in Schedule 1 Part 1 Objectives, Principles and Definitions and is consistent with our statutory duties.

While we agree that this modification is an improvement against the current provisions of the codes and will provide more transparency as to the existence of such arrangements, we are not convinced that this proposal in its own right goes far enough to provide the transparency required to enable the market, and in particular all retailers, to operate more effectively. Ofwat's approach to enforcement in this context is referred to above, in that we will take a risk-based approach based on the evidence we receive. This means that we will not necessarily act upon all of the information we receive.

We are therefore requesting that the Panel directs the Credit Committee to conduct a further review of the extent of the commercial sensitivity attached to the publication of the full details of all Guarantees, including costs, at the earliest opportunity and consider solutions that will allow for the terms of such Guarantees to be made available without compromising the commercial sensitivities associated with the information.

## Reasons for our decision

Our initial views are set out in our [narrative](#) to the KPMG Report, in which we asked the Codes Panel to prioritise taking forward the transparency aspect of the PCG and similar credit arrangements. We set out below our views on which of the applicable Code principles are better facilitated by the modification proposal.

## **Transparency**

The publication and oversight of all Guarantee arrangements should provide a level of assurance and confidence to Trading Parties and others that Guarantees provided on an intra-group basis are done so and utilised in compliance with the respective obligations under competition law of the relevant parties. It will also provide visibility to Ofwat of the detail of these arrangements should any concerns arise around the provision of intra-group credit that may lead to any competition concerns.

## **Efficiency**

The publication of Guarantees within a central location will mean that it is easier to become aware of existing arrangements.

## **Non-discrimination**

Transparency of these arrangements (including oversight, where appropriate, by Ofwat of the commercial considerations involved in Guarantees) provided between related Trading Parties, as well as competition law obligations, should help reduce the potential for discrimination against non-related Retailers.

## **Decision notice**

In accordance with paragraph 6.3.7 of the Market Arrangements Code, Ofwat approves this Change Proposal.

**Georgina Mills**  
**Director, Business Retail Market**

## **Appendix 1 – Request for Information questions and summary of responses**

This section summarises the responses received following the Request for Information (RFI) for DCP016 which was issued on 18 December 2018 and closed on 17 January 2019. In total, 19 responses were received, of which 12 were from Wholesalers and 7 from Retailers.

Of these, 9 respondents (5 Wholesalers and 4 Retailers) agreed with the proposed solution outlined in DPC016.

Those in favour generally felt that the proposal would improve confidence around the use of PCGs by increasing transparency in the market. It was felt that the publication of all Guarantees in a single location would increase visibility and thus improve transparency.

10 respondents disagreed with the proposal. Although respondents were generally in favour of increased transparency of Guarantees, it was felt that the solution proposed in DCP016 would create concerns in its implementation. It was felt that there was a risk to commercially sensitive information if disclosed as proposed, and that the requirement to publish details was unnecessary and disproportionate. It was proposed by some that a more proportionate solution could be provided by the introduction of a simple register of Guarantees, supported by a declaration of assurance from all Retailers.

One Respondent (a Retailer) responded that it would have preferred that associated Retailers were required to publish details of costs paid and payment terms on an intra Group Guarantee.

With regard to the specific questions asked, the responses were as follows:

### **Question 1: Do you agree with the proposed solution in DPC016? Please explain your answer.**

9 Respondents agreed with the proposal (5 Wholesalers and 4 Retailers), and 10 disagreed (7 Wholesalers and 3 Retailers).

Those who agreed with the proposed solution also favoured increased transparency and the simplicity of a single location for Guarantee arrangements. Those who disagreed felt that a more proportionate solution would be beneficial, which could be provided by a simple register of guarantees supported by a declaration of assurance from all Retailers. Most wanted to improve transparency, but the current proposal

contained a risk to commercially sensitive information disclosure, and it was felt that the requirement to publish such detail was unnecessary.

**Question 2: Do you agree with the proposed red line changes in DCP016? Please explain your answer.**

7 Respondents agreed with the proposal (4 Wholesalers and 3 Retailers), and 12 disagreed (8 Wholesalers and 4 Retailers).

The reasons provided were generally similar to given in response to Question 1.

**Question 3: Do you agree with the proposed approach of applying the obligations to all Guarantees, rather than just Parent Company Guarantees?**

13 Respondents agreed with the proposal (8 Wholesalers and 5 Retailers), and 6 disagreed (4 Wholesalers and 2 Retailers).

Those who agreed considered that there were market confidence and increased transparency advantages in accepting the proposal. Those who disagreed felt that it was not clear why the scope was extended to all Guarantees when the original concern related only to intra-group PCGs.

**Question 4: Do you agree with the proposed approach for Retailers to notify and publish Declarations of Assurance including the assurance that they have provided Ofwat with the requisite information to determine that they are at arm's length, rather than to notify and publish the commercial consideration information itself?**

14 Respondents agreed with the proposal (9 Wholesalers and 5 Retailers), and 3 disagreed (1 Wholesaler and 2 Retailers). Two Wholesalers provided no response.

The majority of respondents felt that the appropriate balance of improving transparency whilst maintaining commercial confidentiality was provided by the Declaration of Assurance that the Guarantee was at arm's length and providing Ofwat with the requisite information.

One of those who disagreed felt that the best way to provide confidence to the market was to publish full details, including costing and payment terms, of all intra-group financing arrangements. Another felt that there should be no disclosure, as disclosure would make market participants more reluctant to offer Guarantees, resulting in higher costs being passed on to customers.

**Question 5: How many Guarantee arrangements do you have in place? And who are they in place with?**

All Respondents specified details of existing Guarantee arrangements, except two who had none. The number of Guarantees ranged from 1-8.

**Question 6: MOSL intends to request that Wholesalers provide a compressed folder, containing all their current Guarantee arrangements in PDF format which will then be updated onto the MOSL website. Further Guarantee arrangements will be submitted and uploaded in a similar manner. Retailers are to submit their Declarations of Assurance in a similar manner. Are there any issues with this approach?**

18 Respondents agreed with the proposal (12 Wholesalers and 6 Retailers), and one disagreed (1 Retailer). One Retailer felt that the publication of the Guarantee, together with the costs paid and payment terms should be a requirement.

**Question 7: Please outline the extent to which existing systems and business processes developed by your organisation may need to be amended following the implementation of DPC016.**

Nearly all Respondents stated that there would be very little, if any, change needed to existing systems.

**Question 8: Please outline any implementation and ongoing operational costs to your organisation following implementation of DPC016,**

Nearly all Respondents stated that there would be very little, if any, operational cost following implementation.

**Question 9: Do you believe that the benefits of this change outweigh the implementation and operational costs to your organisation? Please explain your answer.**

12 Respondents agreed with the proposal (7 Wholesalers and 5 Retailers), and 5 disagreed (3 Wholesalers and 2 Retailers). Those that agreed felt that there would be minimal or limited costs.

**Question 10: Do you agree that the proposed change better facilitates the Objectives and Principles of the WRC? Please explain your answer.**

13 Respondents agreed with the proposal (8 Wholesalers and 5 Retailers), and 6 disagreed (3 Wholesalers and 3 Retailers).

Those that agreed noted the increased transparency and simplicity of the proposal. Of those that disagreed, some felt that the obligation to publish the information on its website was a duplication of activity, and not proportionate, and would make the process less efficient. One felt that the full benefits would not be realised unless full details of costs paid and payment details were not to be made public.

**Question 11: How long would you require, following an Ofwat decision to approve the change, to implement this change?**

There were a range of responses, from minimal time to two months.

**Question 12: Do you agree with the proposed implementation date of 26 July 2019? Please explain your answer.**

15 Respondents agreed with the proposal (11 Wholesalers and 4 Retailers), and 4 disagreed (1 Wholesaler and 3 Retailers).

Those who disagreed also did not support the general proposal. One respondent stated that any change should be implemented as soon as feasibly possible.