

Wholesale Retail Code Change Proposal – Ref CPW080

Modification proposal	Wholesale Retail Code (“WRC”) Change Proposal – CPW080 – Simplification of the default and termination process
Decision	The Authority ¹ has decided to reject this Change Proposal.
Publication date	14 December 2021
Implementation date	N/A

We are rejecting this Change Proposal.

On the basis of evidence provided, we cannot reasonably conclude that the Change Proposal will achieve its objective of simplifying the default and termination provisions of the Business Terms. It is also not clear from the information provided that the impacts of this Change Proposal for customers have been sufficiently explored.

Additionally, in some instances the proposed amendments, which are not considered to be minor amendments, have not been consulted on.

Background

Section 10 of the Business Terms of the Wholesale Retail code ('WRC') sets out the circumstances under which a Retailer will be classed as a Defaulting Trading Party. A Retailer will automatically be classed as a Defaulting Trading Party, for example, in the event that it makes a late payment which is not remedied within the specified timeframes, where its licence is revoked or where it is subject to an Insolvency Event.

The Contracting Retailer must be classed as a Defaulting Trading Party under section 10 of the Business Terms before the Contracting Wholesaler is able to consider pursuing the termination of its Wholesale Contract. The provisions relating to termination of a Wholesale Contract are set out in section 11 of the Business Terms. Prior to the

¹ Unless otherwise specified, the terms used in this document are those defined in the WRC

termination of the Wholesale Contract by the Contracting Wholesaler, sections 10 and 11 of the Business Terms require that formal notices are served. Section 20 of the Business Terms sets out the service requirements for these notices.

As part of Ofwat's review of credit arrangements in the business retail market, Trading Parties indicated that the provisions relating to termination of a Wholesale Contract were not clear and that the required notifications do not follow a linear process². Trading Parties suggested that there could be an interim step introduced into the current process which would take place ahead of classifying a Retailer as a Defaulting Trading Party.

The Credit Committee ("the Committee") was tasked by the Panel to develop this Change Proposal which seeks to clarify the process by which a Retailer will be classed as a Defaulting Trading Party and the provisions relating to the termination of a Wholesale Contract. The Committee has subsequently reviewed the relevant provisions of the Business Terms and has proposed changes, which are set out below.

The issue and the Change Proposal³

Default provisions

Section 9.7.2⁴ - Clarification of 'disputed or questioned' and the permissibility of withholding amounts relating to Disputed credit items

Section 9.7.2 currently provides that:

"If any item or part of an item in an invoice or statement rendered by a Party under this Section 9 is disputed or subject to question, payment of the remainder of the invoice or statement shall not be withheld on those grounds, and the provisions of Section 9.9.2 shall apply to the disputed or questioned item from the time, and to the extent that, it shall subsequently be agreed or determined to have been properly payable. Where a Party wishes to dispute or question an item or part of an item in an invoice or statement, it may only do so in good faith and on grounds which are not vexatious or frivolous".

² See KPMG's report which sets out Ofwat's review of credit arrangements in the Non-Household Retail market

³ The proposal and accompanying documentation is available on the MOSL website at <https://www.mosl.co.uk/market-codes/change#scroll-track-a-change>

⁴ Unless otherwise specified, references to section in this document relate to sections of the Business Terms.

The final recommendation report states that there is uncertainty around how a ‘dispute or question’ under section 9.7.2 should be raised and progressed. To address this uncertainty, it is proposed that this section is amended to make clear that such ‘disputes and questions’ are Disputes (as defined by Schedule 1, Part 1 of the WRC) which are required to be raised under the Disputes Procedure, and notified to MOSL.

The final recommendation report also suggests that there is uncertainty regarding whether amounts relating to credit items that are ‘disputed or subject to question’ can be withheld. To address the uncertainty, it is proposed that section 9.7.2 is amended to ensure it is clear that disputed credit items are permitted to be withheld. To achieve this, it is proposed that section 9.7.2 should explicitly refer to Credit Support Notices and the relevant items included therein.

Address an inconsistency between the Credit Support Amount (section 10.1.3) and the Credit Support Balance (section 10.1.4) default events and reduce the number of credit related default events

The final recommendation report suggests that there is inconsistency between the Credit Support Amount and the Credit Support Balance default events in section 10 of the Business Terms. Currently, where a Credit Support Amount is not provided or maintained this will immediately result in a Retailer being classed as a Defaulting Trading Party. However, where there are issues with credit support sources (used as Eligible Credit Support and/or Alternative Eligible Credit Support against the Credit Support Amount and/or the Credit Support Balance) such as Guarantees, the Business Terms provide ten Business Days for the issue to be resolved before a Retailer could be classed as a Defaulting Trading Party.

The final recommendation report outlines the proposed amendments which seek to provide consistency as to how a failure to pay credit support is dealt with. It is proposed that prior to a Retailer being classed as a Defaulting Trading Party for failing to provide or maintain either the Credit Support Amount or the Credit Support Balance, there should be ten Business Days for attempts to be made to resolve the issues.

To achieve this, it is proposed that:

- The Credit Support Amount default event (Section 10.1.3) should be incorporated into the Credit Support Balance default event (Section 10.1.4); and
- The consequentially redundant credit support default events (Sections 10.1.6 to 10.1.9) are removed.

Revision of the associated “Persistent Late Provision of Credit Support Balance” (section 10.1.5) default event have also been proposed as a consequence of the above amendments.

Clarify ‘persistent failure to pay’ (section 10.1.2) and ‘late payment’ (section 10.1.1)

The final recommendation report indicates that there is uncertainty around the interpretation of section 10.1.2 ‘persistent failure to pay’. The report suggests that it is not clear whether the £5,000 threshold that applies to the ‘late payment’ provisions (section 10.1.1) is applicable to section 10.1.2.

It is proposed that section sections 10.1.2 ‘Persistent failure to pay’ and section 10.1.1 ‘late payment’ are amended to make clear that all invoices are required to be paid in full and at which point a Retailer will be classed as a Defaulting Trading Party.

It is also proposed that the £5,000 threshold is removed from section 10.1.1. The final recommendation report indicates that the Committee considers this amendment will reduce administrative complexity and the potential for ‘gaming’. The Committee considered that removal of the £5,000 threshold would take away a level of protection for Retailers but its view was that a £5,000 level would not likely affect a Wholesaler’s decision to take action against a Retailer that persistently failed to pay or persistently paid late.

Remove the ‘Defaulting Trading Party under another Wholesale Contract’ default event (section 10.1.15)

The final recommendation report suggests that section 10.1.15, which classifies a Retailer as a Defaulting Trading Party where it has been classed as a Defaulting Trading Party in another wholesale Area, is not required and should be removed. The Committee took this view because where a licence is revoked it considered that termination of all Wholesale Contracts that a Retailer holds will follow.

Termination provisions

Clarify provisions relating to termination notices (section 11)

The final recommendation report states that there is uncertainty around the process related to issuing termination notices and when a termination notice (issued under section 11 in accordance with section 20) takes effect. There is concern that there might be situations where termination notices are issued but the relevant Contracting Wholesaler continually extends this notice period. The final recommendation report suggests that continued extension would create uncertainty as to when a termination notice would take effect.

To address these concerns and improve clarity around the process, it is proposed that termination notices:

- Can only be served on a Business Day after a Retailer is classed as a Defaulting Trading Party;
- Can only take effect on a Business Day (i.e. the Retailer needs to be a Defaulting Trading Party at 18:00 on that day);
- Would take effect ten Business Days after receipt or deemed receipt (whichever is earlier) of the notice by the Contracting Retailer;
- The Contracting Wholesaler would be able to revoke a termination notice by notifying the relevant Contracting Retailer (formally in accordance with section 20.2). The Authority must also be notified although this notification may be by email); and
- If the Contracting Wholesaler has revoked a termination notice but subsequently wishes to pursue termination of the Wholesale Contract, a new termination notice must be issued.

To improve clarity and certainty, it is also proposed that the termination notice should be considered to be confirmation of the decision to terminate on a given date, rather than notice of intention to terminate. To achieve this, it is proposed that the WRC should be clear that a termination can only be avoided by:

- (a) Resolution of the default; or
- (b) Withdrawal of the termination notice.

Industry consultation and assessment

A consultation on CPW080 began on 28 October 2019 and closed on 11 November 2019. There were 18 responses from 12 Wholesalers, five Retailers and the Consumer Council for Water (CCW).

A summary of the consultation responses and the Committee's replies can be viewed in Appendix 1 of this document.

Panel recommendation

The Panel considered this Change Proposal at its meeting on 26 May 2020. It recommended that the Authority approve this proposal. Ten Panel Members voted to recommend approval, one voted against, and the Customer Representative Panel

Member abstained from voting. The recommendation to approve has been made on the basis of improving the principles of efficiency, proportionality and transparency⁵.

The final recommendation report indicates that concern was expressed by some Panel Members about the proposed removal of section 10.1.15 'Defaulting Trading Party under another Wholesale Contract'. They argued that removal of this section would result in reduced visibility of Retailers that are in financial difficulty. The Panel Member who did not support the Change Proposal said that removal of section 10.1.15 would be detrimental because customers would 'continue to pay Retailers with no knowledge of their situation and would potentially also pick up the costs if a Retailer failed'. It was agreed that the Committee should monitor the impact of the change and report to the Panel.

The Panel Member that did not support the proposal also considered that it represents a gradual erosion of the credit arrangements which is not in customer's interests. The final recommendation report states that this Panel Member considered that every additional day's delay to termination of a Wholesale Contract, which would be caused by only being able to serve a termination notice on a Business Day, combined with other changes, increased the customer exposure. The final recommendation report states that this Panel Member also considered that requiring Retailers to pay on time might increase their risk of them being classed as a Defaulting Trading Party. This Panel Member is stated to have also argued that 'at this financially distressed time, the effective extension of collateral offered by Wholesalers to Retailers potentially threatened the resilience of the business retail market as this could enable weaker Retailers to enter the market'.

The Customer Representative Panel Member remained concerned about the potential impact of the change on customers, but abstained from voting.

Noting that this proposal was discussed at the Panel Meeting on 26 May 2020, a number of Panel Members requested that given the emerging impacts of Covid-19 that the Authority only consider the later implementation date (of 6 November 2020 as opposed to the earlier implementation date of 28 August 2020) as they considered that the Authority might be challenged to assess the impact of the Change Proposal whilst the Covid-19 payment deferral measures were in operation.

⁵ Note that the Panel's recommendation was made prior to implementation of [CPW040/CPW0121](#) on 1 September 2021 which introduced revised principles of the MAC and WRC.

Authority discussions with the Market Operator (MOSL) after receipt of the Panel's recommendation

Following receipt of the final recommendation report, the Authority had a number of questions regarding the proposed amendments which we raised with MOSL. In response to the Authority, MOSL recommended a number of revisions to the proposed legal drafting. The recommended drafting amendments are summarised below and are set out in full in Appendix 2 of this document.

Amendment to section 10.1.2

An amendment to section 10.1.2 to correct a transcribing error so that the proposed drafting reflects that which had been agreed by the Committee (as set out in option D on page 31 of the final recommendation report).

Amendment to section 10.1.4

- Amendments (including in sub-sections (b) and (c)) to make clear that this section relates to a failure to both provision and maintenance of the Credit Support Amount. The drafting proposed in the Change Proposal included reference to a requirement to 'make available' the Credit Support Amount rather than to provide it.
- An amendment to ensure the drafting which sets out the exceptions to the requirements under this section are clear and that the section is applicable where 'any such' (rather than 'this') failure is not Disputed under section 9.7.2.
- An amendment to section 10.1.4 (a) to ensure that the relevant timeframes applicable to the Credit Support Amount and Credit Support Balances in this section are clear.

Amendments to section 10.1.5

- An amendment to the heading to include 'persistent' ahead of 'late failure of the provision of the Credit Support Balance'. This amendment has been recommended to attempt to make it clear that this section relates to both persistent failure to provide the Credit Support Amount and persistent failure to provide the Credit Support Balance.
- An amendment to provide clarity that section 10.1.5 includes to persistent failure to provide the Credit Support Amount as well as persistent failure to maintain it.
- An amendment to make use of the defined term 'Month'.

Amendment to section 11.2.5

An amendment to section 11.2.5 to make it clear that following issue of a termination notice, a Wholesale Contract will not terminate if a Contracting Retailer is no longer a Defaulting Trading Party.

Our decision

We noted that a number of Panel Members asked that given the coronavirus pandemic, the Authority only give consideration to the later implementation date of 6 November 2020. These Panel Members thought that the Authority could be challenged to assess the impacts of the Change Proposal while the payment deferral scheme was in operation⁶. In view of this, and while we continued to respond to the Covid-19 pandemic, we placed the Change Proposal on hold. This Change Proposal subsequently remained on hold whilst we considered higher priority Change Proposals. We have however, now considered the issues raised by the Change Proposal and the supporting documentation provided in the Panel's Final Report and have decided to reject this Change Proposal.

Reasons for our decision

We do not consider that the proposed amendments would further the primary principle of the WRC. The Change Proposal has not been developed, nor would the proposed solution operate, in a manner which best promotes the interests of existing and future Non-Household Customers. It is not clear from the information provided that the impacts of the Change Proposal for customers have been sufficiently explored and considered.

The amendments proposed by this Change Proposal were intended to introduce simplicity and clarity to the default and termination provisions of the Business Terms. However, we cannot reasonably conclude that the Change Proposal will achieve this original objective. It is also not clear how the issue that this Change Proposal is seeking to address affects customer outcomes or the effective operation of the market.

Elements of the Change Proposal could introduce additional confusion as they do not provide the intended clarity or simplify the current process. Additionally, in some instances, the proposed amendments, which are not considered to be minor amendments, have not been consulted on.

⁶ The interim deferral scheme was approved by [CPW093 – Interim deferral of Wholesale Charges](#).

We have set out below more detail relating to our decision to reject this Change Proposal.

Default provisions (sections 9 and 10)

Section 9.7.2 – Clarification of ‘disputed or questioned’ and the permissibility of withholding amounts relating to Disputed credit items

The proposed amendments to section 9.7.2 offer clarification that 'disputed or questioned' in section 9.7.2 means 'Disputed' (as defined by the WRC). We do not have concerns in relation to these proposed amendments.

We note the proposed amendments to section 9.7.2 which sought to ensure it is clear that Disputed credit items are permitted to be withheld. However, this change is not required because a subsequent amendment was made by [CPW079](#) which addresses this issue. CPW079 introduced section 9.14.2 which clarifies that credit amounts which are 'subject to dispute or question pursuant to section 9.7.2 shall not be considered to be owed or due'⁷.

Clarify ‘late payment’ (section 10.1.1) and ‘persistent failure to pay’ (section 10.1.2)

The proposed amendments to section 10.1.1 ‘Late payment’ to remove the current £5,000 threshold were devised by the Committee after consideration of the responses to the consultation. The implications of the removal of the £5,000 threshold from section 10.1.1 are likely to vary from the implications of the amendments to this section which were consulted on – at the point of consultation it was intended that the threshold would be retained. Trading Party and other stakeholder views on the proposed amendment to remove the £5,000 threshold from this section, and the implications of this proposed removal, should have been sought before this proposal was recommended.

Amendments were also proposed to section 10.1.2 ‘Persistent failure to pay’ and section 10.1.1 ‘late payment’ which were seeking to make clearer that all invoices are required to be paid in full and the point at which a Retailer would be classed as a Defaulting Trading Party. However, the proposed drafting amendments do not provide clarity and conversely, we consider these could result in confusion as the amendments add

⁷ Note that the Authority has [consulted](#) on a proposed amendment to section 9.14.2 of the Business Terms to address an unintended consequence.

additional layers of complexity by bringing in a reference to section 10.1.1 whilst also repeating the obligations already set out therein.

Address an inconsistency between the Credit Support Amount (section 10.1.3) and the Credit Support Balance (section 10.1.4) default events and reduce the number of credit related default events

The amendments proposed to sections 10.1.3, 10.1.4 and 10.1.6-10.1.9 appear to remove an inconsistency and provide additional clarity. We did not identify concerns in relation to the amendments proposed to these sections.

Remove the 'Defaulting Trading Party under another Wholesale Contract' default event (section 10.1.15)

We note that the rationale for the proposed deletion of this section as provided in the final recommendation report is that termination of Wholesale Contracts in other wholesale Areas would follow licence revocation.

We do not agree with the proposal to remove the provision relating to a Retailer being a Defaulting Trading Party under another Wholesale Contract or the rationale provided for this. It does not follow that the termination of one Wholesale Contract would necessarily result in the revocation of a Retailer's Licence. Further, we consider that the removal of section 10.1.15 could potentially reduce the options available to Wholesalers to manage the risk of non-payment from a Retailer that may be experiencing financial distress. This in turn may increase a Wholesaler's risk of exposure to bad debt which could result in negative outcomes for customers in the event of a Retailer's disorderly exit from the market.

Termination provisions (section 11)

Termination notice can only be served and take effect on a Business Day and the Wholesale Contract will terminate at 18:00 on the date specified in the termination notice

We do not consider that the implications of the proposed introduction of section 11.2.2, to specify that the Wholesale Contract will terminate at 18:00 on the date specified in the notice were fully explored prior to this recommendation being made. The rationale provided for these amendments is that there is uncertainty about when and how termination notices are served, and when exactly they should take effect. However, it is not apparent that the implications of the proposed amendments have been explored in light of the fact that the Central Market Operating System ('CMOS') is only able to Transfer Supply Points at midnight on a specified day.

CMOS does not have the functionality to Transfer Supply Points at 18:00 on a specified day to align with the proposed time that the termination notice would take effect if CPW080 had been approved. If there were to be an interim supply event, the consequence of the proposed amendment would either be a gap in supply for customers or the necessity to back-date the Transfer so that the Interim Supplier would become the Retailer with effect from the midnight before the termination notice took effect. A gap in supply for customers would not be permissible and the proposed amendments do not account for this. The implications of this element of the Change Proposal do not appear to have been fully considered by the Committee.

To stop a termination notice taking effect it must be withdrawn following which the process will be re-set

These proposed amendments were raised to address the concern that a Wholesaler may continuously seek to extend a termination notice. We are unclear of the basis for this concern or how the proposed amendments would seek to address this. A Wholesaler would still be permitted to withdraw and reissue a termination notice.

Additionally, the proposed drafting amendments have the potential to reduce flexibility for Wholesalers to make decisions about how best to manage their risk during the termination process. This is particularly the case given the proposed introduction of section 11.2.5 which would require formal notice to be served (in accordance with section 20 of the Business Terms) to revoke a termination notice. This would require a Wholesaler to ensure correct service of the revocation notice, including ensuring that deemed receipt occurs ahead of the termination notice taking effect. This does not appear to be practical as it would require the Wholesaler to have decided to withdraw the termination notice relatively soon after service to ensure there is sufficient time for correct service of the revocation notice.

MOSL's recommended drafting amendments in response to the Authority's queries

Whilst the amendments recommended by MOSL went some way to providing additional clarity in some areas, we do not consider that they go far enough to ensure that the Change Proposal met its objective of simplifying the default and termination provisions.

Decision notice

In accordance with section 6.3.7 of the Market Arrangements Code, the Authority rejects this Change Proposal.

Georgina Mills
Director, Business Retail Market

Appendix 1 – Summary of consultation responses and the Committee’s replies

The consultation on this Change Proposal can be viewed [here](#). The Final Report details that the Committee decided not to take forward some of the elements of the Change Proposal which it has consulted on, these included:

- Reducing the notice period in the late payment default event by five Business Days,
- Addition of a new section which would remove persistent late payers from 'post-payment' to 'pre-payment' terms,
- Creation of a new default event for persistent late payers of amounts under £5,000,
- De-minimis levels for withholding payment under section 9.7.2, and
- Increasing the default rate of interest to discourage persistent late payers.

It should also be noted that some elements of the Change Proposal were amended following consultation and in view of the responses received.

Agreement with the Change Proposal

The majority of respondents agreed with the Change Proposal with some highlighting that they consider the proposal improves clarity. However, some respondents had reservations, one suggested that ‘it should be possible to serve notice of late payment as soon as a payment is late, with a 10 day payment notice window after the issuing of the late payment notice’.

One Wholesaler suggested that the proposed process for a Wholesaler to terminate a Wholesale Contract is overly rigid and could incentivise Wholesalers to terminate the Wholesale Contract where they might not otherwise have done so as the only other option would be to wait for 10 Business Days for the process to restart. A drafting amendment to section 9.7.2 which proposed to extend the right to a Retailer to withhold collateral in relation to a non-collateral related dispute was recommended by this Wholesaler. It suggested that the drafting should be narrowed to avoid the unintended consequence that a Retailer would be able to withhold collateral in relation to a non-collateral related Dispute should the proposed drafting be implemented. This, and another, Wholesaler also challenged the proposal to remove section 10.1.15 ‘Defaulting Trading Party under another Wholesale Contract’, suggesting that there was no clarification of what would replace the protection this offers or how communications about the default would be handled.

One Wholesaler that did not agree with the proposal considered that ‘continued non-material persistent failure to pay’ would not be effective as is only focused on timescales but should also consider how to recover all debt owed.

Of the Retailer respondents, the majority agreed with the proposed solution. However, one Retailer that did not agree suggested that the Change Proposal does not simplify the process. Further, this Retailer considered that the proposal would (note that a number of amendments were made to the Change Proposal post-consultation which addressed some of the below concerns):

- Change both payment terms and calculation of credit security;
- Reduce the period for payment of Wholesale Charges by Retailers by 10 Business Days;
- Remove the right of Retailers (in poorly defined circumstance) to an Unsecured Credit Allowance;
- Introduce new default events which would allow a Wholesaler to decide a Retailer is in Default in the space of a single day. The drafting of this proposal indicates a “12 month period”, but there is no minimum period during which notices can be sent, the next Business Day is redefined as after 18:00 on any Business Day.
- Removes the scope for a Retailer to seek injunctive relief through the courts, which is a right expressly provided in section 19.7 of the Business Terms, by redefining two Business Days to take place in the course of a single day;
- Transfers to a Wholesaler the right to determine if a Retailer should pre-pay or post-pay;
- Leave to the discretion of individual Wholesalers how to resolve potential default events. There is no protection or appeal against, for example, a Wholesaler being prepared to only remove a termination notice if they are transferred a controlling interest in a Retailer; and
- Does not provide an appeals or dispute process which could resolve any incorrect determinations of default in a reasonable timeframe.

CCW said that it was not aware that there were issues that need to be addressed at this time, although acknowledged the intention was to remove ambiguity in the process. CCW was also unclear on whether there would be any direct customer impacts as a result of the proposed amendments. CCW considered that the effect of the proposal could be that Retailers change their debt collection processes to be more stringent in response to ‘being placed in an alternative ‘status’ to default. Although, it acknowledged that there is no evidence to suggest that Retailers would respond in this way. Concern was also expressed by CCW about the proposal to move persistent late or non-paying customers from Post-Payment to Pre-Payment terms as this might result in those Retailers changing their billing terms and requiring customers to “pay in advance”.

Agreement with the red line changes

The majority of Wholesalers agreed with the red line changes. One Wholesaler requested further clarity around Persistent Breach. This Wholesaler said "if a retailer

enters default for persistent failure to pay on time – i.e. 3 notices have been issued in a twelve month period – then, whilst it is implied, the code needs to state that this default is not cleared by the subsequent payment of any outstanding balance and that the only way to clear this default is for 12 months of on time in full payments to occur, therefore allowing the wholesaler to provide a last chance to the retailer to get in line with the code, but also allowing the wholesaler to terminate the contract at any point in that 12 months should a further payment be late".

Another Wholesaler considered that the red line drafting required further consideration and clarification, particularly section 11.2.1 as 'red lining currently requires that a Wholesaler who starts a termination process and then wishes to withdraw it is obliged to restart the full default process from the beginning'. Further, this Wholesaler considered that section 9.7.2 provided the opportunity for a Retailer to withhold some collateral that is not linked to a Dispute.

A Wholesaler agreed that the red line changes achieve the intent however, suggested that the process of continued non-material failure to pay needs to be reviewed.

Three Retailers agreed, one suggested that the red line changes need to be reviewed by the Committee following the consultation to ensure that it is workable and that a further consultation should be undertaken. Another Retailer did not agree as it considered that the red line drafting creates new categories of default, is not consistent with the payment terms and risks destabilising the market.

CCW agreed that the red line drafting delivers the intentions although expressed concerns about potential unintended consequences. CCW expressed concern that although there was no evidence to suggest it would happen, it is a possible consequence that Retailers may increase pressure on customers to recover amounts owed in response to being placed in an alternative status to 'default'. CCW considered that the proposal to move Retailers from 'post-payment' to 'pre-payment' terms in some circumstances might result in Retailers changing their billing terms and requiring customers to 'pay in advance'.

Agreement with proposed changes to sections 11.2.1 and 11.2.2 vs a more flexible approach

Most Wholesalers agreed with the proposed changes to sections 11.2.1 and 11.2.2. However, one Wholesaler highlighted that a flexible approach should always be an option in exceptional circumstances, suggesting that a one size fits all solution doesn't always provide the best customer outcomes. Another Wholesaler suggested that the requirement for 10 Business Days' notice to be provided to Ofwat provides an element of flexibility for Wholesalers around whether or not to issue the termination notice before or after the Retailer becomes a Defaulting Trading Party. It highlights that this would

allow termination of the Wholesale Contract on the day that a Retailer becomes a Defaulting Trading Party.

A Wholesaler that agreed with the proposed changes to these sections suggested that the termination time should be 17:00 instead of 18:00 as no bank will progress a transaction after 17:00.

A Wholesaler that favoured considered that the proposed approach to be too rigid and would prefer a more flexible approach. It suggested that the requirement to provide at least 10 Business Days' notice to Ofwat in advance of termination extends the default risk which it considers is only partially mitigated by the five Business Day reduction in the default period. It suggested that additional collateral cover should have been proposed to cover the additional risk. This Wholesaler also requested greater clarity of the rationale for the termination process to need to restart should the Wholesaler choose not to proceed with the initial termination date as set out in the notice sent to Ofwat. It highlighted that this would prevent the Wholesaler from extending the process by for example a further one or two days, which could act as an incentive to terminate.

Out of the five Retailer respondents, four expressed some concerns regarding the drafting of these sections. One was concerned that introduction of options will increase ambiguity due to differing interpretations. Another Retailer indicated that the drafting of 11.2.1 redefines Business Day separately from other use in the codes. Further, this Retailers view is that the drafting removes the opportunity to dispute or appeal the default and specifically removes the right in 19.7 to seek interim injunctive relief. A different Retailer said "the proposed drafting does not explicitly state the criteria where a wholesaler must revoke a notice of termination - e.g. upon receipt of payment. We believe this is a key omission". One Retailer raised concern that if a letter withdrawing a termination notice was not issued in time, termination would automatically go ahead.

CCW suggested that the requirement for the process to restart if a termination notice is revoked seems sensible from an audit perspective.

The Committee's consideration of the consultation responses

The Committee maintained its position against flexibility around the termination date as it considered that any potential for extensions to the termination date would weaken the incentives to resolve the default. In relation to the suggestion that it should be at 18:00, rather than 17:00, the Committee decided that termination at the end of the Business Day would be clearer.

In response to the concerns raised by one respondent that the proposed amendments to section 11.2.1 effectively redefined the definition of Business Day, it was suggested that defining Business Day differently from elsewhere in the codes reduced the potential for appeal against Default to zero. However, it was accepted by the respondent that Business Day had not been redefined. It also was considered to be clear that the termination notice required formal withdrawal. Lastly, it was accepted that there could be logistical problems with late withdrawals.

The Committee decided to clarify that a termination notice could only be served and take effect on a Business Day as this would be clearer. It noted however that this could potentially increase the Wholesaler's liability by an extra day or two.

Two new Sections 11.2.5 and 11.2.6 were added to clarify that the Wholesaler must withdraw the termination in writing and the termination process re-started.

Proposed changes to section 9.7.2 to clarify that this covers credit support

Most respondents agree with the proposed amendments.

One Wholesaler said that its preferred approach would be that where there is a Dispute only the part of the Invoice that is Disputed can be withheld. Another made the same point in relation to Disputes about credit support. A different Wholesaler suggested that a de minimus value would be useful for both Invoices and Credit Support Notices.

One Wholesaler did not consider that where there are questions about credit this should warrant the withholding of a balance. Another thought that the proposed red line drafting was too vague and that this might enable Retailers to withhold material values of collateral in relation to disputes that do not relate to calculation of credit amounts. This Wholesaler highlighted that it was supportive of Retailers having the option to dispute the calculation of Credit Support Notices but considered it would be unfair to extend to collateral the Retailer's ability to withhold a Disputed element. It was thought that this could result in an inappropriate increase in a Wholesaler's risks where an Invoice is disputed. It thought that this proposal might create perverse incentives for Retailers to raise a Dispute to avoid paying collateral.

One Retailer said that the effect of the change is unclear as it appears to be that a Dispute on the provision of credit support can be used by a Wholesaler to immediately trigger default. Another requested further clarity around the process for credit Disputes. CCW expressed concern about the impact that the proposal might have on debt collection practices highlighting that anything which extends the default process is a potential concern.

Committee's consideration of the consultation responses

In view of the consultation responses, the Committee asked MOSL to explore options in Section 9.7.2 for:

- (a) a de minimis level of £5,000 or in line with settlement runs and excluding Unsecured Credit Allowances; and
- (b) a link with the formal Disputes process.

De minimis level

The Committee decided not to take forward suggestions made by consultation respondents due to their limitations. It was noted that it was not clear how observance to a de minimis level could be monitored at present. In relation to excluding Unsecured Credit Allowances from Section 9.7.2, the Committee thought that the process set out for rectifying the credit score problem and then re-issuing the Credit Support Notice would appear to be an example of good practice rather than an area to be codified. It also thought there might be a wider range of issues associated with Unsecured Credit Allowances which might need to be covered by the Disputes process.

A link with the formal Disputes process

The Committee noted that a consultation respondent had suggested that “more clarity is required around the dispute and mediation process, through either the Trading Dispute process or another process.” The Committee observed that “disputed or subject to question” in Section 9.7.2, creates ambiguity regarding which payments (or credit) amounts could be legitimately withheld. This is because it was not clear under which process such a ‘dispute or question’ would be considered. The Committee agreed that a ‘dispute or question’ under section 9.7.2 would be included in the formal Disputes Procedure. The Committee considered that this would ensure section 9.7.2 was applied to substantive disagreements, i.e. not those that were frivolous or vexatious, and that these disagreements would be logged, tracked and managed to resolution.

In addition, the Committee noted that section 9.7.3 would also require an amendment ensure it is clear that such Disputes must be properly raised in accordance with the Disputes Procedure and notified to the Market Operator.

The Committee saw the Trading Disputes Committee's (TDC) consideration of a Unified Disputes Process and Committee as helpful both in bringing section 9.7.2 into the formal disputes process and in streamlining the process itself. Consequentially, the Committee sought endorsement from the Trading Disputes Committee (TDC) before continuing with the proposed amendments to sections 9.7.2 and 9.7.3.

Amendments were made to the proposed drafting to reflect the agreed changes.

Agreement with proposal to reduce the period in section 10.1.1 'Late payment' before a Retailer will become a Defaulting Trading Party by five Business Days (from 15 to 10 Business Days)

Most Wholesalers agreed suggesting that reducing the timeframe would be helpful to minimise delays and simplify the process which could reduce risk and exposure.

One Wholesaler did not agree and suggested that the timeframe should instead be reduced to zero Business Days. Another agreed with the proposal but suggested that the timescale still underestimates the day required between the due date and the termination date and therefore the risk that the Wholesaler is bearing. A different Wholesaler thought that the proposed amendments would result in Wholesalers bearing an additional five Business Day risk which it is not proposed to be covered by additional collateral.

A Retailer considered that the reduction in the timeframe disproportionately impacts Retailers and reduces the time available to resolve Disputes. Two other Retailers did not agree with the proposed amendments, one said that the change would increase the default risk for Retailers and expressed that the current collateral requirement is already a significant burden for Retailers given the low margin in the sector. Another thought that this proposed a fundamental change to payment terms suggesting that this was outside of the Committee's terms of reference. This Retailer thought that a sudden change in payment terms could deter new entrants and undermine confidence of existing market participants.

CCW thought that the proposed amendment could reduce Wholesaler exposure but given the limited instances of Retailer insolvency to date suggested that it is difficult to know whether there is enough to warrant the proposed revision.

Committee consideration of the consultation responses

After considering the consultation responses, the Committee decided not to take forward the proposal to reduce the timeframes set out in section 10.1.1. The Final Report details that Committee considered that this proposed amendment was outside of 'the scope of their remit'. A Committee member highlighted that they did not think the proposal achieved the appropriate balance of risk between Retailers and Wholesalers, with the termination notice period now being too long.

Agreement with the proposed change to the default event, 'Failure to provide and maintain Credit Support Amount' providing 10 Business Days' notice and removing other credit support default events

All Wholesalers supported this proposed amendment suggesting it removes uncertainty and provides consistency.

A Retailer argued that the amendment would increase systemic risk in the market, specifically customer credit risk. A different Retailer thought that the reduction of the notice period of default from 15 business days to 10 business days disproportionately impacts Retailers and limits the time for resolving any point of dispute with the Wholesaler.

CCW considered that the proposed amendment appears to remove an inconsistency and provides a further opportunity for a Retailer to avoid being classed as a Defaulting Trading Party.

Committee's consideration of the consultation responses

The Committee did not agree that the change increased systemic risk and customer risk or undermine confidence in the market. Instead, the Committee thought that it would increase stability by providing Retailers ten Business Days to resolve credit support issues. The Committee did not amend its proposals.

View on modifying the 'Persistent failure to pay' default event and adding a new sanction and a new default event

One Wholesaler did not think that the proposed drafting of the Business Terms is clear enough and another suggested that whilst it agreed, further clarifications were needed. This Wholesaler also noted that there are additional Wholesaler risks where a Retailer post-pays, it therefore encouraged the Committee to confirm whether a move to pre-payment would reset the late payment incident count or whether this would remain unchanged.

A Wholesaler supported the principle of the change but considered that the solution could be unfair and potentially unworkable. It suggested that it only penalises those who pay charges in advance. It asked the Committee to consider alternative options, for example, increased collateral or some collateral for those that pre-pay, an accelerated default process or escalating punitive payments.

One Wholesaler agreed with the changes with the exception of the non-material amount process.

A Retailer expressed concern that the proposed amendments were outside the remit of the Committee. It highlighted that Retailers are entitled to choose whether to pre or post-pay, allowing Wholesalers to determine this would not maintain a fair relationship. Another Retailer thought that if a Retailer is struggling to post-pay then moving them to pre-pay could exacerbate the issues. A different Retailer thought that the proposal required more clarity on Retailer protections in the event of a Dispute. It argued that without adequate protection a Retailer could permanently lose the right to post-pay because of a temporary cash flow issue which may have been resolved.

CCW reiterated their concerns (outlined in response to the first question) about potential unintended consequences for customers.

The Committee's consideration of the consultation responses

The Committee considered the responses to this question and decided not to proceed with introduction of the new default event and sanction. The Committee concluded that default interest should be applicable from an agreed date and on an agreed amount.

The Committee considered how to clarify the existing 'Persistent failure to pay' default event (Section 10.1.2). It agreed that it needed to be clear when the default happened and that the third time or subsequent times a Retailer was late for the payment due date, having been sent two notices for late payment in the previous 12 months, the Retailer would be sent a notice giving it five Business Days to pay before it would be classed as a Defaulting Trading

Removal of 'Defaulting Trading Party under another Wholesale Contract'

Most Wholesalers agreed with the proposal to remove the provisions relating to 'Defaulting Trading Party under another Wholesale Contract'. However, some did not agree. One Wholesaler that did not agree suggested that removing these provisions would enable Retailers to behave differently in different Areas depending on where terms were more favourable to them.

Two Wholesalers supported removal providing the mandatory notification by MOSL of Defaulting Trading Parties is approved. Another Wholesaler also did not support the proposed drafting without clarification around the communication of Defaulting Trading Party notices. This respondent indicated that the consultation did not address that MOSL may choose not to notify Trading Parties and that Ofwat's role is equally unclear.

A Wholesaler did not think that the impacts of removal of the provisions has been adequately assessed. It acknowledged that this is mitigated to some extent by section 10.1.14 'Revocation of Licence in England and Wales' but thought that removal of section 10.1.15 would take away an important deterrent to avoid this. It suggested that section 10.3 already provides an efficient mechanism for Wholesalers to be pragmatic

and apply reasonable judgement where they are notified that a Retailer is a Defaulting Trading Party in another wholesale Area.

A Retailer stated that overall it opposes the proposal because it downplays the meaningful status of a Default and hands control of Default events to individual Wholesalers.

CCWater thought it would be unlikely that a Retailer acted differently between Wholesalers but was interested to hear Wholesalers' views on this.

Committee's consideration of the consultation responses

The Committee noted that the majority of responses were in favour of removing section 10.1.15, although acknowledged that dissenting views were expressed that removal would enable Retailers to behave differently in different wholesale Areas and that it would take away a significant deterrent from Retailers which is only mitigated to a degree by the Licence revocation default event. The Committee noted the suggestions from other respondents regarding improvements being required concerning the disclosure of a Retailer being a Defaulting Trading Party under Section 11.5.3 and views that this disclosure should be mandatory to other contracted Wholesalers.

Having considered the consultation responses, the Committee maintained its view that Section 10.1.15 should be removed.

Should it be mandatory for MOSL to disclose to other contracted Wholesalers that a Retailer is a Defaulting Trading Party?

Most Wholesalers considered that disclosure should be mandatory one respondent however, urged caution and suggested a legal opinion on this proposal should be sought first. One Wholesaler suggested that MOSL should consider whether to disclose this information on a case by case basis.

All Retailers supported that the current approach should be maintained where MOSL may disclose to other Contracting Wholesalers that a Retailer has been classed as a Defaulting Trading Party.

CCW considered that there might be unintended consequences as a result of making disclosure mandatory. However, it acknowledged that there is a real possibility that the Retailers inability to pay one Wholesaler may soon replicate elsewhere so it seems logical that other Trading Parties should be made aware. Due to the potential customer consequences it suggested that further clarification would be needed as to whether 'non-affected' Wholesalers would be able to alter payment terms following a notification that a Retailer is a Defaulting Trading Party.

Committee's consideration of the consultation responses

The Committee considered the suggestions from respondents about improvements to the disclosure of a Retailer becoming a Defaulting Trading Party under Section 11.5.3. In particular, the views that this disclosure should be mandatory to all relevant Contracting Wholesalers.

The final recommendation report states that the Committee asked MOSL to:

- (a) Review the competition law implications of disclosure of Retailer default to contracted Wholesalers and to all Wholesalers; and
- (b) Review the implications of both disclosure and removal of Section 10.1.15 'Defaulting Trading Party under another Wholesale Contract' on the interaction with the Scottish Market.

The final recommendation report states that the legal advice on the competition law implications was that release of a Retailer's Defaulting Trading Party status to Wholesalers might give rise to a breach of competition law as it would be disclosure of commercially sensitive information. Further, it was advised that MOSL could also be in breach as the 'conduit for dissemination of this information'. The legal advice suggested that prior to any such amendment first it should be identified what Wholesalers use this information for. In view of the advice, the Committee recommended that MOSL and Ofwat should set out how this information would be used in practice and that there should not be any change to section 11.5.3.

The final recommendation report states that the Central Market Agency (CMA) in Scotland understands that there is no scope for action to be taken in the Scottish Market with regard to a Retailer operating in Scotland which is in default in the English and Welsh Market. There is no formal arrangement that the CMA is aware of for informing the Wholesaler in Scotland, Scottish Water, of the status of any Retailers operating in both markets although it might find out through informal means.

Having considered the consultation responses and legal advice, no amendments to the proposed drafting of section 11.5.3 were made by the Committee.

Amendment to systems and processes

Most Wholesalers considered that there would be no or minimal changes required. One Wholesaler however suggested that the Change Proposal would have significant impacts on its internal processes and governance for management of non-payment by Retailers.

Most Retailers also thought that the impacts would be minimal. One Retailer however suggested that 'the chaotic nature of Wholesaler demands for payment and unresolved disputes' would mean that it needs implement standby financing facilities in case there would be a need to move to pre-payment at the same time as having to provide credit support. This Retailer thought that this would double its working capital requirements and would therefore, have related cost impacts which would be punitive.

Implementation and ongoing operational costs

The majority of respondents considered that there would be low or zero implementation and ongoing operational costs. One Retailer suggested that it would need to develop a parallel financing structure for working capital and suggested that all Retailers that post-pay would be impacted in this way.

Benefits vs costs

Most respondents considered that the benefits of the proposed changes would outweigh the costs. Those that shared this view did so largely because the costs to implement would be minimal.

One Wholesaler however thought that the proposed changes add disproportionate and unjustified risks to both Retailers and Wholesalers. Another thought that the additional risk introduced by the proposal to remove section 10.1.15 outweighed the benefits of the proposed changes. A Retailer said that there would be very significant financing costs.

Principles and objectives of the WRC

All but one of the Wholesaler respondents thought that the proposal furthers the objectives and principles of the WRC. The one Wholesaler that did not agree considered that the proposed amendments as a whole did not meet the principle of proportionality. Another, whilst agreeing that the majority of changes furthered the principles and objectives it felt that the new default event for non-material sums needed to be reviewed and explored further. A Retailer thought that the proposed change did not further the objectives and principles as it lacks proportionality and removes transparency by allowing Wholesalers to make subjective judgements about Default events. Another Retailer thought it was premature to assess against the principles and objectives until all of the review stages had been completed.

CCW expressed concern that the principle of proportionality may not yet have been met until its concerns around potential unintended consequences have been addressed.

Implementation date

Most respondents agreed with the proposed implementation date. Although one Wholesaler said that the date may be achievable for some of the proposals but others would take longer to implement. A Retailer suggested that the implementation timetable should allow time for inevitable legal challenge.

Appendix 2 – MOSL’s recommended amendments to the proposed legal drafting

The original drafting is in black, shown in blue are the modifications proposed by CPW080 and in purple are the additional amendments recommended by MOSL in response to queries raised by the Authority after receipt of the Panel’s recommendation to approve CPW080 had been submitted.

10.1.2 the Contracting Retailer fails to pay an amount properly due by it under the Wholesale Contract (and not ~~Disputed~~ under Section 9.7.2) for a third or subsequent time having failed on two (2) occasions in the previous twelve (12) Month period to pay in full an amount properly due by it under the Wholesale Contract (and not Disputed under Section 9.7.2) and the Contracting Wholesaler has issued notice to the Contracting Retailer to remedy such non-payment upon at least two (2) of those previous occasions, where and on each such occasion:

- (a) such payment has not been made by the payment due date; and
- (b) on or after the payment due date the Contracting Wholesaler has issued notice to the Contracting Retailer to pay the outstanding amount within a further period of five (5) Business Days after the Contracting Retailer’s receipt or (if earlier) deemed receipt of such notice; and
- (c) the amount ~~invoiced~~ outstanding, if any, has not been paid by the expiry of that further period of five (5) Business Days of the Contracting Retailer’s receipt or (if earlier) deemed receipt of notice pursuant to Section 10.1.2(b); or

10.1.4 the Contracting Retailer has failed to make available provide, or having made available provided, fails to maintain a sum at least equal to the Credit Support Amount through any aggregated combination of either Eligible Credit Support and/or Alternative Credit Support as specified at Section 9.11.2 or to provide the Credit Support Balance as specified at Section 9.12. ~~31~~ (unless, for the avoidance of doubt, the terms of Section 9.13.6 apply or this any such failure is not Disputed under Section 9.7.2) where;

- (a) in relation to the Credit Support Amount on that same date as any such failure and in relation to the Credit Support Balance it is in excess of ten (10) Business Days from the date of issue by the Market Operator of the P1 Settlement Report; and
- (b) on or after the last Business Day in the period specified in Section 10.1.43 (a) the Contracting Wholesaler has issued notice to the Contracting Retailer to pay themake available provide a sum at least equal to the Credit Support Amount or to provide the Credit Support Balance within a further period of ten (10) Business Days after the Contracting Retailer’s receipt or (if earlier) deemed receipt of such notice; and

(c) a sum at least equal to the Credit Support Amount or the Credit Support Balance as the case may be has not been ~~made available~~ provided by the expiry of that further period of ten (10) Business Days of the Contracting Retailer's receipt or (if earlier) deemed receipt of notice pursuant to Section 10.1.34 (b); or

Persistent failure to provide and maintain Credit Support Amount and persistent late provision of Credit Support Balance

10.1.5 the Contracting Retailer fails to provide or maintain a sum at least equal to the Credit Support Amount as specified at Section 9.11.2 or fails to provide the Credit Support Balance as specified in Section 9.12.3 for a third time, having failed on two (2) occasions in the previous twelve ~~Months to so make available, maintain or provide~~ (unless the terms of Section 9.13.6 apply or ~~this-any such failure is not~~ Disputed under Section 9.7.2) and on each of these two (2) previous occasions provides the Credit Support Amount or Credit Support Balance within the additional ten (10) Business Days period specified in Section 10.1.4(b) above.

11.2.5 If, having served the notice under Section 11.2.1, the Contracting Wholesaler subsequently does not want to proceed with the termination of a Wholesale Contract, it must revoke the notice or notices it no longer wishes to rely on in writing informing the Defaulting Trading Party (formally in accordance with Section 20.2) and the Authority (including by email) accordingly. Where the Contracting Retailer is not a Defaulting Trading Party at this time, the Wholesale Contract will not be terminated.