

Wholesale Retail Code Change Proposal – Ref CPW122

Modification proposal	Wholesale Retail Code Change Proposal CPW122 – Introducing Direct Debit as a payment method
Decision	The authority has decided to reject this change
Publication date	3 May 2022
Implementation date	N/A

We are rejecting this Change Proposal.

We are rejecting this Change Proposal on the basis that the Final Report did not clearly articulate that the benefits of the solution for customers outweighed the added complexity and costs associated with the transfer of administrative costs from Retailers to Wholesalers. We do not consider that the Final Report fully assessed the impact that this proposal may have on trading parties, both in terms of implementing the solution and meeting the new requirements on an ongoing basis.

We support the principle of Retailers being offered alternative payment methods where doing so carries with it benefits for current and future customers, including by removing unnecessary costs and inefficiencies from the existing market arrangements. We encourage Wholesalers, in demonstrating their commitment to supporting the business retail market, to take this into consideration when reviewing proposals from Retailers.

We do, however, suggest that if this concept is revisited in the future it should seek to take account of latest developments in the payment systems sector and include convincing evidence on the levels of potential take up across Retailers and articulate how the solution would benefit, either directly or indirectly, end customers.

We acknowledge that running a pilot of the solution could be a reasonable approach to test the use of Direct Debit and gather further data and evidence on the potential benefits and impacts of implementing the solution. Though we were concerned with the feedback from the Panel which suggested that there was not enough information gained during the consultation to develop a robust plan for a meaningful pilot exercise. It was also unclear from the evidence provided that there was strong enough interest in the solution to take it forward in its current form.

Background

Section 9.6 of the Wholesale Retail Code ('**WRC**'), schedule 1 of the Business Terms sets out, among other things, the payment terms and methods between Wholesalers and Retailers. In particular, it states:

"Payment of any amount due under the Wholesale Contract and shown as payable in an invoice and any accompanying statement pursuant to this Section 9 shall include interest applicable, calculated in accordance with Section 9.9, and shall be made by electronic transfer of funds to such bank in the United Kingdom as may from time to time be notified by the Contracting Wholesaler to the Contracting Retailer (in the case of an amount payable by the Contracting Retailer) or by the Contracting Retailer to the Contracting Wholesaler (in the case of an amount payable by the Contracting Wholesaler)"

CPW122 has been developed and proposed by Waterscan following the surveying of Self-Supply Retailers on their views of how current payment arrangements are functioning and the challenges this presents to the effectiveness of the Market.

The issue

The issue as described in the Final Recommendation Report (FRR) is that Self-Supply Retailers have highlighted several challenges with the current payment method in the WRC. These challenges include:

- Direct deposit between Wholesalers and Retailers is too manual, time consuming and comes with a heavy administrative burden.
- There is a constant effort and resource requirement to manage and reduce the risks of late, missed or non-payment or potential breaches of contract.
- The proposer states that as more trading parties enter the market the issues around payment are becoming increasingly complex.

Following two consultations in August 2021 and October 2021, the proposal was developed to explore the mandating of Direct Debit as a payment option in the WRC.

The Change Proposal¹

The change proposal developed by WaterScan Limited and contains two suggested solutions:

1. Option 1 is to mandate Wholesalers to offer Direct Debit as a payment option to those Retailers that request it, providing they do not currently pay their primary charges by pre-payment.
2. Option 2 is to undertake a pilot with a selected number of trading parties to gather further intelligence and evidence with a view to proposing a permanent solution of mandating Wholesalers to offer Direct Debit as a payment option.

CPW122 initially contained proposed amendments to Schedule 1 Part 1 Objectives, Principles and Definitions. This would have defined the term, “Electronic Fund Transfer” to clarify that Direct Debit was included within the definition. The proposed solution defines neither Electronic Fund Transfer nor Direct Debit.

The FRR sets out a number of impacts to trading parties should the change proposal be approved. For Retailers that chose to use Direct Debit as a payment method these include:

- Reduced administrative burden and associated reduction in resources used processing payments
- Increased payment certainty
- Improved experience as customers of Wholesalers

The impacts on Wholesalers implementing the solution are stated as including:

- Increased costs if systems and processes need to be introduced or changed
- Increased administrative burden and associated resources as Wholesalers will be initiating the payment process
- Increased control over the payment process
- Increased payment certainty

Key features of the Change Proposal

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>

Full detail of the solution can be found in the [FRR](#) with a number of the key features outlined below.

Direct Debits normally operate on a standard payment timeline of ten (10) Business Days after the invoice is issued. This is the notice period set out in the Direct Debit Guarantee and attached to both the Direct Debit mandate and the relevant invoices. Notice periods can be modified from the standard ten (10) Business Days if agreed with BACS. Each BACS ID can only have one notice period. Therefore, whilst the timelines may be aligned with those set out in the WRC, Wholesalers will be required to set up and manage one BACS ID for each different payment timeline that needs to be met with each Retailer. This will mean Wholesalers will need to manage a (potentially significant) number of BACS IDs. This could result in practical problems or added complexity.

The solution sets out that to make Direct Debit work effectively, the Retailer would have two (2) Business Days from when the invoice is issued to notify the Wholesaler of any errors with the invoice, for example due to a difference between the settlement figures in the relevant Settlement Report and those in the invoice. This would need to be rectified by withdrawing the invoice and re-issuing a correct one.

The Retailer would have the same timeframe of two (2) Business Days from the invoice being issued to raise issues with the Settlement calculations, where these meet the materiality threshold set for Corrective Unplanned Settlement Runs. Again, the Wholesaler would need to withdraw the invoice and work with the Retailer to resolve the error and re-issue a corrected invoice. If the error is not notified within two (2) Business Days from the invoice being issued, the approach would be for the Retailer to pay the amount due in full and this would then be reconciled in subsequent payment runs following resolution of the issue.

Key requirements that will be placed on Wholesalers under the Direct Debit rules are as follows:

- Wholesalers would be required to set up a BACS ID for each different payment arrangement and related timeline with the Retailer(s) that choose to pay by Direct Debit
- Wholesalers would need to align the timelines within the Business Terms with BACS as they differ from standard Direct Debit timelines
- Invoices would need to be submitted and processed in the required format for BACS
- Where there is a disputed invoice, these would need to be withdrawn in line with the deadline for amendments, which is usually between 3 and 5 days ahead of payment

The costs of implementing this change are set out in the [FRR](#).

Industry consultation and assessment

There were two consultations undertaken in the development of this Change Proposal. The [FRR](#) summarised responses to both consultations and the full responses can be found [here](#).

The second of the consultations built upon the first by gathering further information from Trading Parties to better understand Retailers' preference for using Direct Debit, the costs, impacts and benefits of the proposed solution, and the impact on customers. It also sought views on whether Trading Parties perceived the lack of a Direct Debit offering as a barrier to entry and whether they would participate in a potential pilot to test this payment method.

23 Trading Parties responded to the first consultation, comprising 12 Wholesalers and 11 Retailers (five of which were self-supply Retailers). The second consultation received 18 responses, from 11 Wholesalers, six Retailers (three of which were self-supply Retailers) and the Consumer Council for Water.

The first consultation highlighted that most of the responding Retailers would be in favour of mandating the offering of Direct Debit, with most parties expressing their interest in opting into a Direct Debit arrangement if it was made available. Generally, Self-Supply Retailers were strongly in favour of the proposed solution with some Retailers noting that the option to pay by Direct Debit would greatly reduce the administration costs currently associated with processing payments to Wholesalers. One Self-Supply Retailer noted that the solution would improve its ability to participate in the market.

While many Wholesalers were open minded to increasing the range of payment options available to Retailers, the responses to both consultations generally suggested that most of the Wholesalers considered that the proposed solution would have a negative impact on their business which included the costs and increased resources required to implement and manage the necessary systems and processes. It was suggested by one Wholesaler that the solution would effectively pass the responsibility for administrating payments to the Wholesaler. A significant number of Wholesalers suggested that, if the solution was implemented, they would need to undertake significant systems and process changes to meet the new requirements. Concerns were also raised as to the amount of time suggested to query and resolve invoice amounts prior to payments being taken by Direct Debit. The consultation provided limited quantitative data to illustrate the cost impact of the change on Wholesalers, though one Wholesaler indicated that it had conducted an initial analysis and reported that it would incur costs in the range of £15–£30k to implement and test the solution.

It was questioned by several Wholesalers whether there was sufficient demand to justify the investment required by Wholesalers to implement the changes involved in

making Direct Debit available as a payment option. Several Wholesalers suggested that they had only been approached by one Retailer requesting that Direct Debit be made available as a payment option.

One Wholesaler concluded that due to the small number of Retailers they contract with, it would not be cost effective to offer Direct Debit as a payment method. One Wholesaler stated that based on its experience, there would be a large benefit to Self-Supply Retailers, but it added that it would like to see evidence of the increased efficiencies for all Retailers across the market if the pilot was to take place.

Most respondents to the consultation forecast none or negligible impacts on customers. Those who did suggest that the solution would have a positive or negative impact did not clearly articulate how the proposal would impact end customers.

Below is a summary of responses to the key questions from both consultations:

Will the proposed change better facilitate the Objectives and Principles of the WRC?

This question was asked in the first consultation in August 2021 ahead of the implementation of [CPM040/CPW121](#) (MAC and WRC principles) . Of those that responded, 11 agreed (four Wholesalers and seven Retailers), seven disagreed (six Wholesalers and one Retailer) and five stated "other" (two Wholesalers and three Retailers), which could mean they thought it had both positive and negative impacts or they were unsure.

Most parties who agreed pointed towards the change supporting the principle of efficiency. It was also suggested that the change would provide greater payment certainty to Wholesalers. Though one Retailer who agreed acknowledged that the change would increase Wholesalers' administrative activities.

Those who considered that the change acted against the Objectives and Principles of the WRC argued that the solution would be contrary to the principle of efficiency. With some parties suggesting it would require Wholesalers to make significant investment in system changes, cause the delay of payment and result in tensions between Trading Parties.

One Retailer noted that it would consider this solution as better facilitating the Objectives and Principles of the WRC only if the Retailers' appetite for this payment method would be proportionate to the Wholesalers' implementation costs.

One Wholesaler who disagreed, did so while also noting the benefit of expanding the options of payment methods for Retailers, which would support the market.

Do you consider it appropriate to mandate Direct Debit as a payment method?

In the first consultation of those that responded, 11 stated no (10 Wholesalers and one Retailer and 12 responded yes (two Wholesalers and 10 Retailers).

As a Retailer would you be interested in opting into a DD arrangement? As a Wholesaler would you be interested in offering DD without a mandate?

13 of the respondents stated that they would be interested (four Wholesalers, nine Retailers), four stated that they would be somewhat interested (four Wholesalers) and five stated that they would not be interested (three Wholesalers, two Retailers).

A self-supply Retailer noted that the absence of Direct Debit as a payment option in the market was one of the reasons it had yet to fully switch across its sites to self-supply. Cautious support was expressed by two Retailers who suggested that they would like the process for challenging disputed invoices to be more clearly defined.

Several Wholesalers were supportive of an optional, non-mandatory, approach being adopted in the market. One Wholesaler suggested that it could be more comfortable supporting the change after a trial period of implementation.

Those against the suggested approach raised concerns about shifting the responsibility and burden for payment timeliness on to Wholesalers.

Based on your invoice validation process, do you agree that two (2) Business Days is an appropriate timeframe to identify and notify any errors? Please explain your answer.

This question was posed in the first consultation. Eight respondents agreed that two business days was an appropriate timeframe (2 Wholesalers and 6 Retailers). Nine disagreed (4 Wholesalers and 5 Retailers), and six respondents as "other" (6 Wholesalers).

Some of the Retailers that agreed with the proposed timeframe did so noting that another party validates invoices on their behalf.

Those that disagreed generally suggested that the timeframe was not sufficient for them to perform necessary internal review and validation checks. One Wholesaler suggested four to five Business Days would be more appropriate to allow it to review the invoices. Another Wholesaler considered that the timeframe should be of two Business Days from the issuance of settlement reports by MOSL rather than from the invoice date. This would allow the Parties to identify and resolve any issues by agreement and before the invoice is issued, which it would find preferable as the invoice is normally issued one week following the issuing of settlement reports.

Would you prefer to use Direct Debit for the payment of Primary Charges instead of the payment method that you are currently using?

This question was asked as part of the second consultation to Retailers only. Of those that responded to this question two responded 'Yes' with four Retailers responding 'No'.

The self-supply Retailer who indicated a desire to use Direct Debit as their main method to pay primary charges suggested that it would result in reduced administration time and costs which could be redirected to customer service benefits.

Do you consider the lack of offering Direct Debit a potential barrier to entry?

This question was asked as part of the second consultation. Four respondents stated 'Yes' (four Retailers including two self-supply), 11 respondents stated No (nine Wholesalers, two Retailers) and three respondents were unsure (two Wholesalers and CCW).

The four Retailers indicated that the lack of offering Direct Debit can be considered a barrier to entry on the basis that the current processes require more resources than a Direct Debit would, which may disadvantage smaller players. A Self-Supply Retailer reiterated its view that this is the reason why it hasn't fully utilised its licence as it would not be able to authorise and process its payments on time with the payment methods currently available within the market. A Wholesaler noted that it is a possible barrier, and based on its experience some Retailers do encounter problems aligning their systems and processes to the current market requirements for payments.

Several Wholesalers did not consider the lack of Direct Debit to be a barrier to entry, with one noting that they had not seen evidence of a market-wide appetite for Direct Debit as a payment option.

One Wholesaler wanted to see further evidence on whether this is a barrier to entry. On a similar note, the Consumer Council for Water suggested that the only way to establish if this was a barrier to entry would be to understand if the current payment methods are creating significant problems for Trading Parties.

Would you participate in a pilot to test Direct Debit?

This question was asked as part of the second consultation. Five respondents answered 'Yes' (three Wholesalers and two Retailers) with 12 respondents answering 'No'. There was 1 N/A from Consumer Council for Water.

Of the Wholesalers who said they would participate in a pilot trial, one said it could not trial Direct Debit for pre-payment terms as the Direct Debit notice period would not align with the due dates in the Business Terms. The other Wholesalers expressed a desire to know who else would be participating in the pilot, with one asking for a view on the projected payment amounts expected by Direct Debit.

Panel recommendation

The Panel considered this Change Proposal at its meeting on 30 November 2021. The Panel agreed by majority decision to recommend CPW122 for approval, with eight Panel Members voting in favour of the change, three against and one abstention.

The reasons stated for agreement included that the Panel considered Direct Debit should already be a payment method in place within the market and that implementation costs would have already been absorbed.

The Panel Members that recommended the change be approved stated that they would only recommend a pilot as an alternative to rejection of the solution. The reasons given were that the plan as set out in the FRR for the pilot exercise did not contain enough detail on how it would work and as a result there was uncertainty as to whether a pilot would provide sufficient evidence and information to enable future discussions.

The Panel Members that recommended the solution did not believe that at this stage a strict cost benefit analysis was required as Direct Debit should already be in use within the market. One Panel Member stated that offering different payment options to Retailers would lead to good customer service to those Retailers.

As part of the Panel's discussions, it was noted that any changes that are made to the codes now should also cater for new technologies and developments in payment systems that may emerge in the future. It was recognised however that this may not be entirely possible, as it can be difficult to futureproof the codes to consider new developments and technological innovations. The Panel also stated that those parties that wish to utilise Direct Debit payments currently could be disadvantaged if they had to wait for codes to change again to include future payment technologies. The Panel concluded that that any proposed legal drafting to mandate the offering of Direct Debit should not preclude any future developments in payment technology. One Panel Member abstained from voting on the basis that there were ongoing developments in the payment systems sector that this Change Proposal did not take account of. However, they did not feel this was a reason to vote against the change proposal, as they agreed with the principal that the Change Proposal is trying to achieve.

Two of the three Panel Members that voted against the Change Proposal were in favour of undertaking a pilot to better understand why there may be resistance to the use of Direct Debit. One Panel Member stated that they would have agreed to the pilot proposal if it had also included research on whether other markets use Direct Debit in similar contexts.

Our decision and reasons for our decision

We have considered the issues raised in the Change Proposal and the supporting information provided. We welcome Change Proposals that seek to reduce unnecessary costs and remove inefficiencies from the market arrangements that can benefit current and future customers. We also agree with the principle of Wholesalers being more flexible and proactive in relation to the way in which Retailers are able to make payments. However, the evidence as presented in the FRR did not sufficiently demonstrate how the **primary principle** of seeking to protect and promote the interests of, and participation by, existing and future Non-Household Customers would be furthered in this instance.

We acknowledge that there is support for the solution amongst some trading parties, particularly Self-Supply Retailers. However, we do not believe that sufficient evidence has been presented that demonstrates that the benefits² to non-household customers outweigh the costs involved in implementing this solution.

Costs of implementation, potential take-up across Retailers and impacts on customers

The evidence obtained through consultation responses and set out in the FRR does not demonstrate that there is significant interest across the market in taking up Direct Debit as a payment option.

The FRR sets out an estimation of the costs to Wholesalers in preparing the system changes should Direct Debit be mandated as a payment option (estimated at being up to £50k per Wholesaler). From reviewing the consultation responses, we consider that the actual cost of implementation has been difficult to assess.

More information on projected costs, compared with projected uptake in the market, and a clear articulation of the direct and indirect effects on non-household customers, would have been helpful in determining a view on the potential benefits to customers and the market of implementing this solution. We note CCW's position that there is a need for further information in relation to costs and the likeliness of these being passed onto customers.

In the FRR it is noted that Wholesalers would be required to set up the necessary infrastructure following a Retailer's request to use Direct Debit. The impact of the change on Wholesalers is acknowledged by allowing a minimum implementation time

² Benefits to non-household customers can include direct as well as indirect benefits.

of six (6) months. We understand that Trading Parties can mutually agree on a shorter or longer duration for implementation. The FRR also notes that all Retailers that opt into Direct Debit with a Wholesaler will have to provide a minimum of six (6) months' notice period if they then wish to opt out. We note from the consultation responses that there was some uncertainty about the length of time it would take Wholesalers to implement the system updates required to implement the solution. Several Wholesalers suggested that it could take them in the region of nine months to ensure that their systems could meet the new requirements.

We support the principle that there should be choice around payment options for Retailers in the market. However, we note that there are developments in the payment systems sector as part of open banking initiatives that may mean Direct Debits become obsolete or superseded, and therefore unnecessary costs incurred. If this concept is to be considered again at a future date, we agree with the Panel member who noted the need for a review of developments in the payment systems sector to ensure that any solution put forward is compatible with foreseeable developments in that sector.

Increased risk of disputes through alignment of timescales

One of the reasons for Ofwat's decision to reject this Change Proposal relates to the risk of payments being automatically taken when the Retailer has not agreed the charges. We acknowledge that the legal drafting sets out the approach to disputes. However, the FRR does not sufficiently address the concern raised by several stakeholders that two (2) business days is insufficient time to address any invoicing issues before the payment is taken. One of the proposed mitigations to the risk of creating more disputes is to implement a 6 month opt out notice should Retailers wish to change their payment method. Whilst we acknowledge this is a potential approach, given the complexities and costs to setting up Direct Debit, we do not believe it directly mitigates the risk of more disputes arising. In our view, the process set out in the solution of withdrawing invoices and reissuing them ahead of payments being taken, or Retailers raising a dispute, will not promote the **simple, cost effective and secure principle**.

As stated previously, if this concept is revisited again in the future, we would encourage further thinking on whether the proposed timeframe of two Business Days is adequate for Wholesalers and Retailers to process and review invoices ahead of payment.

Decision notice

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

Georgina Mills

Director, Business Retail Market