

Wholesale Retail Code Change Proposal – CPW136 – Drawing Credit Following Retailer Exit

Modification proposal	Wholesale Retail Code Change Proposal – Ref CPW136 – Drawing Credit Following Retailer Exit
Decision	The Authority has decided to approve this Change Proposal
Publication date	29 March 2023
Implementation date	7 April 2023

We are approving this Change Proposal.

We consider that implementing this Change Proposal will benefit existing and future customers by improving the effectiveness of credit arrangements set out in the Wholesale Retail Code ('WRC') in the event of Retailer failure.

Under the current arrangements, if a Retailer fails, Wholesalers can use a mechanism through the price control arrangements to recover revenue for services consumed by that Retailer, but which are un-invoiced at the time the Retailer exits the market. This process enables Wholesalers to recover a proportion of these costs through making adjustments to customer bills.

However, before going down this route, to reduce the impact of these costs being passed on to and borne by customers, we expect that Wholesalers should first seek to utilise the credit security that Retailers put in place under the provisions of the WRC to recover outstanding un-invoiced revenue. This change to the WRC will enable Wholesalers to draw down on credit collateral for this purpose.

Background

In [September 2021](#), Ofwat set out proposals to deal with un-invoiced wholesale charges in the event of an unplanned Retailer exit from the market.

Ofwat noted that, where a Retailer fails and exits the market, unrecovered charges that have been invoiced for are treated as bad debt. The current price control arrangements allow Wholesalers to recoup from customers a portion of such bad debt costs via a cost

sharing mechanism, with any amounts recovered by companies via this mechanism being subject to the company specific cost sharing rate (as per the company's PR19 final determination) to ensure additional costs are fairly shared. However, there was no similar provision for wholesale charges for usage that are un-invoiced when a Retailer fails.

In [November 2022](#), Ofwat confirmed that should a Retailer failure occur in time for it to be considered as part of the 2024 price review (PR24), Wholesalers will benefit from an adjustment in relation to un-invoiced revenue through the Revenue Forecasting Incentive (RFI) formula at the end of period reconciliation for PR19. Furthermore, Ofwat indicated that it intends to introduce a mechanism during PR24 to allow for in-period adjustments relating to un-invoiced revenue in the event of a Retailer failure. However, Wholesalers would be expected to use all reasonable endeavours to exhaust securities and credit provisions and to offset them against unpaid charges, including in respect of amounts relating to un-invoiced usage before such adjustment.

When developing its policy position on un-invoiced charges, Ofwat became aware of a restriction on the drawing of credit in the WRC that was implemented by CPW079 (Protections for Credit Support Security) on 14 February 2020. The intent of CPW079 was to prevent Wholesalers from drawing on credit support above the level of payment owed by a Retailer.

Paragraph 9.14.2 of the WRC refers to sums that are "owed and due". However, where "owed" is taken to relate to services that have been consumed by Retailers and become "due" once an invoice for those services is subsequently raised, it follows that un-invoiced sums are not "due". As Wholesalers cannot issue invoices to failed Retailers, paragraph 9.14.2 therefore prevents a Wholesaler from drawing down on credit support in respect of sums which remain un-invoiced in the event of a Retailer failure (i.e., sums that are "owed" but not "due").

Consequently, the current wording of the code inadvertently inhibits the application of Ofwat's proposals to deal with un-invoiced wholesale charges in the event of an unplanned Retailer exit, as confirmed in its November 2022 decision and therefore changes to the WRC are required to address this conflict.

The proposed change to the WRC has evolved since Ofwat's consultation issued in September 2021. In that consultation document, Ofwat proposed a specific code solution to address the problem that had been identified, namely, to remove the term 'and due' from paragraph 9.14.2 of the Business Terms, thereby allowing credit support to be used, where appropriate, against amounts that remain un-invoiced (i.e., owed but not due). In light of feedback received during the consultation process, Ofwat has reviewed and subsequently amended the legal text that will implement this change.

Details of how the legal text has evolved are set out in the Appendix.

The issue

In November 2022, Ofwat published its decision on dealing with un-invoiced wholesale charges in the event of an unplanned Retailer exit. Ofwat's decision set out a mechanism available to Wholesalers for the recovery of amounts in respect of un-invoiced revenue, with Ofwat stating its expectation that Wholesalers should firstly draw down on credit support in an effort to recover un-invoiced sums before this mechanism is used. However, a consequence of the legal drafting implemented in Section 9.14.2 of the WRC following code change CPW079 (Protections for Credit Support Security) is that it currently prevents Wholesalers from legitimately pursuing this action.

The Change Proposal¹

The Change Proposal (CP) is an Authority timetabled change which was raised by Ofwat on 21 December 2022.

The CP seeks to amend the WRC to enable Wholesalers to draw down on credit support in order to recover un-invoiced sums for services provided to a Retailer before its unplanned exit from the market.

The proposed solution is to add a new section 9.14.3 to Schedule 1, Part 2 (Business Terms) of the WRC as follows:

“Notwithstanding the provisions in 9.14.2, in the event that a Contracting Retailer has become subject to an Insolvency Event, then the Contracting Wholesaler shall be entitled to draw on any Eligible Credit Support or Alternative Eligible Credit Support up to the limit of the sums owed to the Contracting Wholesaler at that time in relation to services provided which carry a Primary Charge.”

The proposed implementation date of this change is 7 April 2023.

Industry consultation and assessment

As was made clear in the original policy consultation on this issue published by Ofwat in September 2021, that document has been treated as the formal consultation mechanism under section 6.3.3 of the Market Arrangements Code for this proposed change.

A full summary of the consultation responses was attached to the Final Recommendation Report which can be found [here](#). The vast majority of respondents

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>

were supportive of the proposal to amend the WRC, with just two parties expressing concern regarding the legal drafting that was proposed to implement the change.

One Wholesaler stated that it could not support the proposal at that time, however this Wholesaler did not specifically comment on the WRC change proposal itself but noted that its opposition was based upon the fact that it did not support the mechanism Ofwat intended to implement to enable Wholesalers to recover un-invoiced revenue in the event of a Retailer failure. The Wholesaler stated that it could not support the WRC amendment because of the points it made in response to other questions posed in the consultation document, where Ofwat sought views on the mechanism it intended to implement to enable Wholesalers to recover un-invoiced revenue in the event of a Retailer failure. The Wholesaler considered that the proposed mechanism did not appropriately consider the settlement timetable. They considered that, due to the timing of the market billing cycle and the availability of meter readings, un-invoiced revenues may not be fully crystallised until the last RF settlement is issued. As a result, any adjustments to the Revenue Forecasting Incentive (RFI) for an unplanned Retailer exit may impact the RFI calculations for several financial years.

In response, we explained that the settlement timetable was considered when developing the original policy proposals and we understood that balances from future settlement runs that occur after a Retailer failure would be invoiced to the Retailer that takes on the failed Retailer's customer book after an interim supply event. We therefore considered that this process should limit the extent to which Wholesalers are exposed to un-invoiced revenue in the event of a Retailer failure. We also pointed out that Trading Parties have the ability to request unplanned settlement runs to enable the recalculation of primary charges for an invoice period outside of the planned schedule of reconciliations. For example, this can be carried out when an incorrect data item has affected the calculation of primary charges reported in a planned settlement run.

One Retailer considered that the proposed legal drafting changes to paragraph 9.14.2. of the Business Terms would allow a Wholesaler to draw on credit security in respect of un-invoiced sums in all circumstances, not just in the event of a Retailers' unplanned exit. The Retailer suggested that the existing WRC drafting should be left unchanged, and the following text be added to paragraph 9.14.2: "The references in [this] Section 9.14.2 to amounts due shall be disregarded in respect of a Contracting Retailer where the Authority has issued a Notice of Cessation of Supply in respect of that Contracting Retailer pursuant to the Interim Supply Code as defined in the document of that name issued by the Authority as amended from time to time."

We did not agree that the proposed change would allow a Wholesaler to draw on credit security in respect of un-invoiced sums in all circumstances. Under the WRC Schedule 1 Part 2 Business Terms (the Business Terms), where the Contracting Retailer selects the option of Post-Payment or Reduced Notice Post-Payment it must provide and maintain Eligible Credit Support and/or (with the agreement of the Contracting Wholesaler) Alternative Eligible Credit Support for the Credit Support Amount. A Wholesaler is not entitled to draw on any Eligible Credit Support or Alternative Eligible Credit Support unless a Retailer is classified as a Defaulting Trading Party, with section

10 of the Business Terms setting out the conditions that need to be met for a Retailer to be considered to be a Defaulting Trading Party.

We therefore considered that it would be a disproportionate and unlikely course of action for the Wholesaler to immediately draw down on credit support in respect of un-invoiced sums following the classification of the Retailer as a Defaulting Trading Party, particularly in circumstances where the Retailer is continuing to pay its bills on time. In most circumstances, such action would only cause further financial difficulties and complications for the Retailer, which could have implications for the Wholesaler itself.

Whilst we noted that we would not expect Wholesalers to attempt to draw down upon credit and securities for un-invoiced revenue where there is still an opportunity to raise an invoice with an active Retailer for services consumed, we acknowledged that there was scope to tighten up the original proposed legal drafting. Working alongside the Market Operator (MOSL), the drafting was amended in a way to deliver the original intent, while removing any potential ambiguity by ensuring the change would only apply in cases where a Retailer has made an unplanned exit from the market.

Our view is that the amended legal drafting successfully delivers the intent of CPW136 whilst mitigating risk of a Wholesaler incorrectly drawing down credit in relation to un-invoiced amounts for any other reason other than Retailer failure and unplanned exit. Reference to “Insolvency Event” makes use of the existing defined term to limit the application of the clause to the intended context. We stated that we could not foresee any circumstances other than insolvency that would result in unplanned Retailer failure and exit. We also noted that it would not be in a Wholesaler’s interest to declare a Retailer insolvent under the “Insolvency Event” definition, for example by virtue of having negative net assets, where the Retailer is continuing to pay its bills on time. The settlement report schedule should ensure that a Wholesaler can determine “the limit of sums owed”, therefore the proposed solution does not create any additional risk of a Wholesaler claiming in excess of this.

Views of the Customer Representative

The Customer Representative (CCW) was supportive of the proposed amendments to the WRC. CCW acknowledged that it is important for customers that this change is made alongside the proposed changes to the Totex cost sharing mechanism. Clarifying that wholesalers can draw on credit support for all unpaid usage costs will potentially avoid customers having to bear some of the burden.

CCW agreed that the proposed amendments set out in the September 2021 consultation would remedy the unintended consequence created by CPW079, making it clear that sums that are owed but not yet due (i.e., un-invoiced usage costs) are the same as those owed and due for credit support purposes.

CCW considered that failing to address the CPW079 unintended consequence would potentially lead to customers bearing an extra unnecessary cost burden through the Totex cost sharing mechanism in the event of a retailer failure. CCW agreed that this change would minimise the risks to customers, whilst the proposed legal drafting

would provide clarity to wholesalers on the outstanding usage costs that they can claim, thus increasing transparency, and furthering the principle of efficiency.

Code Change Committee (CCC) discussion and recommendation

The Final Recommendation Report for this CP was presented to the Code Change Committee (CCC) on 8 February 2023. The committee unanimously agreed to recommend CPW136 for implementation.

After deliberating the background, purpose, and impact of the change proposal, the CCC concluded that CPW136 would not place any additional credit burden on Retailers and would have a positive impact on customers. It recommended, by unanimous decision, that the Authority approve this CP. Whilst some members had mixed views as to whether CPW136 would significantly benefit customers directly (with regard to the Primary Principle), overall, the Code Change Committee was supportive of CPW136.

The recommended date of implementation is 7 April 2023.

Our decision and reasons for our decision

We have considered the issues raised by the Change Proposal and the supporting documentation provided in the CCC Final Recommendation Report (FRR) and have decided to approve the proposal. We have concluded that the implementation of CPW136 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.

This change aligns with Ofwat's Statutory Duties as the intention is primarily to protect the interests of consumers.

We consider that this change will better facilitate the **Primary Principle** of the WRC (as set out in schedule 1, part 1) by delivering benefits for existing and future customers through improving the effectiveness of credit arrangements in the event of Retailer failure. In short, we think that where a Retailer becomes insolvent, it is right that debts they have accrued should be borne by that Retailer as far as possible and not picked up by customers overall; therefore, allowing Wholesalers to draw down on credit collateral in relation to un-invoiced amounts helps to reduce potential burdens on customers in the case of an unplanned Retailer exit from the market.

In addition to advancing the Primary Principle, we consider that the proposal furthers the following supporting principles: **Continued development and sustainment of an effective market**: this change will promote effective market functioning in the event of Retailer exit by minimising the risk of negative impacts on other market participants resulting from a disruptive Retailer exit, noting that, where appropriate, exit is a feature of an effectively functioning market. The policy intent of this change will help reduce such risks by enabling Wholesalers to draw down on credit collateral against un-invoiced amounts; **Transparency and clarity**: this change will provide clarity to Trading

Parties and security providers regarding the use of credit collateral where amounts remain un-invoiced in the event of a Retailer failure. **Efficiency:** this change will promote the efficient, economic, and co-ordinated operation of the water and wastewater sector to the extent impacted by the WRC by enabling Wholesalers to draw down on credit collateral against un-invoiced amounts, in the appropriate circumstances, targeting the costs of exit more efficiently to the exiting Retailer.

We also note that the change proposal aligns with the Strategic Panel's strategic priority "Getting the Money Right". It will provide a route for Wholesalers to be paid for the services it has delivered to a Retailer who exits the market.

Decision notice

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

Dan Mason
Director, Business Retail Market

APPENDIX – Legal text evolution for this Change Proposal

Proposed changes to the legal text of the WRC, as published in Ofwat’s September 2021 consultation:

“9.14.2. The Contracting Wholesaler shall not be entitled to draw on any Eligible Credit Support or Alternative Eligible Credit Support in excess of sums owed ~~and due~~ to the Contracting Wholesaler at that time (amounts subject to disputes or question pursuant to Section 9.7.2 shall not be considered owed ~~or due~~). Should the Contracting Wholesaler draw on any Eligible Credit Support or Alternative Eligible Credit Support in excess of sums owed ~~and due~~ (contrary to this section 9.1.4.2), the amount of Eligible Credit Support or Alternative Eligible Credit Support that the Contracting Retailer is required to provide pursuant to Section 9 shall be reduced by the amount that the Contracting Wholesaler drew upon in excess until such time as that excess amount is reimbursed to the Contracting Retailer by the Contracting Wholesaler.”

Final legal text, as set out in the CPW136 Change Proposal raised in January 2023

The proposed final legal text leaves section 9.14.2 unchanged and instead adds a new section 9.14.3 to Schedule 1, Part 2 (Business Terms) of the WRC as follows:

“Notwithstanding the provisions in 9.14.2, in the event that a Contracting Retailer has become subject to an Insolvency Event, then the Contracting Wholesaler shall be entitled to draw on any Eligible Credit Support or Alternative Eligible Credit Support up to the limit of the sums owed to the Contracting Wholesaler at that time in relation to services provided which carry a Primary Charge.”