

## **Decision on the Wholesale Services Agreement and associated Directions to support the implementation of standard licence condition B4 on Financial Resilience**

29 March 2023

On 14 March 2023, the Commission published a [consultation](#) on the required changes to the Wholesale Services Agreement, in line with previous decisions, on the introduction of a new voluntary licence condition on financial resilience and the Directions that would give effect to those changes.

This document summarises the responses received to the Commission's consultation and sets out the Commission's decision.

This document has been sent to:

- All licensed providers;
- Scottish Water;
- The Central Market Agency Limited;
- The Scottish Government; and
- Consumer Scotland.

This decision document is also available on the Commission's website:  
<https://wics.scot/consultations/retail-market-consultations/decisions>

## 1. Background

The Covid-19 pandemic has highlighted the importance of ensuring that all market participants are and remain appropriately capitalised and can withstand external shocks. Experience from other markets<sup>1</sup> has shown the detriment that may be caused to consumers when market participants are not financially resilient. It is therefore important that we learn from those lessons.

The Commission has a duty to promote the interests of customers and ensure there is no detriment to the wholesale business of Scottish Water. Mindful of its statutory duties, the Commission implemented [steps](#) to support customers and licensed providers in response to the Covid-19 pandemic. Scottish Water also supported licensed providers by temporarily [suspending](#) the two-month wholesale prepayment requirement.

In May 2021, the Commission took further [steps](#) to introduce a new voluntary licence condition requiring licensed providers to demonstrate their financial resilience to Scottish Water and the Commission (SLC B4). The Commission also concluded that the specific level of wholesale prepayments would have to be consistent with a 3-month cap and a 1.5-month collar for licensed providers who have opted-in to the voluntary licence condition and would, ultimately, be based on Scottish Waters' assessment of the licensed provider's creditworthiness. This assessment would be set out by Scottish Water in a Financial Resilience Statement (FRS).

On 14 March 2023, the Commission published a consultation [document](#) on the required modifications to the Wholesale Services Agreement (WSA) to allow Scottish Water to make the necessary changes to the level of prepayment based on its assessment of licensed providers' financial strength. The document also consulted on the wording of the Directions that would give effect to those modifications.

This document summarises the responses received and sets out the Commission's decision.

## 2. Representations received

### 2.1 General representations

The Commission has received two responses to the consultation published on 14 March 2023. The Commission would like to thank those stakeholders for responding to the consultation.

The first response welcomed the Commission's approval of the FRS and outlined its support for the proposed changes to the Wholesale Services Agreement (WSA) without further recommendations.

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<sup>1</sup> [Ofgem report into its regulation of the energy market](#)

The second response has been summarised as part of the following table:

Issue category	Issue description	The Commission's response																		
Timescales of P1 payment terms	<p>Raised concerns that providing only 4 BDs to prepay wholesale charges (as per 8.2.1 of the WSA) may increase late payments, especially if the level of prepayment may increase.</p>	<p>The Commission disagrees with this statement. Clause 8.1A.2 of the WSA clarifies that a licensed provider would receive over one month notice prior to any change in the prepayment level taking effect. For example, if a licensed provider moves from 2 to 3 months prepayments the following timetable would apply:</p> <table border="1" data-bbox="745 587 2078 959"> <thead> <tr> <th data-bbox="745 587 920 627">Date</th> <th data-bbox="920 587 2078 627">Description</th> </tr> </thead> <tbody> <tr> <td data-bbox="745 627 920 667">20/07/2023</td> <td data-bbox="920 627 2078 667"><i>Financial resilience score assessed by Scottish Water</i></td> </tr> <tr> <td data-bbox="745 667 920 707">01/08/2023</td> <td data-bbox="920 667 2078 707"><i>Scottish Water issues two notices to relevant licensed provider:</i></td> </tr> <tr> <td data-bbox="745 707 920 746">08/08/2023</td> <td data-bbox="920 707 2078 746"><i>1. confirming change of score</i></td> </tr> <tr> <td data-bbox="745 746 920 786"></td> <td data-bbox="920 746 2078 786"><i>2. confirming change of Prepayment Invoicing Date (moving from 2 to 3 months prepayment), taking effect in September 2023</i></td> </tr> <tr> <td data-bbox="745 786 920 826">14/08/2023</td> <td data-bbox="920 786 2078 826"><i>Scottish Water issues provisional invoice for October 2023</i></td> </tr> <tr> <td data-bbox="745 826 920 866">18/08/2023</td> <td data-bbox="920 826 2078 866"><i>The licensed provider pays provisional invoice for October 2023</i></td> </tr> <tr> <td data-bbox="745 866 920 906">12/09/2023</td> <td data-bbox="920 866 2078 906"><i>Scottish Water issues provisional invoice for November 2023 and December 2023</i></td> </tr> <tr> <td data-bbox="745 906 920 946">18/09/2023</td> <td data-bbox="920 906 2078 946"><i>The licensed provider pays provisional invoices for both November 2023 and December 2023</i></td> </tr> </tbody> </table>	Date	Description	20/07/2023	<i>Financial resilience score assessed by Scottish Water</i>	01/08/2023	<i>Scottish Water issues two notices to relevant licensed provider:</i>	08/08/2023	<i>1. confirming change of score</i>		<i>2. confirming change of Prepayment Invoicing Date (moving from 2 to 3 months prepayment), taking effect in September 2023</i>	14/08/2023	<i>Scottish Water issues provisional invoice for October 2023</i>	18/08/2023	<i>The licensed provider pays provisional invoice for October 2023</i>	12/09/2023	<i>Scottish Water issues provisional invoice for November 2023 and December 2023</i>	18/09/2023	<i>The licensed provider pays provisional invoices for both November 2023 and December 2023</i>
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Late payments	<p>Suggested that Scottish Water's assessment of licensed providers' creditworthiness should only penalise late payments for P1 payments and not further reconciliation runs. Reconciliation runs are more likely to be lower in value and relate to admin errors rather than indicate a lack of funds.</p>	<p>Whilst reconciliation payments may represent on average a lower monetary value, they may in the event of bulk transfers of customers represent large monetary sums. It is important to note that any form of late payment as part of the settlement run may be an important indicator of a licensed providers' ability to honour its obligations.</p> <p>It is also worth noting that following engagement with licensed providers, the scoring methodology has already been changed to account for the number of late payments rather than number of late paid invoices. For example, late payments for R1, R2 and R3 settlement runs would count only as one late payment rather than three.</p>																		

## **2.2 Alternative credit term arrangements**

The Commission also received two proposals, one of which in writing, on the use of Letter of Credits as an alternative credit term arrangement to wholesale prepayments. The Commission would like to thank those licensed providers for their contributions.

The consultation document published earlier in March explained that in line with the Commission's statutory duties, any alternative credit arrangements must satisfy both Scottish Water and the Commission that it can meet the following tests:

1. Offers Scottish Water an equivalent protection to the wholesale prepayment requirement;
2. Does not present additional financial risks to Scottish Water; and
3. Does not bring any economic detriment to Scottish Water (e.g. no additional monitoring or carrying cost).

The consultation document also outlined the Commission's current view that alternative credit arrangements are unlikely to offer (at least) an equivalent level of security as the prepayment terms and be more cost-effective than the current arrangements.

In reviewing the proposals, the Commission also identified several additional policy issues as to the practical application of these tests that would need further consideration in light of its duty to secure the participation of licensed providers in a manner that is not detrimental to Scottish Water's core functions.

The Commission remains open to discussing and reviewing alternative credit term arrangements that can meet the above-mentioned tests. It is important, however, that the Commission can be reassured on all outstanding issues given its statutory duties, and the industry-level impact of implementing any alternative credit term arrangements across market participants.

In light of this, the Commission plans to undertake a public consultation in June 2023 to give proper consideration to these issues that have arisen throughout our engagement process, including the specific points raised by licensed providers in the proposals we received. In the interim, the WSA and the FRS will only include wholesale prepayments and we have, therefore, removed references to "*credit security agreement*" from the final version of both documents. The Commission will revisit this position following at the June 2023 consultation. Following that process, the Commission will determine its final policy position on this issue.

## **3. Conclusion**

The Commission now intends to issue the Directions to implement the changes as outlined in this decision document. Appendix 1 of this document contains a clean version of the final Directions that will give effect to the necessary modifications to the Wholesale Services Agreements to support the implementation of the FRS. This will ensure that these changes are made consistently across all market participants. The Directions will come into effect on 6 April 2023.

The Annex to Appendix 1 of this document contains a tracked changed version of the Wholesale Services Agreement.

The final version of the FRS has also been included as part of Appendix 2 of this document. Any future proposed change to the FRS that may be appropriate shall be consulted on and require the Commission's approval.

#### **4. Next steps**

The Commission will continue to work closely with Scottish Water, the Central Market Agency and all licensed providers to help ensure that the financial resilience framework works effectively. As mentioned previously, the Commission plans to undertake a further consultation on alternative credit term arrangements.

The Commission will also work with Scottish Water to keep the financial resilience framework closely under review. Any further revisions to the FRS shall be consulted on and ultimately approved by the Commission.