

Aquavitae- proposed revisions to the market framework February 2009

This is the Commission's response to the consultation issued in November 2008 on proposals to revise the market framework following the collapse of Aquavitae and the revocation of its licences by the Commission on 2 September 2008.

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Background

On 9 June 2008, Aquavitae (UK) Limited (**Aquavitae**) entered administration. As previously advised in the consultation document *Aquavitae - proposed revisions to the market framework*, Aquavitae were served a Notice of Revocation by the Commission on 2 September 2008.

Comfort was taken from the fact that all processes for dealing with the collapse of a market participant functioned as expected. However, as a result of the revocation of Aquavitae's licences, the Commission decided to review the processes involved and proposed amendments on three inter-linked areas of the market framework:

1. Information from licensed providers
2. Time delays following payment defaults; and
3. The usefulness of the minimum level of CMA charges.

Responses

We received three responses to the consultation from Scottish Water (**SW**), Business Stream (**BS**) and the Central Market Agency (**CMA**). We would like to thank all respondents to the consultation for their comments and suggestions, which we have found very useful.

The Commission would like to respond to some of the responses below.

1. Information from Licensed Providers

The Commission proposed to strengthen the reporting requirements under Standard Licence Condition (SLC) A3 by issuing an open letter outlining specific information required under paragraph 1 of SLC A3. Under the terms of the open letter, the Commission would be able to require licensed providers to report on a regular basis. To encourage a more open culture, the Commission may also ask licensed providers to update by way of face-to-face briefings.

Support was received for the Commission's proposals to strengthen reporting requirements by licensed providers. Regular credit checking and the checking of the filing of annual accounts were proposed as further checks where any changes in risk status could act as a trigger for action by the Commission and the CMA. It was also suggested that the Commission consider introducing a requirement that licensed providers produce an annual certificate confirming their financial standing.

The Commission believes its proposal for an open letter will allow us to request such information if required and become proactively involved at a much earlier stage.

A proposal was also made which would require licensed providers to provide an address within Scotland at which all legal documents could be served in order to minimise

procedural impediments on the termination of a wholesale services agreement. Alternatively, it was proposed that licensed providers should be required to appoint a firm of Scottish lawyers with authority to accept service of such notices.

Whilst the Commission acknowledges the thinking behind such proposals, we consider it would be an additional administrative and financial burden, particularly on those licensed providers who operate throughout the United Kingdom, which would produce little additional benefit.

2. Time delays following payment defaults

The Commission's intention is to ensure that any non-payment of sums due within the market framework is flagged to the Commission as soon as possible. However, the Commission is mindful of the fact that late payment is a normal characteristic of commercial operations. The Commission would not wish to see any licensed provider removed from the market in situations where a more proportionate remedy may be appropriate. The Commission therefore proposed to amend both the Market Code and the Wholesale Service Agreement (**WSA**) to co-ordinate the default and termination provisions under those documents and provide more certainty in communication between the Commission, Scottish Water and the CMA.

There was clear support for the principal that non-payment of sums within the market framework should be flagged to the Commission as soon as possible.

The CMA believes that the appointment of an administrator constitutes grounds for a licensed provider to be classed as a Defaulting Trading Party (**DTP**) under the Market Code. The Commission supports amending the definition of a DTP to include the situation where a licensed provider is in default under its WSA and SW has issued a notice of termination.

Concern was expressed that deletion of the default trigger amount could mean that a licensed provider could default on a very small sum. Where there is concern that the default trigger is too high, BS supported a lowering of the default trigger amount rather than a complete deletion of it altogether. The Commission does not wish to amend the basic processes for managing late payments as set out in the market framework. Flexibility and discretion will remain part of the process, however, more certainty in the communication between the Commission, Scottish Water and the CMA is essential in order to ensure that the Commission is able to identify and monitor the progress of any default, or potential, default situation. The Commission therefore intends to remove the default trigger amount completely.

It was also noted that the consultation document refers to the CMA having discretion on whether or not to serve notice on non-trading parties. The CMA would welcome an amendment which removes this discretion or a statement from the Commission confirming that the CMA has such discretion. The Commission confirmed in the Consultation that discretion remained with the CMA with regards to securing payment for sums due. The

Commission does not wish to change the basic process for the management of late payments set out in the market framework. Nor does the consultation set definitive timescales within which the CMA, or SW, should issue payment demands. Such discretion on securing payment remains with the CMA. The consultation does however propose changes to both the Market Code and the WSA, to co-ordinate the default and termination provisions and to provide more certainty in communication between the Commission, SW and the CMA to ensure that all necessary stakeholders are aware of any defaulting licensed provider at the earliest possible stage in the process.

SW expressed concern that existing financial exposures will continue with regard to reconciliation payments and that there was potential that the exposure could be greater where a licensed provider's market share has been growing rapidly prior to termination of its WSA. SW is concerned that the proposed changes do not mitigate this particular risk.

Under the current legal provisions, a licensed provider would have to be declared insolvent in order to trigger the implementation of the Provider of Last Resort (PoLR) provisions. Whilst the Commission appreciates the concerns of SW, the consultation proposals aim to create a process which will be more proactive than the current approach and requires both SW and the CMA to act in a prompt manner in identifying to the Commission any defaulting licensed providers, to allow for a reaction before insolvency proceedings commence, thereby ensuring that the PoLR provisions are also enacted more speedily.

SW favours a system where compulsory notification of late payment by SW to the Commission is limited to non-payment of primary charges. SW believes that non-payment of other charges should be determined on a case-by-case basis, but agree that SW could be required to inform the Commission where formal notices are served on licensed providers with regard to non-payment of non-primary and primary charges. The Commission is content to allow SW to use its discretion in such a scenario in light of the new requirements to encourage more prompt notification to the Commission of any defaulting parties.

3. The usefulness of the minimum level of CMA charges

Section 7.10 of the Market Code allows the CMA to set a minimum charge, below which an invoice will not be issued, and any outstanding charges will be rolled forward into the next month- the *de minimus* provision. The provision was originally included to reduce the administrative burden on both the CMA and the licensed provider of operating the charge collection system.

As a result of this process no invoice was issued to Aquavitae for its CMA charges. Had an invoice been issued before entering administration, it is likely Aquavitae would have defaulted on payment, which would have triggered the PoLR provisions much earlier. The Commission therefore proposes to remove the *de minimus* provision from the Market Code and the similar *de minimus* provision contained in the WSA with regard to the payment of charges other than the provisional monthly charges.

SW and BS support the proposal to remove the *de minimus* provision with BS highlighting the fact that the cost benefit of the *de minimus* provision has been negative to the market. BS also questioned whether Aquavitae would have paid the invoice had it been issued and suggests that all licensed providers should make monthly payments to the CMA as late payments could provide an indication of a licensed provider experiencing financial difficulties. Regular payments would also help the CMA and would be good practice.

The CMA noted that the *de minimus* provisions were included as a result of the Insolvency Act 1986 where unpaid debt must exceed £750 before proceedings can commence and sought clarification on the Commission's position.

The Commission's intention in removing the *de minimus* provisions is to ensure that the Commission, and other stakeholders, are made aware of any defaulting payments much more quickly than at present, regardless of the amount. It is not within the jurisdiction of the Commission to initiate, or be involved in, insolvency proceedings.

Additional Amendments to the Market Code

As a result of the consultation two further amendments have been made to the Market Code in addition to the amendments proposed in the consultation. We have amended Clauses 7.8.3 and 10.7.1(i) as follows:

7.8.3- Where an amount is unpaid in respect of CMA Charges as described in Section 7.8.1 the CMA shall take reasonable steps (including court proceedings if appropriate but will not include the need to send notices under this Market Code other than those anticipated in Section 10.7.1(i)) to pursue and recover the unpaid amount from the non-paying Trading Party.

10.7.1(i)- A Licensed Provider will be classed as a Defaulting Trading Party if:-

- (i) The Licensed Provider has failed to pay an amount properly due by it, under the market code where:-
 - (a) It is in excess of ten (10) Business Days from the payment due date; and
 - (b) On or after the last Business Day in the period specified in Section 10.7.1(i)(a) above the CMA has issued notice to that Licensed Provider to pay the outstanding amount within a specified further period of business days; and
 - (c) The amount invoiced has not been paid by the expiry of that further specified period of Business Days;

The additional amendments have been included to clarify the language and to make the intention clearer.

Amending the Documents

The Commission will amend the Market Code, the Wholesale Services Agreement and the Water Services (Codes and Services) Directions and publish them on the website by means of the processes set out below.

Market Code

A Commission Change for the Market Code will take place under section 8.7.2 of the market code which states-

- (i) *If and to the extent that the Commission considers that making a Change is necessary in the interests of securing the orderly participation of Trading Parties in the provision of Services and would be consistent with the Market Code Principles, the Commission may require that a Change be made to the Market Code...*

Wholesale Service Agreement (WSA)

The Commission will write to all licensed providers directing them to update their copy of the WSA accordingly under the powers set out in Standard Licence Condition A7 paragraph 6 which states, “the Commission may (following such consultation as the Commission may consider *appropriate*) *issue directions providing that any wholesale services agreement to which the licensee is party shall have effect with or subject to such modifications as are specified in such directions*”.

The Water Services (Codes and Services) Directions

The Commission will amend the Water Services (Codes and Services) Directions, published 6 December 2007, under the powers set out under s11(2) of the Water Services etc. (Scotland) Act 2005.