

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

14 March 2023

This document consults 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 on the Directions that would give effect to those changes.

Any comments should be sent to competitionteam@wics.scot no later than 27 March 2023.

This document has been sent to:

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

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

1. Background

1.1 Learning from the Covid 19 pandemic and other markets

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 markets¹ 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 interest 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 two new voluntary licence conditions which required licensed providers to support customers affected by the Covid-19 pandemic through a partial deferral scheme (SLC B5) and demonstrate their financial resilience to Scottish Water and the Commission (SLC B4).

Later in May 2021, following public consultation, the Commission issued a decision [document](#) setting out the Directions that would allow Scottish Water to cater for the modifications to the Wholesale Services Agreements in support of the two new voluntary licence conditions and the gradual reintroduction of wholesale prepayments. In July 2021, the Commission issued a decision [document](#) setting out the final revisions to the standard licence conditions to support the implementation of these measures.

As a result of these decisions, the Commission offered all licensed providers the opportunity to opt in to either or both of the two new SLCs B4 and B5, respectively on financial resilience and a partial deferral scheme. Licensed providers who opted in the two licence conditions have benefited from a more gradual reintroduction of wholesale prepayments.

1.2 Credit term arrangements

In light of the Covid-19 experience, the Commission's decision [document](#) outlined above concluded that:

- 3 months of wholesale prepayments to Scottish Water represents a reasonable level of liquidity that should be required by any licensed provider who has committed to evidence their financial resilience;
- In the absence of such commitment licensed providers would have to prepay 3.5 months of wholesale charges;
- 1.5 months of wholesale prepayment represents the lowest level of prepayment that would be consistent with its duty to ensure no detriment to Scottish Water; and
- The specific level of wholesale prepayments consistent with the 3-month cap and the 1.5-month collar outlined above for licensed providers who have opted in the voluntary licence

¹ [Ofgem report into its regulation of the energy market](#)

condition on financial resilience, would be based on Scottish Waters' assessment of the licensed provider's creditworthiness.

The same decision documents concluded that licensed providers who sign up to the new licence conditions would have the ability to negotiate tailored credit arrangements with Scottish Water. In line with the Commission's statutory duties, however, any alternative credit arrangement would have to 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 Commission is open to discussing and reviewing alternative proposals that meet the above-mentioned tests. However, the Commission's current view is 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.

2. Recent developments

Since April 2021, Scottish Water has been working in close collaboration and has extensively consulted² with market participants to develop the Financial Resilience Statement (FRS) as per SLC B4. The FRS sets out a framework to assess the financial strength and creditworthiness of those licensed providers that have outlined their consent to SLC B4 on financial resilience. This framework will be used to determine the specific level of wholesale prepayment of each licensed provider consistent with the cap and collar set out by the Commission.

The final version of the FRS has been included in the Appendix to this document and can be found [here](#). Any future proposed change to the financial resilience statement that may be appropriate would be consulted on and require the Commission's approval.

3. Updating the Wholesale Services Agreement

This document consults on the required modifications to the Wholesale Services Agreement to allow Scottish Water to implement the terms and prepayment arrangements on the basis of its assessment of licensed providers' financial strength.

The Annex to the Appendix of this document contains a tracked changed version of the Wholesale Services Agreement. For ease of reference, the modifications have been summarised in the following table:

² April 2021 – Scottish Water published initial draft security and resilience policy.

June 2021 – Scottish Water published first draft of the financial resilience framework.

July 2021 – Following consultation with licensed providers, Scottish Water published second draft of the financial resilience framework.

August 2022 – Scottish Water published third draft of the financial resilience framework.

September 2022 – Workshop to brief licensed providers on framework and outline implementation plan.

October 2022 – Scottish Water published final version of the financial resilience framework.

| Category | Reference | Brief Description of Change |
|------------------------------|--------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------|
| Financial resilience | 8.1.2 (b) 8.1A.1.(a) 8.1A.1.(b) 8.1A.2 8.1A.4 8.2.1 8.2.2 (a) Schedule 1 Schedule 1A | Includes clarifications around payment terms based on the financial resilience score and all other necessary arrangements to enact the framework |
| Tailored Credit Arrangements | 8.1.2 (c) 8.1A.1.(c) 8.1A.3 8.1A.5 8.1A.6 8.2.2 (b) Clause 26 Schedule 1 | Includes certain amendments relating to tailored credit arrangements |
| Interest | 8.3.3 8.8.2 8.8.3 Schedule 1 | Includes updates on the interest paid on prepaid balances by Scottish Water |
| Other | Footnote 1 8.5.3 8.6 8.11 Clause 22 Clause 26 | Includes clarifications around method of payment, serving of notices, offsetting of invoices and an amendment of address |

4. Directions

Section 11(2) of the 2005 Act authorises the Commission to give directions of a specific or general nature to Scottish Water or licensed providers to secure the participation of licensed providers in the provision of water and sewerage services in an orderly manner and in a manner that is not detrimental to the exercise of Scottish Water's core functions.

This document also consults on the wording of the Directions, contained in the Appendix, that would 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.

5. Next steps

Any comments to the proposed changes to the Wholesale Services Agreement and the Directions to give effect to these changes should be sent to competitionteam@wics.scot no later than 27 March

2023. Following consultation, the Commission is planning for the Directions to come into effect on 7 April 2023.

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. The Commission will also keep the financial resilience framework closely under review and may consult on revisions to the FRS the Commission considers appropriate.