

## Minutes of Credit Committee Meeting 08

21 May 2019 | 10:30 – 15:15

Etc.venues County Hall, Riverside Building, Belvedere Road, London SE1 7PB

Status of the Minutes: Final

### MEMBERS PRESENT

Member	Role
Adam Richardson	Chair
Lee Austin	Committee Member (Wholesaler)
Matthew Labrum	Committee Member (Wholesaler) - teleconference
Julian Tranter	Committee Member (Wholesaler)
James Wilson	Alternate Committee Member (Wholesaler) – teleconference
Chris Milner	Committee Member (Associated Retailer)
Scott Christie (SC)	Committee Member (Unassociated Retailer) - teleconference
Jacob Tompkins	Committee Member (Unassociated Retailer) - teleconference
Oliver Farrell	Secretary (MOSL)
Charles Unvala (CU)	Presenter (MOSL)

### APOLOGIES

Member	Role
Richard Berger	Committee Member (Wholesaler)
Richard Spencer	Committee Member (Wholesaler)
Neil Pendle	Committee Member (Unassociated Retailer)
Richard Moore	Committee Member (Unassociated Retailer)
Dan Mason	Ofwat Representative

## 1. 1. Welcome and Introductions

- 1.1. The Committee Chair welcomed the Members and James Wilson as alternate for Richard Spencer. The Chair noted apologies from Richard Berger, Richard Moore, Richard Spencer, Neil Pendle and Dan Mason.

## 2. Minutes and Outstanding Actions

- 2.1. The Committee approved the previous meeting's Minutes, subject to the addition of SC's objection to the Committee's conclusion on change proposal CPW057.

**ACTION CC08\_01**

- 2.2. The Committee agreed Actions **CC07\_01**, **CC07\_02** and **CC07\_03** were all complete. CU confirmed that **CC07\_04** would be completed with the updating of the Credit Committee webpage following agreement of the revised meeting date by the Committee.

## 3. Overview of the Default process

- 3.1. The Committee considered a range of matters related to Default including:

- Persistent failure to pay
- Defaulting Trading Party under another Wholesale Contract
- Notice of intention to terminate a Wholesale Contract
- Clarification of the interpretation of the termination provisions
- Remediable breach provisions.

### *Persistent failure to pay*

- 3.2. A Committee Member stated that Section 10.1.2 'Persistent failure to pay' does not appear to work. They felt that, where there were outstanding sums, the Retailer would already be a Defaulting Trading Party (DTP) and so there was a question about what purpose the clause is serving. CU agreed that Section 10.1.2 needed to be clarified.

### *Defaulting Trading Party under another Wholesale Contract*

- 3.3. A Committee Member stated in relation to Section 10.1.15 'DTP under another Wholesaler Contract' that it is unclear whether this should be communicated and to whom. Another Committee Member stated that where a Retailer became a DTP in one Wholesaler area it would not necessarily reflect the sustainability of a business and so questioned whether that should be communicated to all Wholesalers to trigger the default process.

*Notice of intention to terminate a Wholesale Contract*

- 3.4. A Committee Member felt that provisions relating to notice of termination of a Wholesale Contract were not clear. They questioned whether the code required a Wholesaler to provide a further 10 Business Days' (BDs') notice of intention to terminate the Wholesale Contract to the Authority following a Retailer becoming a DTP and prior to the date in the notice to the Retailer. The Committee Member stated that they disagreed that this should be the case and noted that this had been queried during the development of the codes.
- 3.5. A further Committee Member asked what would happen if the Wholesaler did not provide 10 BDs notice. The first Committee Member stated that, whilst there was the legal right to terminate the contract, failure to provide the required 10BDs' notification might lead to enforcement action by Ofwat under Section 11.2.4.
- 3.6. The first Committee Member set out his position that Wholesalers should be able to terminate the Retailer's Wholesale Contract at the point when the Retailer became a DTP with the default and termination processes running concurrently. The Committee Member explained that in the case of late payment default his company send a precautionary notice to Ofwat 5 BDs after the due date for payment so that after 15 BDs when it becomes a DTP, Ofwat having been given 10 BDs notice, the Wholesaler can terminate the Wholesale Contract. The Committee Member further stated they would like to understand Ofwat's rationale for requiring 10 BDs notice of termination after a Retailer becomes a DTP. They made the point that the sooner a Wholesaler could terminate the Wholesale Contract, the sooner the Wholesaler could reduce its liabilities. Another Committee Member agreed that it would be useful to understand Ofwat's rationale as they questioned why the regulator needed 10 BDs.
- 3.7. In considering the timescales before contract termination, A Committee Member stated one of the Committee's remits was to discuss what provisions could be put in place to avoid the nuclear option of Wholesale Contract termination, which also has the effect of crystallising the Wholesaler's loss. Another Committee Member agreed that this was a natural incentive not to push that button unless the Wholesalers believed there were no realistic prospect of receiving payment, even at a later date.

*Clarification of the interpretation of the termination provisions*

- 3.8. The Committee requested that a legal review be undertaken to clarify the practical meaning of the current code drafting on two aspects of the termination process. Firstly, a Committee Member enquired whether provision of the Credit Support Balance at some point in the 10 BDs between notice of termination and that termination taking effect, would remedy the breach. Secondly, another Committee Member noted that the Wholesaler's termination notice to a Retailer was with effect from a specific date (having provided Ofwat with notice of its intention to terminate the Wholesaler Contract at least 10 BDs prior to that date) and asked for clarification that this terminated the Wholesale Contract rather than providing the option to do so at any subsequent date.

**ACTION CC08\_02**

*Remediable breach provisions*

- 3.9. The Chair enquired about the application of “breach of a material obligation under the Wholesale Contract” under Remediable breach (Section 10.1.10) noting that whilst it excluded the Default events for late payments (Sections 10.1.1 and 10.1.2) and those for failure to provide a Credit Support Balance (CSB) (sections 10.1.4 and 10.1.5), it did not carve out Failure to provide and Maintain Credit Support Amount (CSA) (Section 10.1.3). He asked whether Section 10.1.10 could also apply to Sections 10.1.3 and the remaining default events.
- 3.10. A Committee Member stated they wanted to understand how a Remediable breach would work without the existing code provisions. The Committee Member stated that in a commercial relationship, the two parties will manage defaults that are capable of remedy between themselves. They would expect this approach would include confirmation of how contract breaches would be rectified where they were capable of remedy. The details of how these were remedied and whether the parties allowed exceptions to the contract should be commercial decisions for them. The Committee Member felt it was important that the codes provided for a level playing field but that it would be difficult to cover every eventuality in the codes and that to do so would introduce additional complexity which would run counter to their desire for simplification.

*Summary*

- 3.11. The Chair provided a summary of the areas for action which included:
- Clarifying reasons for default and the associated triggers.
  - Looking at the termination notice period - how this works and would be used.
  - Simplifying the default process including considering the applicability of the remediable breach process to other default events.
  - Considering whether more detail of the process was required for the external default events from Insolvency to Force Majeure (10.1.13-10.1.16).

## 4. Clarifying of existing default and termination processes and testing of new proposals

- 4.1. The Committee considered the Default process set out in Section 10 of the Wholesale Retail Code's Business Terms and examined scenarios where the Default status of a company could be challenged.
- 4.2. CU set out three Scenarios where there could be potential to challenge the required Credit Support Amount (CSA):
  - Scenario A - P1 contains erroneous data leading to a spike in the Credit Support Requirement (CSR);
  - Scenario B - Alternative Eligible Credit Support is withdrawn at short notice by the Wholesaler; and
  - Scenario C - Disagreement between the Wholesaler and Retailer over the basis or size of an Unsecured Credit Allowance (UCA)before presenting a range of solutions.
- 4.3. In Scenario A, a Committee Member asked for clarification on how the erroneous data was derived. Another Committee Member stated this was related to data error issues and that trading dispute mechanisms existed to help resolve this, alongside bilateral discussions.
- 4.4. The Chair questioned whether the sudden spike in CSR could place the Retailer in a difficult position and potentially enable the Wholesaler to terminate the contract if the Retailer did not pay the increased CSA associated with the increased requirement identified in the P1 run in question. Committee Members felt that the Wholesaler would act pragmatically in this situation.
- 4.5. A Committee Member stated that Scenarios A, B and C were all good but were not necessary issues that needed a solution and Trading Parties could take steps to mitigate that risk. In relation to Scenario C, the Chair reminded the Committee of a Member's view that different Wholesalers often look at same information and come to different conclusions for the UCA.
- 4.6. A Committee Member stated that he felt that it was unclear whether Section 9.7.2 'No deduction or withholding' included credit amounts. Whilst, another Committee Members stated their view that it clearly did as it referred to Section 9 in general, the Committee did not express a view on this.
- 4.7. The first of the solutions to Scenarios A, B & C, Solution 1 (Create a manifest error mechanism), led a Committee Member to highlight the potential for a Retailer identifying every data error and using it to justify collateral reduction. Another Committee Member said they hadn't seen evidence of such an issue needing a solution and advocated a pragmatic approach to resolve clear data errors. The Committee Member continued that specific scenarios did not need to be codified.
- 4.8. The Committee considered Solution 2 (Create a fast track 'dispute/appeal' resolution mechanism) where a Trading Party could raise an appeal to be looked at and determined by an independent adjudicator in the period before termination. However, there was no appetite for this approach to be developed further.

- 4.9. A Committee Member stated that Solution 3A (Extend the period before a party is classed as 'defaulting' through breach provisions) required more investigation. The proposal was to apply the Remediable and the Fundamental breach provisions to failure to provide and maintain a CSA and possibly after default events, which would extend the notice period to 15 or 20 BDs respectively.
- 4.10. Solution 3B (withdrawal etc. of an Alternative Credit Arrangement (ACA)) created a new default event for ACA to provide 10 BDs' notice to resolve the issue. This was along the lines of those default events for Guarantees, Letters of Credit and Surety Bonds. However, a Committee Member stated that it was incumbent on the Retailer to make sure when negotiating an ACA to ensure that it contained a reasonable notice period. Furthermore, concern was expressed that specifying such a default event could potentially constrain the flexibility of ACAs.
- 4.11. The Chair said that another point to address was the inconsistency between default events. In particular, whilst failure to provide or maintain CSA led to a Retailer immediately becoming a DTP, where the cause of this failure was the withdrawal of a Guarantee there was 10 BDs to resolve that default event before becoming a DTP. He suggested an approach to resolving this inconsistency was to allow the withdrawal of the Guarantee to be resolved as long as a certain percentage of credit cover was maintained. For example, where the percentage maintained was 90% as the cover provided by the Guarantee that had been withdrawn was 10%. In response to this, a Committee Member requested a clear example of the issue and the Chair said that a simple set of default triggers would need to be worked up. Another Committee Member stated the objective was to get more clarity and certainty in the most extreme circumstances.
- 4.12. A Committee Member stated that from a Wholesaler perspective, a failure of a large Retailer could take months or years to recover from and that it would propose that new Retailers should take on the liabilities from when a Retailer became a DTP, rather than when the Wholesale Contract was terminated, which would mean that Ofwat would have to change the Interim Supply Code.
- 4.13. The Chair said that the starting position should be that process amendments put forward should not extend the existing period taking account of the notice period. The Committee requested that MOSL discuss the rationale with Ofwat for the 10 BDs' notice of termination, to build in any learnings from recent events and to clarify how the liabilities would fall as a result of any Interim Supply Allocation process.

**ACTION CC08\_03**

- 4.14. In conclusion, the Chair said that MOSL would consider everything discussed and put this into a simplified process to produce a draft change proposal which could include a reduction in the number of default triggers, standardisation of notice period steps and clarifying drafting amendments to the late payment terms. If there is Committee support for the proposed solution, the change would then need to be formally raised and the industry would be consulted in the usual manner, prior to any recommendation being made to the Panel.

**ACTION CC08\_04**

## 5. Revised Meeting Date

- 5.1. CU presented the forthcoming meeting dates to The Committee. A Committee Member stated they would prefer the dates to be brought forward. However, the Committee agreed to move the next meeting to 31 July 2019.

## 6. Any Other Business (AOB)

- 6.1. There was no Other Business to discuss and the Chair closed the meeting.

### Actions

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| <b>ACTION CC08_01</b> | MOSL to add SC's objections to the Committee's conclusions on CPW057 to the CC07 Meeting Minutes.  |
| <b>ACTION CC08_02</b> | MOSL to carry out a legal review of two aspects of the termination process in relation to remedying a default during the termination notice and when a termination would take effect.                                  |
| <b>ACTION CC08_03</b> | MOSL to discuss rationale with Ofwat for the 10 BDs' notice of termination, to build in any learnings from recent events and to clarify how the liabilities fall as a result of any Interim Supply Allocation process. |
| <b>ACTION CC08_04</b> | MOSL to produce a draft change proposal from the discussion points for the next meeting.   |