

Minutes of Ad-hoc Panel Meeting 41a

15 April 2020 | 10:00 – 12:00 | Teleconference

Status of the Minutes: **Final**

MEMBERS PRESENT

Jim Keohane	JK	Chair	Martin Marvin	MM	Panel Member (Wholesaler)
Mike Brindle	MBr	Panel Member (Associated Retailer)	Pamela Taylor	PT	Panel Member (Independent)
Barry Hayward	BH	Panel Member (Associated Retailer)	Elsa Wye	EW	Panel Member (Independent)
Nicola Smith	NS	Panel Member (Unassociated Retailer)	John Vinson	JV	Alternate Panel Member (Independent)
Claire Yeates	CY	Panel Member (Unassociated Retailer)	Mike Keil	MK	Panel Member (Customer Representative)
Trevor Nelson	TN	Panel Member (Unassociated Retailer)	Dan Mason	DM	Affiliated Panel Member (Ofwat)
Mark Holloway	MH	Panel Member (Wholesaler)	Adam Richardson	AR	Panel Secretary

OTHER ATTENDEES

Stuart Boyle	SB	MOSL (Presenter)	Christopher Wright	CWr	Castle Water (Observer)
Charles Unvala	CU	MOSL (Presenter)	Ray Porter	RP	Castle Water (Observer)
Amanda Hinde	AH	MOSL (Observer)	James Wilson	JW	Yorkshire Water (Observer)
Oliver Robins	OR	MOSL (Secretariat)	Antoine Schmidt	AS	Thames Water (Observer)
Julian Tranter	JT	Thames Water (Presenter)			

APOLOGIES

Michael Rathbone	MR	Panel Member (Wholesaler)
Helyn Mensah	HM	Panel Member (Independent)
Sarah McMath	SM	Affiliated Panel Member (MOSL)

1. Welcome and Introductions

- 1.1 The Chair introduced Panel Members and all other attendees to Ad-hoc Panel Meeting 41a and noted apologies from Helyn Mensah (HM), Sarah McMath (SM) and Mike Rathbone (MR).
- 1.2 The Panel welcomed Pamela Taylor (PT) and Barry Hayward (BH) to their first meeting as Panel Members.
- 1.3 The Chair thanked all attendees for making themselves available at short notice to consider the urgent change.

2. Urgent change process overview

- 2.1 Stuart Boyle (SB) outlined the urgent change process that had been implemented on 8 April 2020 following Ofwat's approval of [CPM006 'Introducing a process for Urgent Change Proposals'](#). The Panel noted the key criteria for assessing the case for urgency with regards to [CPW095 'Urgent: Maintain Credit Requirements'](#).

3. CPW095 Urgent Change: Maintain Credit Requirements

- 3.1 The Panel considered the Draft Recommendation Report (DRR) for the urgent change proposal [CPW095 'Maintain Credit Requirements'](#). This change sought to mitigate an increase in bad debt risk for Wholesalers during the Coronavirus pandemic brought on by increased vacant premises (following implementation of [CPW091](#)), and deferred payments by Retailers (following implementation of [CPW093](#)).
- 3.2 Julian Tranter (JT), presenting as the Proposer on behalf of Thames Water, explained that the change sought to maintain Credit Support Requirements at the level as determined from the publication of the March 2020 P1 Settlement report in February 2020 for Retailers that deferred payment of primary charges (as permitted following the implementation of [CPW093](#)). The Panel noted that, under [CPW095](#), Retailers that continued to pay charges on time and in full would be required to lodge credit based on P1 Settlement reports in the usual way.
- 3.3 JT summarised the rationale for presenting the change as urgent as twofold: firstly to allow the change to apply to the Credit Support Notices due to be issued by 16 April 2020; and secondly, to minimise the magnitude of financial impact on Wholesalers and Non-Household Customers where Retailers that utilise the mechanisms provided by [CPW091](#) and [CPW093](#) for cashflow assistance will additionally benefit from reduced collateral.
- 3.4 JT explained where Retailers can now legitimately defer charges without Wholesalers being able to terminate their contract, the level of unsecured debt carried by Wholesalers across the market could potentially rise from £600 million to £800 million whilst collateral remained at £300 million (although this baseline level could drop by £70 million through the Vacancy Flag mechanism). As a result, if all Retailers were to default, Wholesalers could be exposed to £200+ million more bad debt than they had signed up to through the market codes. These additional costs would likely be borne by the customer in the long term.
- 3.5 Dan Mason (DM) acknowledged that while Ofwat was cognisant of the link between settlement and credit, it had not taken a view on the impact on credit arising from the

potential interaction of CPW091 and CPW093. He noted that both these changes were progressed on an urgent basis in order to provide vital cashflow relief to Retailers, and so this was an unintended consequence of those urgent and temporary changes.

CPW095 case for urgency

- 3.6 The Panel agreed that CPW095 met the criteria to be considered as an urgent change proposal (7 out of 11 Panel Members). Those that did not confirm urgency questioned the scale of the risk that Wholesalers would be exposed to and the possible impact of this.
- 3.7 One Panel Member noted that the figures referenced by the Proposer represented the level of unsecured debt across the whole market rather than the level of risk that would be borne by individual Wholesalers. JT explained that the figures gave a market wide perspective so to avoid the significant complication of variance in individual Retailer behaviour and invited the Panel to consider the values as potential and indicative in nature.

CPW095 solution

- 3.8 A Panel Member queried whether the change would be justified in circumstances where the Vacancy Flag mechanism had been appropriately and accurately used. JT explained that a Retailer using the Vacancy Flag mechanism in its intended way should have less reason to defer charges and could therefore still benefit from collateral reductions associated with reduced settlement charges if it paid on time in the usual way.
- 3.9 The Panel discussed the suitability of setting the collateral at the March level and whether the change should instead seek to increase the level of collateral to be provided where Wholesalers are taking on additional risk. JT stated that the March level provided a reasonable baseline level for the market in respect to the emergence of Covid-19. Rather than seeking to unwind CPW091 and CPW095 and increase the strain on Retailers, the change sought to ensure that Trading Parties utilise these new mechanisms appropriately.
- 3.10 Several Panel Members requested clarification on the customer impact (immediate impact due to an increased risk of Retailer failure and long-term impact due to a potential increase in charges) and the variability in exposure and impact across individual Trading Parties rather than baseline assumptions. JT explained that the position of individual companies will be temporally variable depending on the degree to which settlement charges are deferred and the extent to which the Vacancy and YVE mechanisms are used¹. The Proposer observed the solution retained the ability for Retailers to choose how to best manage their cashflow and so accounted for this variability.
- 3.11 One Panel Member suggested that the change could be associated with a risk of creating an unlevel playing field between Associated and Unassociated Retailers (where Associated Retailers might benefit from Parent Company Guarantees), and another Panel Member queried why there had been no Retailer engagement (for example with the UK Water Retail Council) in the development of the change proposal. JT acknowledged the comment and explained that this had not been possible due to the urgency of the change proposal.

¹ The Proposer indicated they had seen variation across Retailers ranging between a 5% and 40% reduction in P1 for its contracting Retailers.

- 3.12 A Panel Member stated that despite the change proposal being imperfect, they would support it based on the protection it would provide for Wholesalers.
- 3.13 Another Panel Member agreed that it was a proportional response to address the unintended consequences of two other imperfect changes. JT added that whilst the solution could be considered as a “blunt tool”, it still maintained the provision for Retailers to choose how best to manage their cashflow, and would help to ensure that the market is in a stronger position to unwind from the temporary Code changes following the resolution of the Covid-19 pandemic.
- 3.14 The Panel discussed whether it would be more suitable to redirect this issue to a Panel sub-group rather than vote on the proposal now. Panel Members observed that a sub-group had been established to consider matters relating to liquidity as identified by Ofwat. AR explained that the sub-group was primarily focussed on the level of reporting required to inform how a deferral mechanism might operate in the longer term and how it might be unwound in the future, but acknowledged that the sub-group could examine the relationship between the deferral mechanism and credit provisions, and how these may change, as a consequential piece.
- 3.15 Several Panel Members considered that there was a risk of creating additional unintended consequences by implementing another imperfect change at speed, with one Panel Member suggesting that from the perspective of unwinding these temporary provisions in the future for the optimum benefit of the market, the balance of risk would better sit with Wholesaler due to them possessing strong assets in a well-regulated industry. JT reiterated that the current provisions could see bad debt needing to be recovered from customers in the long term.
- 3.16 The Panel discussed the materiality of the figures presented in the CPW095 DRR. CU explained that the £3.8 million figure represented the monthly difference between the Credit Support Requirement (CSR) as currently calculated, and the CSR corrected for a 50% deferral of payments for two months, on average for a Wholesaler in the market. The Panel noted that the average cost, and its impact, would significantly vary across Wholesalers, and that, because the calculation had been performed on the basis that all Retailers were on post-payment², this value represented a maximum average level of exposure.
- 3.17 The Panel discussed the need for the issue of liquidity and bad debt to be considered holistically rather than on a piecemeal basis and noted that Ofwat would shortly be circulating a Request for Information regarding a longer-term solution to these issues. DM confirmed that Ofwat would ensure to consider the impact of this solution on the provisions put in place by CPW095 (if implemented).
- 3.18 The Chair invited views from observers present at the meeting. No comments were received.
- 3.19 JT thanked the Panel for its feedback on CPW095. JT summarised that any change that sought to reduce level of unsecured debt in the market going forwards should be viewed positively from the perspective of protecting customers in the long term and ensuring that the market can efficiently revert to business as usual operations post Covid-19, without increasing Retailer costs.

² MOSL does not have visibility of payment provisions in place for individual Retailers.

3.20 The Panel:

- **AGREED** (4 in favour, 6 abstentions) to recommend to Ofwat the implementation of CPW095; and
- **AGREED** to recommend implementation on 16 April 2020.

3.21 Several of the six Panel Members who abstained from the vote explained that they were unsure where the balance of risk should sit between Retailers and Wholesalers. Others acknowledged the principle behind CPW095 but expressed concern over the lack of information (due to the urgency of the change) regarding the risk of Retailer default, and how this lack of this information, and lack of holistic thinking, could lead to other unintended consequences.

3.22 One Panel Member commented that whilst the implementation of CPW095 may reduce the risk of adverse customer impacts in the long term, it may exacerbate the risk of Retailer failure in the short term which would have an immediate adverse effect on customers.

3.23 The four Panel Members who supported CPW095 did so on the basis that the change would protect customers as well as Wholesalers, and would preserve the credit requirement in relation to the March 2020 P1 settlement run for Retailers who deferred charges rather than increasing the credit requirement above this amount.

4. AOB

4.1 A Panel Member requested an update on [CPW087 'Ability for Wholesalers to add Meter Reads'](#). AR confirmed that MOSL would provide this at the regular Panel Meeting scheduled for 28 April 2020.

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Actions

P41a_A01 – MOSL to provide an update on CPW087 at the April Panel meeting.