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15 March 2012

Peter Allport  
Chair  
Retail Advisory Group  
c/o Electricity Authority  
2 Hunter Street  
WELLINGTON

By email: rag@ea.govt.nz

Dear Peter

## Genesis Energy supports the need for policy changes to address the allocation of risk for generators

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Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide a submission to the Retail Advisory Group (“the RAG”) on the consultation paper “Retail customers in retailer default situations – Discussion Paper” dated 7 February 2012.

### **Overview of Genesis Energy’s comments**

Genesis Energy considers that when an electricity retailer fails, the best means of managing the potential for supply disruption to consumers is through legally enforceable arrangements that ensure that all of the participants in the supply chain continue to be paid.

Consistent with this position, we support the RAG carrying out further work on the proposal to re-establish a legal mechanism for the Clearing Manager to place a retailer in default under receivership (“option two”). However, we are not convinced that there is a need for a regulated customer transfer mechanism (“option three”). Market forces can, and should, be relied upon as the most efficient means for transferring affected customers to viable retailers.

## **Support the need for policy changes to address the allocation of risk for generators**

We consider that when a retailer fails there are strong incentives for that retailer to initiate the process of selling its customers (that will be its most valuable asset) and to initiate this process quickly. Therefore, the risk of customers being stranded en masse by a defaulting retailer is low.

Notwithstanding this, we agree that there should be legal mechanisms in place to manage the wholesale risk for generators who, in the first instance, will bear the loss of continuing to supply a defaulting retailer's customers. The inability for generators to manage this risk through direct arrangements with retailers on the wholesale spot market is a problem that could warrant a change to the Electricity Industry Participation Code ("the Code"). Legal mechanisms are necessary for the financial security of the wholesale market and to remove incentives for inefficient risk-taking by retailers.

We therefore support the RAG carrying out further work on the proposal to re-establish the legal basis for the Clearing Manager to place a retailer in default under receivership ("option two"). We consider that the process of receivership is well understood and is consistent with what would occur in other markets.

However, we seek further details from the RAG on the legal advice they have received on this option (this point is discussed further in our response to question two in Appendix A). We also consider that there is potential for this issue to be more effectively addressed as part of the Wholesale Advisory Group's ("the WAG") Settlement and Prudential Review. In our view, the issue is essentially about balancing the need for a financially-secure wholesale market while ensuring that there are no unnecessary barriers of entry into the retail market.

## **Do not support a regulated customer transfer mechanism**

We do not support the proposal for a regulated customer transfer mechanism where the Electricity Authority ("the Authority") would have the power to order other retailers to accept customers of a failed retailer ("option three"). We question the need for this power and the degree that it manages the implications for consumers should an electricity retailer fail. We provide our assessment of the likely implications for consumers below.

### Unlikely that customers will automatically be disconnected

We note that in the initial stages of a retailer failing, customers will continue to be connected and will continue to receive electricity supply. This is because the Authority's ability to suspend a defaulting retailer has no practical effect for the continued supply of electricity to that retailer's customers<sup>1</sup> and electricity distribution companies have poor incentives to disconnect these customers en masse.<sup>2</sup>

### Market forces can be relied upon to transfer a failed retailer's customer base

We consider that it is highly unlikely that efforts to secure a transfer of a failed retailer's customer base would prove unsuccessful because of market conditions. Certain market conditions (for example on-going high spot prices and insufficient hedge contracts) will have a bearing on the price of a failed retailer's customer base but are unlikely to prevent transfer of a customer base occurring altogether. In our view extreme and largely unprecedented market conditions would need to be in place for this to occur.

We agree that a small minority of customers may not transfer smoothly to a new retailer under a market-based approach. This is likely to include customers who are unwilling to contract with new retailers on the basis of existing market prices and conditions. Some of these customers may eventually be disconnected, removing the risk to the wholesale market.

We do not agree that the RAG should be developing policy with wider intentions of protecting this minority group of customers. The financial risk and cost to retailers of taking on these customers are costs that are ultimately borne and passed onto other customers. We consider that in a competitive market, it is appropriate for retailers to determine the terms that they are willing and able to supply customers.

In our view, the Authority's statutory objective to support the interests of consumers should be based on an assessment of what is in the best interests of all consumers. We consider that putting in place a regulated customer transfer mechanism would only serve to benefit a very small minority of consumers. The paper does not put forward a policy rationale for why this approach should be supported.

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<sup>1</sup> Retail Advisory Group, *Retail customers in retailer default situations – Discussion Paper*, 7 February 2012, p.19-20.

<sup>2</sup> Retail Advisory Group, *Retail customers in retailer default situations – Discussion Paper*, 7 February 2012 p.23-24.

Genesis Energy's responses to the consultation questions are in Appendix A. If you would like to discuss any of these matters further, please contact Lizzie Wesley-Smith on 04 495 6357.

Yours sincerely



Lizzie Wesley-Smith  
Regulatory Advisor



Jeremy Stevenson-Wright  
Regulatory Affairs manager

## Appendix A: Responses to Consultation Questions

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QUESTION	COMMENT
<p>1. Does our summary of settlement risk allocation under the former NZEM capture the main elements; are there other lessons from experience for the design of current arrangements?</p>	<p>Yes.</p> <p>We consider that the paper captures the main elements under the former New Zealand Electricity Market (NZEM). In particular, the summary demonstrates that under the former NZEM, customers of defaulting retailers were transferred in a structured manner with relatively little disruption to the market.</p> <p>We agree that market dynamics have changed since the former NZEM. However, we do not agree that the “residual value” of customers is significantly less now, due to the propensity of customers to switch or be “less sticky”. We consider that this change in consumer behaviour is evidence of growing competition in the retail market and an increased willingness on the part of retailers to target new customers.</p> <p>We consider that there are also lessons and experiences to be drawn from the gas market. The recent exit of E-Gas from the gas market is an example of a successful transfer of customers through market forces and without the need for a regulatory response.</p>
<p>2. Do you agree with our summary of the regulatory tools that are available in the case of a failed retailer?</p>	<p>The summary does not clearly describe the legal advice the RAG has received on all of the issues discussed. In particular, we note that some of the legal advice relied on in the paper relates to the old NZEM rules. We seek clarification of the specific legal advice provided on the following:</p> <ul style="list-style-type: none"> <li>• whether the Electricity Industry</li> </ul>

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	<p>Participation Code (“the Code”), or any of the provisions contained within, could amount to a “security interest” for the purposes of the Receiverships Act 1993;</p> <ul style="list-style-type: none"> <li>• the legal effect of part 14.63 of the Code that states “Nothing in sub-clause (1) or clauses 14.55 to 14.62 limits the statutory right of the clearing manager to apply to the Court for the appointment of a receiver, interim liquidator or liquidator”; and</li> <li>• whether section 45(b) of the Electricity Industry Act 2010 (“the Act”) could in fact be relied on by the Authority to compel production of technical information to “enforce compliance” with Part 11 of the Code.</li> </ul> <p>We consider it would be helpful if the RAG released to participants the legal advice it has received on all of the issues. In a policy development context this would be helpful for consulted parties to understand and these benefits would outweigh any technical privilege issues.</p> <p><u>No power to obtain the information needed to switch customers</u></p> <p>We consider that it would be helpful if the consultation paper contained a more in-depth analysis of the exact information needed to switch customers and the precise legal and practical impediments to obtaining that information. For example, we consider that the process for obtaining technical versus personal information about a customer will be different.</p> <p>As noted above, we consider that there may be legal grounds under the Act that</p>

QUESTION	COMMENT
	<p>provide the Authority a right to compel the production of technical information that retailers are required to place on the Registry.</p> <p>We consider that the extent that there are impediments to obtaining a customer's personal information will depend on the customer. While this information is directly held by the defaulting retailer and arguably subject to privacy law considerations, customers who are willing to act in their own interests by transferring to a viable retailer (rather than run the risk of disconnection) can provide this information.</p>
<p>3. Do you agree with our summary of possible scenarios that could develop once a retailer begins to fail?</p>	<p>Yes.</p>
<p>4. How likely, and in what situations, do you think that efforts to secure a transfer of a failed retailer's customer base would prove unsuccessful?</p>	<p>We consider that where a retailer defaults, provided there is an appropriate body in place to manage the sale of that customer base, there are sufficient incentives within the market to facilitate a commercially-based transfer. In our view the transfer of customers by BDO following the E-Gas default is a good example of this. We consider that certain market conditions may have a bearing on the price of a failed retailer's customer base but are unlikely to prevent the transfer of that customer base from occurring.</p> <p>We agree that a very small minority of customers may not transfer smoothly to new retailers.</p>

QUESTION	COMMENT
<p>5. Do you think it plausible that customers of a failed retailer would be disconnected from their electrical supply?</p>	<p>We agree that electricity distribution companies do not have sufficient incentives to disconnect customers at a mass level. However, as noted in the cover letter we consider that this scenario is unlikely to occur as there are sufficient incentives within the market for the commercial transfer of the majority of customers.</p> <p>Consistent with what occurred in the E-Gas situation, it is plausible that a very small minority of customers who do not transfer to a viable retailer may be disconnected. .</p>
<p>6. Do you agree that this summary identifies correctly the problems with the current arrangements for governing a retailer failure; are there additional problems that we have not identified?</p>	<p>We consider it is unlikely that information could go missing from a retailer because of "data loss". Most retailers would hold this data in more than one form.</p> <p>As consistent with our response to question two, we consider the problems around sufficiency of information need to be assessed in more detail. In particular, the consultation paper should differentiate between technical information about a customer and personal information.</p> <p>As noted in the cover letter, we consider that it is possible that a minority of customers will not be transitioned smoothly. However, the consultation paper does not put forward an argument for why the types of customers who are likely to be affected in this way should be.</p>
<p>7. Do you consider the problems with the current arrangements for governing a retailer failure of sufficient magnitude to warrant investigation into options for resolving these problems?</p>	<p>We support further investigation into options for resolving the current issues around the inability of generators to manage the risk of a retailer default through direct arrangements with retailers on the wholesale spot market.</p>

QUESTION	COMMENT
8. Do you consider the problems with the current arrangements for governing a retailer failure of sufficient magnitude to rule out doing nothing to address the identified problems?	No.
9. Have we identified the relevant advantages and disadvantages of a mechanism to allow the Clearing Manager to appoint a receiver if a retailer is in default for a period that exceeds its prudential cover ?	Refer to the cover letter.
10. Have we identified the relevant advantages and disadvantages of a mechanism to allow the Clearing Manager to transfer a retailer's customers if a retailer is in default for a period that exceeds its prudential cover?	Refer to the cover letter.