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Discussion Paper: Retail customers in retailer default situations.

Mighty River Power (MRP) welcomes the opportunity to respond to the Retail Advisory Group (RAG)'s Discussion Paper: "*Retail customers in retail default situations*" paper, dated 7 February 2012. No part of the submission is confidential and we are happy for it to be made publicly available.

Elements of all the options presented have merit but we do not fully support any one of the presented options as an adequate complete solution. Our key comments are provided below.

Clearing Manager must have power to appoint a receiver

The ability for the Clearing Manager to appoint a receiver (as per option 2), should be reinstated. Generators, distribution and metering companies are otherwise unduly exposed compared to any other normal commercial supplier / purchaser relationship. Inability to act results in higher risk, longer resolution timeframes and greater losses and will create additional costs to these participants which will ultimately be borne by end use consumers over time.

Our assessment of likely scenarios suggests the exposure generators carry without the Clearing Manager's power being reinstated represents a much larger and faster accruing potential cost than that which would be incurred from exposure by other participants in an extended default scenario. We therefore support the implementation of a receiver as a high priority.

Current risk of retailer default and unallocated customers low

Our assessment of the materiality of retailer default in the current market is relatively low. We consider it unlikely that a major gentailer would find itself in a retail default situation given the nature of such vertically integrated businesses, but that the risks are higher for a stand-alone independent retailer.

We agree with the historic experience that the customer portfolio of a failed retailer will in all probability be transferred to an alternative retailer via some commercial arrangement and without the need for intervention.

While there may be concerns as to how residential customers that may be less financially attractive to retailers, such as those with poor credit histories, might be allocated, we consider the risks and materiality of this issue are low given:

- Across the industry, poor credit histories typically represent a minority proportion of a customer base – the vast majority of people pay their bills and would be included in a commercial transfer;
- Significant innovation has occurred and is ongoing within the industry to develop new retail products to effectively manage such customers; and
- There is a strong aversion with the supply sector towards disconnection which suggests the potential costs of maintaining connection to a relatively small proportion of customers would likely be internalised, and the supply of electricity to customers would be maintained.

If concerns exist that in some extreme scenario unallocated customer issues may not be naturally resolved by participants, we believe that, in this unlikely situation, the EA would be best placed to direct efforts as appropriate, at that time. Trying to prescribe measures now for a hypothetical situation with low materiality is of questionable value.

Merit in further consideration of impacts of future retailer default

While we consider the risks and materiality of retailer default are currently relatively low and would likely be managed by the market, this may not hold into the future. The current prudential regime does not provide sufficient cover to ensure generators would be adequately compensated over the period it would take to reasonably exit a defaulting retailer from the market. This, along with other measures to promote retail competition, could create incentives for future aggressive entry into retail markets at scales significantly larger than present, with the unfunded risks of default effectively borne by generators. As such we consider there is merit in further considering options for managing retail default and improving incentives for appropriate credit support management, particularly in the context of the Wholesale Advisory Group (WAG) prudential review.

Importance of co-ordination with WAG Prudential Work

We fully support the current work by the WAG to investigate measures to increase the efficiency of the current prudential regime. This work is likely to have wider ranging benefits for the market and new entry. As above, we consider that the issue of retailer default and prudential reform are inherently linked and therefore there would be merit in consideration of the costs and benefits of tighter retailer default powers in the context of the efficiency reforms currently being considered by the WAG.

In particular, we would appreciate analysis as to whether there may be benefits from affecting the transfer of a defaulting retailer on a more timely basis than would likely occur under current arrangements given the other efficiency benefits being considered by the WAG.

We understand that there have been interlinkages between the RAG and WAG work streams and fully support greater co-ordination going forward. We consider that any proposed solutions to retailer default should not be partial and should be implemented at the same time as reforms to the prudential arrangements. Such an outcome is desirable to promote regulatory certainty and stability.

Should you have any queries in relation to any of the above or other related issues please contact me direct on 09 580 3623 or nick.wilson@mightyriver.co.nz

Yours sincerely

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