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19 March 2012

Electricity Authority
Level 7, ASB Bank Tower
2 Hunter Street
WELLINGTON

By Email

Dear Sir/Madam

SUBMISSION – RETAIL CUSTOMERS IN RETAILER DEFAULT SITUATIONS

Thank you for the opportunity to provide a submission on the consultation relating to retailer default situations.

We feel that the problem situation has been adequately identified. However, we strongly recommend that the Authority does not base any future analysis on the price paid by Meridian for the On Energy customers in 2001. This historic situation is not entirely relevant in considering how the default of a small new-entrant retailer may play out today. We believe the Authority should question further whether a customer base of a defaulting retailer in 2012 would have a positive value at all. At the very least, it is likely to be significantly less attractive than the effective regional incumbency purchased by Meridian. The customers are likely to be much less “sticky”, given that they have already switched at least once, they will probably have a higher credit risk and higher cost to serve (due to the likely distributed nature of the customer base), and a receiver will have a strong desire to sell them promptly to reduce further losses. In addition, the major retailers are now accomplished at acquiring customers via targeted campaigns (reducing the need/desire to purchase customers), and, importantly, most participants have a much more “balanced book” than in the past. These factors, coupled with increased market volatility and additional penalties like the Customer Compensation Scheme, substantially degrade the value of a defaulting retailer’s customer base below what was paid in 2001.

If the value of a customer base is to be used in other workstreams (for example assessing the residual value of a retailer as part of the prudential workstream), we feel it is crucial that the Authority does not overestimate this figure. It is also important that the synergies between this workstream, the wholesale prudential workstream and the network prudential workstream are adequately identified and accounted for.

Answers to the specific questions posed are provided in the table attached at the end of this letter.

If you have any questions regarding this submission, please get in touch with me on 07 574 4754.

Yours faithfully,

James Tipping
REGULATORY STRATEGY MANAGER

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Submission by TrustPower Limited

Question No.	Question	Response
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>TrustPower believes that the paper captures the main elements with respect to settlement risk. However, TrustPower advises caution regarding the heavy emphasis placed on the historic examples provided in the paper. The market dynamics and the environment that existed surrounding the cases listed in Table 1 are very different to those today. The examples provided indicate the price a [very] long generator was prepared to pay for quality customers – in essence an incumbency or regionally-focused customer base. The exiting retailers, while keen sellers, were also not in receivership.</p> <p>In contrast, the customer base of a failed new-entrant retailer is likely to be significantly less attractive (and may well secure nil value) due to the “reduced stickiness” of its customers, higher credit risk and higher cost to serve (due to the likely distributed nature of its customer base), and a receiver’s desire to reduce further losses. In addition, most retailers are now accomplished at acquiring customers via targeted campaigns, and, importantly, most participants have a more “balanced book” than in the past. These factors, coupled with increased market volatility and additional penalties like the Customer Compensation Scheme, substantially degrade the value of a defaulting retailer’s customer base – so much so that the value per customer may be less than zero.</p> <p>In summary, it is not hard to imagine a situation in which storage levels are very low, wholesale prices are very high, and compensation payments are in force. The last thing a retailer is likely to want to acquire in that situation is a large number of [loss-making] customers, even if they happen to have a bit of length in their trading book.</p>
2	Do you agree with our summary of the regulatory tools that are available in the case of a failed retailer?	Yes, TrustPower agrees with the summary and that the tools as they stand are inadequate. At present it is more likely that the retailer themselves, or a creditor other than the Clearing Manager, will determine the outcome.
3	Do you agree with our summary of possible scenarios that could develop once a retailer begins to fail?	Yes, TrustPower agrees with the summary.
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	TrustPower believes for the reasons outlined in the answer to Question 1 above that the possibility of achieving a transfer via commercial processes has been significantly degraded.

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	unsuccessful?	
5	Do you think it plausible that customers of a failed retailer would be disconnected from their electrical supply?	TrustPower believes that it is highly unlikely that the customers of a defaulting retailer would be disconnected in large numbers.
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?	Yes, TrustPower agrees with the summary.
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>TrustPower believes that the problem is of sufficient magnitude to warrant investigation into options for resolving these problems.</p> <p>The Authority is tasked with encouraging competition within the sector. Stranded or disconnected customers would currently lead to a shambolic transition of customers from a defaulting retailer. This would harm the industry's reputation, and reduce the propensity of customers to switch in future. The assumption given in paragraph 6.2.2 is flawed; it seems to be premised on a defaulting retailer illegally favouring all other creditors over the Clearing Manager to avoid one of those creditors appointing a receiver. Once appointed, a receiver's obligation to stop the loss would be more compelling than its obligations to other participants.</p>
8	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?	<p>TrustPower notes with respect to paragraph 6.3.4 that this outcome is no more or less likely than if the Clearing Manager did nothing.</p> <p>TrustPower notes in respect to paragraph 6.3.6 that as has been outlined in the answer Question 1, market dynamics are now considerably different.</p> <p>TrustPower notes that even if the Clearing Manager were to be given the power to appoint a receiver, it is still quite possible that another creditor may do so first – the customers and industry would still face the same challenge.</p>
9	Have we identified the relevant costs and benefits of a mechanism to allow the Clearing Manager to appoint a receiver if a retailer is in	Yes, TrustPower agrees with the summary.

Question No.	Question	Response
	default for a period that exceeds its prudential cover?	