



Submission to the Retail Advisory Group

Arrangements for Managing Retailer Default
Situations

Discussion Paper

25 September 2012

The Electricity Authority proposes to establish a process for managing retailer default situations as the Retail Advisory Group has identified flaws with the current arrangement in that

- 1) “There is no effective mechanism to cease supply to the defaulting retailer’s customers, and hence no effective means under the Code for stopping financial loss incurred by industry participants.
- 2) The authority has no effective remedy if a payment is not made to the clearing manager.”
- 3) Current triggers for default “primarily concern amounts due to the clearing manager, rather than amounts due to other industry participants.”
- 4) The EA as no effective means available to stop financial losses incurred by generators should a retailer fail to make payments due to the clearing manager and exhaust its prudential cover.
- 5) “There is no role for the Authority should a retailer fail to make payments to distributors (perhaps while continuing to make payments to the clearing manager);
- 6) The termination and suspension provisions in the Electricity Industry Act 2010 may take over 84 days to progress and even then provide no mechanism for stopping the financial loss (if the retailer’s customers have not transferred to a viable retailer).
- 7) The backstop provisions would be ineffective if the retailer’s contracts with its customers do not include a right of assignment.”

ENL will focus its submission on points relevant to Distribution Businesses.

If you have any questions regarding this submission, please contact Brent Stewart (06) 869 0700

A. Summary

Overall the RAG's preferred approach to dealing with events of default is supported with some caveats.

- ENL strongly recommends that the process include all participants in the market not just the clearing manager.
- There are currently limited options for distributors to deal with retailer defaults.
- Insisting that retailers transfer to a conveyance use-of-system agreement is not a desirable outcome.
- The Authority should be advised of default events as soon as an event occurs.
- The Retailer's should have eight days to transfer customers prior to the Authority or the Distributor notification to customers

B. Industry Participants

ENL strongly recommends that the Authority include all participants in the market when considering events of default. That is, failure to pay an invoice due to an industry participant and/or failure to restore prudential security levels to these participants is defined as an event of default under the Code. All participants are important to the market and failure to provide a process for one or some of the participants could lead to complicated and adhoc processes across various sectors of the industry. It would be more efficient and less complicated for everyone concerned if all participants were subject to the same process.

C. Options available to Distributors in event of a default by Retailer

The discussion paper outlines the options available to distributors in the event of default by a retailer.

These options include:

- a) Remedy under an interposed use-of-system, in the event of a "serious financial breach" by a retailer, whereby the distributor may terminate the use-of-system agreement and advise the retailer's customers that they will be disconnected unless they transfer to an alternative retailer;
- b) Distributors insist on a conveyance use-of-system agreement, where the distributor retains a direct contractual relationship with the consumer and enters into an agency agreement with the retailer. In such cases, the funds collected by the retailer on behalf of the distributor are generally held in trust and may not be available to the retailer's creditors; and
- c) Initiation of a Code-prescribed process as a result of an unresolved serious financial breach by a retailer. The distributor would have the option of referring the termination of the Use-of-System agreement to the Authority rather than commencing a process of disconnection of the retailer's customers.

D. In response to questions posed in the discussion paper, ENL respond as follows

Q1. Do you agree with the summary of options available to a distributor in the event of a default by a retailer, or are there other remedies available to a distributor?

These are currently the only options available.

Q2. Do you consider that a distributor could be sufficiently concerned about the prospect of a default by a retailer to insist on a conveyance use-of-system agreement for the use by retailers of its network, and if so, would this be an undesirable outcome?

Yes there could perceivably be sufficient concern to insist on a conveyance use-of-system agreement but this would be an undesirable outcome not only because of the costs involved but also because of the uncertainty around funds actually being held in trust by the retailer.

Q3. Should a distributor, after terminating a use-of-system agreement with a retailer as a result of an unresolved serious financial breach by that retailer, have an option of advising the Authority that it considers an event of default exists and that this event should be subject to the proposed arrangements under the Code to manage the event of default?

ENL agrees that there should be an option to advise the Authority and for the Authority to manage the event under the Code. However, the Authority should be advised as soon as an event of default occurs not **after** terminating the use-of-system agreement. Once the termination of the use-of-system agreement occurs, the process is already underway. The process needs to commence prior to termination of the agreement and if the Authority is to manage this process, then they will need to be aware of events prior to termination of the use-of-system agreement.

Further questions that ENL would like to respond to follow:

Q5. Should the Code provisions governing the notification of a default be broadened to require all participants and service providers to notify the Authority as soon as that entity has reasonable grounds to believe that an event of default is likely to occur, or has occurred?

Yes. Requiring this would enable the Authority to be aware of any impending issues, especially if there were several participants that notified the Authority of an event or likely event regarding a single retailer over a short space of time. Individually these amounts may not be large but in total it could be significant. Notifying the Authority in advance would also allow more time for the Authority to prepare for managing an event.

Q10. If distributors are provided with an option of notifying the Authority that they had terminated a retailer's use-of-system agreement as a result of an unresolved serious financial breach, should the Authority be tasked with assessing whether the distributor had complied with the notice terms of the use-of-system agreement and, in the absence of action by the Authority, would be entitled to notify consumers that they would be disconnected unless they switched to an alternative retailer?

In the first instance, ENL believes there is no benefit from assessing whether the distributor had complied with the notice terms of the use-of-system agreement. It is highly unlikely any distributor would not at least contact the retailer to seek payment.

Distributors however, should be entitled to notify customers that they will be disconnected if they do not shift to an alternative retailer in the absence of action by the Authority. As costs incurred could be significant while waiting for action by the Authority, we believe it is important for Distributors to retain this ability to minimise financial risks.

Q13. What period of time, measured in days, is necessary to allow sufficient time for a retailer to transfer responsibility for its customers to another retailer or to rectify the default?

ENL submits that eight working days from the date of notice that payment is overdue is sufficient time for consumers to be transferred to another retailer. After eight days, the Authority should communicate with the retailer's customers and proceed to terminate the retailer's rights to trade under the Code.

While delaying this action further to allow time for the sale of customers to another retailer, may provide best value for the receivers, this will be at the expense of generators and distributors if they do not have enough prudential to cover this extended timeframe.

If retailers are permitted to trade for a period beyond the eight working days following a default, they will continue to increase their debt to distributors and generators for potentially another six weeks. Given that the debt up to and including the date of default is already 51 days of supply, a further six weeks will take the debt up to 92 days of supply before the transfer of customers takes effect. This is far greater than the two months of prudential permitted under the Model Use of Systems Agreement and exposes distributors to risks greater than they are permitted to obtain security for.

Further, maintaining prudential cover at a rate equal to the sum of the bank bill yield rate plus 15% is extremely expensive and results in costs falling on distributors if they need to maintain sufficient security to mitigate their risk of supplying fiscally weak retailers. These additional costs should not fall to distributors who are required to provide services regardless of risk, but to those who are in a position to better manage that risk in the first place, ie the owners of the defaulting retailer.

Q18. If, at the end of the eight-day period, the defaulting retailer has not satisfied the Authority that it (the retailer) is no longer in default, or has not transferred all of its customers to another retailer, should the Authority have the ability to communicate with the retailer's customers advising those customers that their retailer had defaulted, that they should switch to another retailer and, if they did not switch by a specified date, the Authority would arrange for them to be transferred to another retailer.

ENL agrees that this is the correct course of action to take by the Authority.

Q19. Should the Authority be able to facilitate this voluntary transfer by providing the customer list of the retailer in default to competing retailers so that they may make their own approaches to the customers of the retailer in default?

ENL agrees with this process if it facilitates the quick transfer of customers to another retailer.

Q20. What period of time, measured in days, should be provided by the Authority to the customer of the retailer in default to voluntarily switch to an alternative retailer?

We submit that no more than eight days from the date of the notice should be provided to customers to switch to an alternative retailer.