



meridian

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Retail Advisory Group Submissions
c/o Electricity Authority
PO Box 10041
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By email: rag@ea.govt.nz

RAG August 2012 Discussion Paper on Retailer Default Arrangements

Meridian welcomes the opportunity to provide feedback on the Retail Advisory Group's ("RAG's") August 2012 "Arrangements for managing retailer default" discussion paper in this submission made on behalf of Meridian and its subsidiary Powershop.

Our submission comprises this cover letter and its attached appendix containing our responses to the specific consultation questions.

Meridian supports the RAG's review and problem definition

Meridian is concerned by the RAG's finding that there is currently no effective means for the Clearing Manager or the Authority to stem the losses that would continue to accrue to industry participants, indefinitely, in the event a defaulting retailer, having exhausted its prudential cover, continues to hold customers. Meridian does not consider this to be acceptable and is highly appreciative of the RAG's focus on developing mechanisms for addressing the risks inherent in existing arrangements.

The timeframe for exit is a critical input to wholesale prudential calculations

Meridian considers it is critical the RAG develops a robust estimate of the time period to exit a defaulting retailer. This information is an important input into wholesale market

prudential assessments. Meridian is pleased to note that the RAG has been in dialogue with the WAG on the current review of prudential arrangements. We submit that further engagement will be important as the prudential and settlement review continues to be progressed by the Authority.

Meridian supports the proposed multi-staged approach. This should be designed to ensure minimal risks to system operation and delays in the transfer of customers.

On the basis of the information provided, Meridian supports each of the individual components comprising the RAG's proposed multi-staged approach. The legal advice referenced in the discussion paper must, however, be made available, even if only in summary form.

The proposed approach is in Meridian's view strongly preferable to the current "backstop" amendments that provide no certainty to industry as to precisely how a customer transfer process would operate and the potential scale of their liability in connection with the insolvent retailer. We also consider it offers the advantage of establishing a process for addressing the risk of failure by the market to ensure an efficient and orderly transfer of the defaulting retailer's full set of customers whilst not precluding a market solution from taking place. For the approach to deliver maximum benefits, it will need to be supported by a sound wholesale prudential regime, accurate registry information, and timely compliance investigations in respect of reconciliation data.

Regarding the detail of the arrangements, Meridian submits there is a need for the Authority to evaluate potential flow-on implications prior to facilitating the allocation of customers of a defaulting retailer. This is needed to ensure the approach is robust to a range of potential scenarios, including ensuring there are adequate safeguards in place that protect against potentially triggering cascade failure¹.

For events the Authority has determined pose minimal risks to system operation, it is Meridian's strong preference that the process of Authority-led assignment of customers is undertaken on the basis of mandatory pro-rating across retailers for the particular GXP network using historic retail volumes. This is underpinned by a concern that seeking to run

¹ Depending on the size of the retailer, and the market circumstances, allocating customers without any countervailing hedging capability (whether physical or financial) could result in financial difficulties for the receiving retailer.

a competitive tender at this late stage of the process will lead to delays in resolving the situation, thereby exposing participants to greater financial exposure, for no clear gain.

Meridian agrees with the majority of the RAG's suggested Code amendments

The majority of the proposed supporting Code amendments appear appropriate to support the RAG's proposed approach and / or will serve to improve the Code. Meridian notes that detailed drafting is likely to identify other areas that may need to be amended. We would welcome further information on whether the Authority intends to establish a technical group to assist with detailed Code drafting.

While Meridian supports obligations being placed on industry participants to advise the Authority of actual events of default under the Code, we do not support requiring industry participants to advise the Authority when they consider an event 'may be likely'.

Further testing of estimated timeframes needs to be pursued as a priority

As highlighted above, Meridian considers a robust estimate of the timeframe for resolving a default situation to be an important output of the RAG's work. Along with forming critical input for the current review of the wholesale prudential regime, Meridian considers this estimate is needed from the perspective of ensuring the arrangements, if ever invoked, lead, in practice, to an efficient and orderly transfer of customers.

Meridian appreciates the work undertaken to-date to "stress test" the timeframes set out in the discussion paper for progressing individual elements of the RAG's proposed approach. We also appreciate the RAG's efforts to develop a timeframe that balances practical considerations against the objective of efficient resolution of a default situation. Having noted the 21 day estimate to fully progress the proposed approach assumes a number of 1 working day deadlines are achieved, for instance for acquiring retailers to switch customers acquired as a result of an allocation process, Meridian considers that more detailed analysis is needed to test the feasibility of certain suggested timeframes. Detailed flow charts, setting out precise details in respect of information / data flows and actions required on the part of the Authority and industry, should form the starting point to this analysis. Meridian submits this analysis should be a necessary pre-condition to adopting a firm estimate of 21 days, or other estimate, for prudential assessment purposes.

Please don't hesitate to contact me if you have any queries regarding this submission.

Yours sincerely

A handwritten signature in blue ink that reads "Alannah MacShane".

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Appendix 1: Responses to consultation questions

Question	Response
<p>1. Do you agree with the summary of the options available to a distributor in the event of a default by a retailer, or are there other remedies available to a distributor?</p>	<p>Meridian agrees the paper appears to provide an accurate summary of options available to distributors in the event of default.</p> <p>Meridian is not able to comment definitively on the likely effectiveness of a conveyance agreement (with a retailer billing) from a legal perspective, having not undertaken any detailed analysis of the strength of a distributor's ability to access any funds held in trust with a defaulting retailer.</p> <p>We do, however, consider there are significant risks that a conveyance arrangement will prove to be of limited effectiveness from a practical perspective, given the situation of default is likely to alter incentives around meeting the terms of the agreement, including the placing of received monies into / retaining monies in a Trust account.</p>

Question		Response
2.	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?	<p>As the paper correctly points out, a distributor's choice of contractual arrangement will ultimately depend on the distributor's judgement as to whether perceived benefits, including from a risk management perspective, are sufficient to outweigh costs of renegotiating and changing their contractual arrangements. The scale of these costs will vary on a case by case basis but could potentially be significant.</p> <p>Meridian does, however, consider it is a distinct possibility that a number of distributors would be sufficiently concerned about the prospect of default to seriously entertain the idea of insisting on conveyance agreements.</p> <p>As conveyance agreements can be complex to deal with for retailers, Meridian would be concerned if distributors were to seek to move to wide-spread use of conveyance agreements, particularly given that a finalised model conveyance agreement has only recently been supplied and in the absence of suggested retail minimum terms and conditions for conveyance style relationships.</p>

Question		Response
3.	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 an event of default?	<p>Meridian strongly agrees with the RAG's premise that non-payment by a retailer should ideally be dealt with by the retailer and the distributor under their use-of-system agreement, for instance, by seeking additional prudential cover to the maximum amount allowed for under Part 12A of the Code. As per the comments made in our last submission², Meridian also accepts, however, that distributors will be very sensitive to the public relations issues associated with disconnection, meaning they may be reluctant to pursue disconnection as a course of action.</p> <p>Meridian agrees that distributors should have the option of prompting the proposed Code prescribed process for transferring customers, provided the Authority can first satisfy itself that the event involves more than minimal risks for the market.</p>
4.	Are there any other events not currently captured by clause 14.55 that should be defined as an event of default and if so on what rationale?	With the exception of the termination of an agreement arising from a serious financial breach of a use-of-system agreement (UoSA), Meridian considers clause 14.55 currently captures the main events that should constitute a default under the Code, and does not need to be revised to incorporate any other additional events.
5.	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?	No. While Meridian supports broadening notification obligations to require all participants to notify the Authority as soon as an actual event of default has occurred, presumably in so far events that are captured by clause 14.55 of the Code, we are concerned that an obligation on participant's to advise the Authority that an event may be possible will give rise to significant risks of "false positives".

² Available at the following link: <http://www.ea.govt.nz/document/16246/download/our-work/consultations/advisory-group/retail-customers-default-situations/submissions-on-retail-advisory-group-discussion-paper-retail-customers-in-retailer-default-situations/>

Question		Response
6.	Should the clearing manager have an obligation to advise an entity if it has not complied with a requirement of Part 14 of the Code and that this non-compliance is an event of default?	Yes as we consider this will serve to codify best practice.
7.	Should the Code be clarified and simplified by bringing the actions that may be taken by the clearing manager in the event of a default into one sub-part and re-drafted to stipulate, to the extent practical, the actions the clearing manager would take in relation to a shortfall in payment or a failure to meet a call?	Meridian agrees that these amendments will improve the clarity of the Code.
8.	Should the Code stipulate that on being notified of an event of default, the Authority would immediately investigate and determine: <ul style="list-style-type: none"> a. whether an event of default exists; and b. if an event does exist whether that event is a minimal risk event arising from a technical or administrative failure that has or will be corrected within one business day or a commercial disagreement that doesn't affect the retailer's long-term ability to trade? 	<p>In the interests of managing the financial exposure of other market participants, Meridian considers it is critical the Authority makes a decision quickly on whether the event involves more than minimal risks and agrees with the proposal to immediately investigate likely risks. We consider that these investigations should be undertaken in collaboration with the Clearing Manager.</p> <p>Meridian submits that further testing of the suggested 1 working day timeframe for undertaking these assessments, as well as consideration of options for ensuring the Authority can gain quick access to the information it will need to achieve this timeframe in the majority of instances, will be important. As per the comments set out in our cover letter, we consider detailed flows charts will play an important role in this further testing.</p>

Question	Response
<p>9. Should any assessment by the Authority of whether the event is a minimal risk include a materiality threshold, equivalent to the serious financial breach threshold under the draft model use-of-system agreement?</p>	<p>Meridian agrees a materiality threshold set at a similar level applicable to financial breaches under the model UoSA (i.e. the greater of \$100k or 20% of average monthly purchases) could be useful for the purposes of <i>informing</i> risk assessments.</p> <p>Meridian does not, however, consider it would be appropriate for the Authority to seek to determine the scale of the risk resulting from a particular event solely on the basis of a pre-determined monetary value as this could lead to inadequate consideration of smaller events and prevent early consideration of events that transpire as having serious market implications. It also may not allow for consideration of the scale of the event relative to the size of the retailer and its available resources.</p>
<p>10. 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?</p>	<p>Yes, provided the arrangements can be implemented at minimal administrative cost, with the onus at all times on distributors to provide the Authority with the information needed to confirm whether or not contractual notice terms have been complied with. Meridian considers these checks would be a necessary part of the Authority's "due diligence".</p>

Question	Response
<p>11. Should the Code stipulate that on determining that an event of default of more than minimal risk exists the Authority would advise the retailer and its agent(s) that unless the default is rectified within a specified number of days, the Authority would:</p> <p>a. communicate with all of the retailer’s customers advising them that their retailer had defaulted and that the customer should switch to another retailer and that if they did not switch by a specified date the Authority would assign them to another retailer; and</p> <p>b. proceed to terminate the retailer’s rights to trade electricity under the Code?</p>	<p>Yes.</p>

Question		Response
12.	Should the Code require that retailers include an assignment clause in their customer contracts?	Meridian considers re-assignment clauses to be a necessary pre-condition for the proposal to be effective and supports the proposed amendment. We also consider the amendments to be consistent with principles set out in the Authority's minimum terms and conditions for domestic contracts for delivered electricity.
13.	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?	<p>Meridian considers the 8 working days suggested in the paper is at the upper end of a timeframe that strikes a reasonable balance between providing sufficient time for retailers to attempt to resolve the situation and managing the financial exposure of generators.</p> <p>Under the Code, retailers have a number of responsibilities e.g. payment for wholesale purchases, submission of reconciliation data, switching customers and so forth. Clarification is required here as to which of these obligations would be expected to have been transferred in the 8 working day period.</p>
14.	Should the relevant period of time be specified in working days or in calendar days?	Meridian is indifferent, provided the timeframe allowed for does not exceed 8 working days.

Question		Response
15.	Should a mechanism exist to extend the number of days provided to the retailer in default to rectify the event of default, including any interest payable, if that extension of time is approved by the parties who would bear the financial risk of an extended time period?	Meridian would support allowing for the timeframe provided to the defaulting retailer for addressing the situation to be extended where there is wide-spread support amongst those that will bear associated financial risks. We consider this might, in some circumstances, lead to a quicker and better resolution than might otherwise result.
16.	Should any extension of time for rectifying the default require approval of a majority in number representing 75% in value of the money owed or some other threshold?	Meridian considers the approval threshold should be set at 75% of gross NZEM generation revenue calculated over the 3 weeks prior.
17.	Should the Code provisions that provide for generators to be assigned or subrogated to the rights of the clearing manager be removed from Part 14?	Agree as we consider the RAG's concerns regarding the clauses giving rise to risks of potential confusion and complexities are valid. Meridian would welcome further information on whether these rules may be better suited to early NZEM arrangements rather than the current "gross pool" system.

Question	Response
<p>18. 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, that if they did not switch by a specified date, the Authority would arrange for them to be transferred to another retailer?</p>	<p>Yes.</p> <p>Meridian notes, however, the suggested 1 working day timeframe for the Authority to complete the process of contacting customers assumes the Authority has access to accurate customer contact information. Please refer to the comments in our cover letter regarding suggested further analysis.</p> <p>Meridian submits that there should be an obligation on the Authority to advise industry participants immediately of the defaulting participant's failure to remedy the situation.</p>
<p>19. 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?</p>	<p>Assuming this will not be prevented by privacy obligations, Meridian supports the concept of making customer lists widely available to retailers. We note that further consideration will be needed as to whether this will require consequential revisions to minimum terms and conditions for domestic energy contracts.</p>
<p>20. 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?</p>	<p>Meridian considers the 10 day working day period suggested by the RAG is reasonable from the perspective of managing the credit exposure of participants. We do, however, consider it will increase the likelihood of a regulated solution being required.</p>

Question		Response
21.	<p>Should the Code impose on retailers an obligation to have the following provisions in their contracts:</p> <p>a. in a default situation, the Authority may terminate the contract between the retailer and its customer; and</p> <p>b. if the Authority terminates the contract under (a), the customer would become bound by a contract with another retailer stipulated by the Authority?</p>	<p>Meridian submits provision (b) should be re-drafted to specify that the contract is to be of open-ended rather than fixed duration and clarified to only apply to customers who have not made arrangements to transfer to another retailer.</p> <p>Meridian otherwise agrees with the proposal.</p>
22.	<p>Should retailers in the same network area be required by the Code to enter into contracts with customers of the defaulting retailer whose contracts have been terminated by the Authority?</p>	<p>Yes, but only for those retailers who trade on GXPs on the same network.</p>
23.	<p>Should the Code provide for the Authority to invite other retailers to tender to provide contracts to the customers of the failed retailer whose contracts the Authority has terminated?</p>	<p>No. Given that a competitive process would mostly likely already have been attempted at this stage (whether by a retailer, receiver, or liquidator), Meridian is concerned that seeking to run a competitive process at this stage in the process will lead to delays in resolving the situation, and greater financial exposure for participants, for no clear gain.</p>

Question		Response
24.	Should the Code enable the Authority to allocate, as a last resort, any remaining customers of the retailer in default amongst retailers on the affected network on a pro rata basis based on a historic retail volume measure?	Yes, provided the allocation only occurs across retailers retailing on the GXPs on the given network and, as per the comments set out in our cover letter, the Authority is first able to satisfy itself the allocation will not lead to further failures across the system.
25.	If you do not agree with a pro rata basis, what method should the Authority use to allocate any remaining customers of the retailer in default amongst retailers on the affected network?	N/A.

Question	Response
<p>26. Should responsibility for the customer, caused to be transferred by Authority, change to the new retailer on the date of the switch?</p>	<p>Yes. Meridian agrees alignment with existing practices is important and agrees with the RAG's position that the transactions costs of establishing a non-standard switching regime is unlikely to outweigh the benefits. Meridian questions, however, whether additional mechanisms will be needed to address risks of weak incentives on customers of the defaulting retailer to meet their financial obligations in the interim.</p> <p>For the transfer to occur within 1 working day as the paper suggests, Meridian submits it will be critical for acquiring retailers, at a minimum, to be provided with accurate customer contact details along with all registry information on the customer. Even with these details, it is likely that retailers will on occasion face practical difficulties, such as difficulties establishing correct ICP details, which may prevent this timeframe from being achieved. Meridian also like to understand how the proposed allocation process will align with Code required switching processes, including the 5 working day time limit for completing 50% of customer switches, and more about intended arrangements for dealing with customers being switched outside of the normal meter read process. Please refer to the comments in our cover letter regarding suggested further analysis.</p>
<p>27. Should the Code be amended to require a retailer in default to provide the Authority with the information it would need to write to all of the retailer's customers advising them that the retailer is in default, and if necessary, to cause any remaining customers to transfer to another retailer?</p>	<p>Yes, although Meridian considers non-compliance is likely to arise, given that a defaulting retailer will be dealing with multiple competing priorities and may have limited incentives to comply with the obligation.</p>

Question	Response
<p>28. Do you agree that to address the potential for information difficulties the Code should provide for the Authority to:</p> <ul style="list-style-type: none"> a. advertise to advise customers of the retailer in default that they should choose an alternative retailer; b. access information held by the Registry and distribution utilities to reconstruct a customer database if necessary; and c. instruct the Registry to act as counterparty for customers switching voluntarily from the retailer in default, if required? 	<p>Yes as Meridian considers the concerns raised by the RAG regarding limited incentives on defaulting participants to co-operate with the Authority are valid.</p>