

25th September 2012

Retail Advisory Group Submissions

Submission: Arrangements for Managing Retailer Default Situations

NZX appreciates the opportunity to submit on the Retail Advisory Group's (RAG) discussion paper "Arrangements for Managing Retailer Default Situations." The paper presents an innovative and moderate preferred option which is sensible considering the legal and operational difficulties discussed in case of insolvency.

In our role as the clearing manager, we are pleased to see the issue of potential retailer default studied and progressed. The status quo had been unsatisfactory as a sub-optimal or mishandled retailer default not only has the potential to destroy value through delay or ill considered activities, but it can damage market confidence. Even if the 'do nothing' is selected, we consider that the RAG review process has added value.

In this submission NZX has elected to emphasise some general points and comment on a subset of consultation questions.

Interaction with Settlement and Prudential Security Review.

The ultimate landing with respect to managing retailer default situations will be an important input for determining levels of prudential security required for participation in the wholesale market. Increased costs due to rapid customer switching may be offset by reduced costs to meet prudential security requirements. The balance of costs should be carefully considered by the RAG and WAG prior to finalising recommendations.

NZX realises that one means to accommodate extended retailer default periods is to relax expectations on the degree to which market participants are protected from participant default. While the wholesale market operates with an independent and administrative prudential security regime and the industry is free to elect a moderate or even symbolic level of prudential security requirements, moral hazard and systemic risk should be considered.

NZX favours features which reduce the period of time in which participants are exposed to retailer default.

We also note that retailers are not the only participants with exposure to the wholesale market. Generators and Financial Transmission Rights Participants also bring a level of risk to the wholesale market.

Customer switching may de-stabilise the market under certain conditions

It is conceivable that an event such as scarcity pricing could lead a retailer to exit the market. In such a period of market stress, requiring a retailer to absorb or additional customers and their incremental, unhedged load may unbalance carefully constructed risk positions and could destabilise other retailers.

Materiality

Fixed, or 'greater of' materiality limits, could set up situations where smaller retail exposures or defaults are not recognised or dealt with efficiently. While materiality limits are sensible, there should be processes to deal with outright non-compliance which fails to meet the materiality threshold.

Questions

Q.7. Clarification of clearing manager actions upon default.

Yes, the Code should be clarified to specify actions that may be taken by the clearing manager upon default as well as any requirements of the clearing manager.

Q.8. Authority investigation of default.

Defaults related to commercial disagreements that don't affect the retailer's long-term ability to trade should not be considered a minimal risk event where the default was a short payment to the clearing manager. We consider allowing for short payments due to commercial disputes will undermine the market and increase costs.

Another option:

One possible (and very un-tested) means of limiting the exposure of the market to defaulting retailers without restricting the ability of the retailer or a receiver to sell the customer base could be to novate customer receipts to the regulator or clearing manager in case of extended default. These customer receipts will support wholesale electricity purchases during the default period and provide time to secure a suitable purchaser.

I would be happy to discuss or expand on the points in this paper if desired. Alternately, please feel free to contact me on 04-498-0026 with any questions.

Best regards,

Erich Livengood
Head of Energy