Arrangements to manage a retailer default situation

Submission to the Electricity Authority

20 August 2013

contact

This submission by Contact Energy Limited (**Contact**) is in response to the Electricity Authority's (**Authority**) consultation paper *Arrangements to manage a retailer default situation.*

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General comments

Contact supports the establishment of arrangements to manage a situation where an electricity retailer does not meet its financial obligations or becomes insolvent.

Like the Retail Advisory Group (**RAG**), we believe that the key issue (in the event of a retailer defaulting) is not the cessation of supply to a defaulting retailer's customers, but rather that there is currently no effective mechanism under the Electricity Industry Participation Code (**Code**) to stop the financial loss incurred by industry participants.

Full responses to the Authority's questions are provided from page 4.

Finally, we would like to take the opportunity to reiterate how important it is that the rules are applied consistently across different areas and under different use-of-system agreements (**UOSAs**); in particular, there needs to be a consistent definition for 'serious financial breach'. To address this, Contact recommends the Authority adopts the meaning of 'serious financial breach' as defined in the model-use-of-system agreement (**MUoSA**).

Question no.	Question	Response
Q1	Has there been any development since submissions were received on the problem definition developed by the RAG that might warrant the Authority reconsidering its view as to the nature of the problem?	No.
Q2	Do you agree with the objectives of the proposed amendment? If not, why not?	Yes.
Q3	Do you agree with the proposed Code amendment which would introduce a new category of default when the following conditions are satisfied: a. the retailer is no longer entitled to trade on a distribution network because its use of system agreement has been terminated due to a 'serious financial breach' by the retailer b. no unresolved disputes remain between the retailer and the distributor c. the retailer has not taken timely steps to arrange a customer switch d. the distributor has been unable to remedy the situation e. the distributor requests the Authority to initiate its process for managing an event of default.	Yes. ***A Code definition of 'serious financial breach' is recommended*** While 'serious financial breach' is a defined term in the MUoSA, the term is not defined in the Code. The result of this is that it is open to distributors to seek to amend the base MUoSA definition in their individual UoSAs, which could create inconsistencies in the threshold applying across different networks/distributors. For example, Vector has offered a new UoSA with a definition that changes the MUoSA wording to "exceeds the **lesser of**" (instead of "exceeds the greater of"). The Authority should define the term 'serious financial breach' in the Code in order to remove any potential inconsistency. In our view, this definition should be based on the one used in the MUoSA. ***General comments about the new category of default*** There are some inconsistencies between the conditions outlined in the consultation document (e.g. as set out in Q3) and the draft Code amendment wording itself. For example, the paper refers to the retailer having not taken timely steps to arrange a customer switch, whereas the proposed Code amendment refers to the retailer continuing to have customers on the network. It is unclear why these differences exist and it would be helpful for the Authority to explain this and/or take the various aspects into account in finalising the proposal. We propose the following changes to the draft Code amendment (Appendix A) to make it more consistent with the MUoSA and/or add clarity to

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		the wording: ***<u>Clause 14.55(h)</u>*** "termination of a **retailer's use-of-system agreement** with a **distributor** because of a **<u>serious financial breach</u>** ~~as defined in the **use-of-system agreement**~~ if~~–~~ Note: The above change assumes the term 'serious financial breach' will be defined in the Code. **<u>Clause 14.55(h)(i)</u>** "the **retailer** continues to ~~have~~ <u>supply</u> a **customer** or **customers** on the **distributor's local network**." **<u>Clause 14.55(h)(ii)</u>** "there are no unresolved disputes between the **retailer** and the **distributor** in relation to the **<u>serious financial breach</u>** <u>that triggered the</u> termination." Note: The above change assumes the term 'serious financial breach' will be defined in the Code. ~~H~~However, we note that the description of the proposed new event of default is different to the way the new clause is actually worded. It is unclear to us why this difference exists. The questions should be consistent with the solution or outcome being proposed.
Q4	Do you agree that the proposed Code amendment should apply not only to the network or networks across which the event of default has occurred? If not, why not?	Yes.
Q5	Do you agree that the trigger for the actions to be undertaken by the Authority should be limited to a breach of sub-clauses 14.55(a), 14.55(b), 14.55(f), and (the new) 14.55(h)? If not, why not?	Yes.
Q6	Do you agree that the process for managing a retailer default should ensure that responsibility for all ICPs of the retailer in default, active and inactive,	Yes.

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	are transferred to another retailer? If not, why not?	
Q7	Do you agree that the process should accommodate situations where the default might not be resolved but an acceptable resolution has been agreed and all payments that should have been made have been made? If not, why not?	Yes. There needs to be adequate safeguards (albeit ones that can be exercised expeditiously/urgently) to ensure that if either the default conditions do not, in fact, exist or if the retailer can resolve the default without undue delay and in a sustainable manner, the consequences of the breach situation are minimised and any adverse effects on the retailer and its business can be reasonably resolved.
Q8	Do you agree with the judgement arrived at by the RAG that a total period of 17 days for managing an event of default would provide a reasonable balance between the costs of too short a period and the costs of an extended period? If not, why not?	Yes.
Q9	If a period of 17 days is maintained, should this time be allocated as follows: seven days for a retailer to resolve the dispute or transfer its customer base, seven days for customers to voluntarily switch to another retailer, and a maximum of three days for communication with customers and ensuring all switches are processed?	Yes. However, we are not sure why this refers to a 'dispute'. This links back to the concept of a 'situation' referred to above. We would like to see some clarity around the terminology and scenarios that are applicable.
Q10	Do you agree that the Code should be amended to require a retailer in default to provide information on its customers to the Authority and for the Authority to obtain this information from distribution networks and the registry if the information is not forthcoming from the defaulting retailer? If not, why not?	Yes. It is noted that customers (active-contracted) are only a subset of the ICPs that need to be switched, the gap being active-vacant and inactive ICPs. If the distributor has been provided with an EIEP4 file then it will hold all the customer (active-contracted) details for customers to be contacted. Otherwise, we agree that the information should be able to be sourced from the distributor or registry (which will be physical addresses of ICPs only).
Q11`	Do you agree that the Code should be amended to provide for the registry to complete the switch of any	Yes.

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	customer of a retailer in default that chooses to switch to another retailer, if the retailer in default does not meet its obligations under the switching rules? If not, why not?	
Q12	Do you agree that the Code should be amended to provide for the Authority to direct the registry not to complete the switch of any customer to a retailer in default after the Authority has advised the customers of that retailer that their retailer is in default and they should transfer to another retailer? If not, why not?	Yes.
Q13	Do you agree that the Authority should advise retailers and other interested parties that an event of default has occurred, and if it considers appropriate, identify the entity in default, to enable these parties to make necessary preparations? If not, why not?	Contact considers the defaulting participant should not be identified until the initial 7-day period has lapsed or a) the Authority is provided with information that confirms the event of default will not be resolved within the initial 7-day period or b) customers are switched to another retailer (trade sale). The Authority should determine in advance the threshold for what it considers to be sufficient information to act upon. Whilst in some circumstances it will be crystal clear that a retailer could never get out of default, in others a subjective element is required. This approach provides a balance between ensuring the defaulting retailer has a reasonable opportunity to remedy the default (without publicity triggering cherry picking by other retailers), and providing as much time as possible for other retailers to make the necessary preparations in case the event of default remains unresolved at the end of the initial 7-day period.
Q14	Do you agree that the Code should provide for the Authority to communicate directly with the customers of the retailer in default, including via mass media? If not, why not?	Yes.
Q15	Do you agree that the Code should provide for the Authority to provide customer information to the	Yes.

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	retailers to whom it transfers customers, should a mandatory transfer be required? If not, why not?	
Q16	Do you agree that the Code should be amended to require that contracts between the retailer and its customers provide for the Authority to assign the contract to another retailer if an event of default is unresolved after 17 days? If not, why not?	Yes. However, the current approach seems to envisage the customer's existing contract with the defaulting retailer (Contract A) being transferred so that a new retailer becomes the customer's supplier and (presumably simultaneously) it then modifies the terms of that contract to reflect the new retailer's own standard terms and conditions (**T&Cs**). In our view the concept would be more accurately described if it stated that retailers **must** include a clause in their contracts that, in the event of a default not being resolved, the customer, having not voluntarily switched to another retailer, agrees to become a customer of the new retailer, on the new retailer's standard T&Cs (assuming those to be materially no worse than those of the original retailer), as nominated by the Authority if the customer does not select a replacement retailer and switch within the defined time period. No retailer will want to inherit different or legacy T&Cs by taking on a defaulting retailer's customers, or to have to go through the process of formally amending those customers' contracts or to notify them of the differences between their original contract and that new retailer's contract.
Q17	Do you agree that the terms offered by recipient retailer (who is assigned customers by the Authority) should be those terms (including price) normally offered by the recipient retailer at the date the Authority was notified of the default? If not, why not?	Yes. The customer's contract with the new retailer should be on the new retailer's terms for the product most equivalent to that which the customer was on with the defaulting retailer.
Q18	Should the arrangements for managing an event of default provide for the Authority to tender the remaining customer base of the retailer in default after the Authority had exercised its rights to assign the contract on the terms of the recipient retailer? If not, why not?	No. Contact considers a tender process would add too much complexity. A simple process is required to enable affected customers to voluntarily switch to alternative retailers or have their contracts assigned on the terms of the recipient retailer, thus allowing the market to return to normal as quickly as possible.

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Q19	If a tender arrangement is provided for, should the Authority invite tenders on the basis of the prices that would be charged to the customers by the recipient retailer (but no higher than standard terms offered by that retailer) with the Authority assigning the customers on the basis of the lowest priced retailer? If not, why not?	Yes.
Q20	Do you agree that, should the Authority be required to allocate customers of the retailer in default, it should do so on the basis of market share in the relevant networks but without any de minimus threshold? If not, why not?	Yes.
Q21	Do you agree that the arrangements for managing a retailer default should provide an opportunity for any retailer that is assigned customers to object on the basis that the assignment would threaten its financial viability, with the onus on the retailer to substantiate such a claim? If not, why not?	Yes. However, the Authority should clarify what a retailer would need to do in order to 'substantiate' a claim; for instance, who determines whether the claim is valid and on what basis? We would also note that one of the most probable reasons for retailer default is having insufficient generation or hedging in place to meet customer load during periods of sustained high prices, for example a dry winter. If the cause were dry year overexposure, it is foreseeable that all retailers will be stretched and accordingly no retailer may be willing to take on new customers. In our view the ability to 'opt out' is dependent on other retailers being prepared to take on more of the defaulting retailer's customers, otherwise the default allocation should be to all retailers based on market share. While there is a potential risk to one or more other retailers from a default assignment, this has to be balanced by the alternative of unassigned customers, which will impact all retailers trading on the network and potentially the customers themselves. The process to transfer all affected customers to another retailer must be as simple as possible and undertaken on a timely basis.
Q22	Do you agree that the Code should require that the	Yes.

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	recipient retailer is responsible for notifying their assigned customers that they were now a customer of the recipient retailer, and advising the terms and conditions of their new contract? If not, why not?	
Q23	Do you agree that the Code should require that contracts between retailers and their customers should include provisions that: provide for the retailer to give customer details to the Authority in the event of a default; allow the contract to be assigned by the Authority in the event of default, with the terms and conditions to be replaced by the recipients retailers terms and conditions; provide for the retailer to assign the contract? If not, why not?	Yes.
Q24	Do you agree the proposed amendment is preferable to the other options? If you disagree, please explain your preferred option in terms consistent with the Authority's statutory objective in section 15 of the Electricity Industry Act? If not, why not?	Contact considers the proposed amendment has some flaws, as follows: **Clause 11.15A(1)(b)(ii)** It would be impractical and unreasonable to expect the recipient retailer and Authority to agree on terms that are "more advantageous to the customer", particularly for non-standard HHR customer contracts. It also seems this qualifier is unnecessary. We suggest deletion of the words "as the recipient **retailer** and **Authority** agree". **Clause 11.15A(3)** Contact does not agree with the proposed wording of this clause. It is not practical for retailers to change their customer contracts so quickly that they could comply with this requirement from the time the clause comes into force. We note that the MUoSA has a similarly impractical expectation. Contact has been able to negotiate terms in its UoSAs that allow a 12-month period for modifying all existing **and** new customer contracts to include provisions that have substantially the same effect as the provisions required to be included by the MUoSA.

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		We consider this a more practical and realistic time period and expectation. Accordingly, Contact recommends this clause be amended to read: "(3) This clause applies to all customer contracts from a date 12 months after this clause comes into force." **<u>Schedule 11.5</u>** **Clause 5** Clause 5 does not deal with allocating the remaining un-contracted active-vacant and inactive ICPs for which the defaulting retailer is responsible in the registry. Contact considers the residual allocation of these ICPs should reflect the share of total customer contracts already switched (voluntarily or by trade sale) or assigned (by the Authority), as appropriate to the NHH and HHR market segments. **Clause 7** Clause 7 has a typo – 's witch' should be 'switch' and the reference should be Schedule 11.5. **Proposed clause 9** Contact suggests a new clause 9 along the following lines: "9. The **Authority** will allocate remaining **ICPs** for which the defaulting **retailer** is responsible and there is no contract. "(1) All **ICPs** for which the defaulting retailer is the responsible **retailer** in the **registry** at the time of the **event of default**, but which have not switched to another **retailer** or been assigned to another **retailer** by the **Authority**, are to be allocated by the **Authority** to other **retailers** in the same proportion to the **ICPs** that have switched or been assigned to those **retailers**." **Consequential changes to clause 6** Consistent with the suggested additional clause 9, the following amendments will be required to clause 6: Insert after "5(2)" the words "or clause 9". Amend (a) as follows: "the number of **<u>ICP</u>**<u>s associated with</u> **customer** contracts assigned to the retailer<u>, and the number of **ICP**s without</u>

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		associated customer contracts allocated to the **retailer**;" Amend (b) as follows: "any information that the **Authority** holds about the **customers** assigned to the **retailer** where the **ICP**s are associated with **customer** contracts, and about the **ICP**s allocated to the **retailer** where the **ICP**s are not associated with **customer** contracts."
Q25	Do you agree that a period of 17 days strikes the right balance to achieve the benefits of an arrangement for managing an event of default while minimising the costs of achieving those benefits? If not, what period of time should be specified and why?	Yes.
Q26	Do you agree that the benefits of the proposed arrangements would exceed the costs? If not, why not?	Contact agrees that a retailer default process is necessary. However, the costs of implementing it may be understated. For example, if Contact is required to alter its standard customer contract (T&Cs) at a time when no other changes are contemplated, the cost of destroying old stock, printing and replacing it with new stock, and customer communications via letter (consistent with Contact's standard approach (e.g. when our T&Cs were last amended in 2012)), would be around $1 per customer, which is significantly more than $75k. Nevertheless, overall, Contact is satisfied that the reduced probability of default and having a regulated structure in place to manage an unresolved event of default are sufficient benefits to outweigh the implementation costs.
Q27	Do you agree that the proposed arrangements meet the Authority's Statutory Objective? If not, why not?	Yes.
Q28	Do you have any comments on the drafting of the proposed amendments?	Please see below and also note our comments on Q3 and Q24 (which are also covered here): ***Define 'serious financial breach' in the Code:*** It is suggested that the Authority give consideration to including the MUoSA definition of 'serious financial breach' in the Code amendments to ensure consistency across all

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		networks. ***Clause 14.55(h)(i)*** The following are suggested changes to the draft Code amendment to be more consistent with the MUoSA. "the **retailer** continues to ~~have~~ supply a **customer** or **customers** on the **distributor's local network**." ***Clause 14.55(h)(ii)*** The following are suggested changes to the draft Code amendment to add clarity. "there are no unresolved disputes between the **retailer** and the **distributor** in relation to the serious financial breach that triggered the termination." ***Clause 11.15A(1)(b)(ii)*** It would be impractical and unreasonable to expect the recipient retailer and Authority to agree on terms that are "more advantageous to the customer", particularly for non-standard HHR customer contracts. It also seems this qualifier is unnecessary. We suggest deletion of the words "as the recipient **retailer** and **Authority** agree". ***Clause 11.15A(3)*** Contact does not agree with the proposed wording of this clause. It is not practical for retailers to change their customer contracts so quickly that they could comply with this requirement from the time the clause comes into force. We note that the MUoSA has a similarly impractical expectation. Contact has been able to negotiate terms in its UoSAs that allow a 12-month period for modifying all existing **and** new customer contracts to include provisions that have substantially the same effect as the provisions required to be included by the MUoSA. We consider this a more practical and realistic time period and expectation. Accordingly, Contact recommends this clause be amended to read: "(3) This clause applies to all customer contracts from a date 12 months after this clause comes into force." ***Schedule 11.5***

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