

# Requests for a shortened post- default exit period

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Policy



## Version control

Version	Date amended	Comments
0.1	21/07/2015	Draft for CE review
0.2	29/07/2015	Final copy for Board approval
1.0	14/08/2015	Board approval
1.1	08/09/2016	Updated link to Consultation Paper - Settlement and Prudential Security Review
1.2	14/08/2017	Add a requirement to review the post default exit period provisions once the first application has been processed

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# 1 Introduction

- 1.1 The Electricity Industry Participation Code 2010 (Code) includes prudential security requirements for participants (Part 14A), remedies for events of default (Part 4, Subpart 7), and a process for a trader event of default (Schedule 11.5). These parts of the Code are intended, between them, to protect the electricity market from the financial consequences of a participant not meeting its financial commitments to the clearing manager and continuing to consume electricity without paying for it.
- 1.2 The prudential requirements in the Code include defined post-default exit periods for three types of participant (direct purchaser, retailer, and any other participant). However, a participant can propose a shorter post-default exit period. Any shortened post-default exit period will only become effective if approved by the Authority.

## 2 Purpose of this policy

- 2.1 The purpose of this policy is to guide the Authority in its decision-making so as to ensure that if the Authority decides to approve a request for a shorter post-default exit period, the electricity market remains reasonably protected from the financial consequences of the participant not meeting its financial commitments to the clearing manager.

## 3 What the Code says

- 3.1 Sections of the Code that are relevant to this policy include:
  - (a) Part 14A: Prudential requirements, particularly clause 14A.22 and Schedule 14A.1
  - (b) Part 14: Clearing and settlement, particularly clause 14.49
  - (c) Schedule 11.5: Process for trader event of default.
- 3.2 The most relevant clauses of the Code to this policy are included in Appendix A. In summary, these requirements are:
  - (a) the post-default exit period is 18 trading days for a retailer and 7 trading days for a direct purchaser or any other participant, unless a participant requests a shorter post-default exit period and this is approved by the Authority (subclause 14A.22(4))
  - (b) the prudential exit period for a participant is equal to the post-default exit period for that participant plus 1 trading day (subclause 14A.22(3))
  - (c) the minimum amount of prudential security that a participant is required to provide is equal to the sum of:
    - (i) the expected amount of the clearing manager's outstanding financial exposure to the participant

- (ii) plus the exit period prudential margin for the participant (which is the clearing manager's estimate of the amount that the participant will incur and earn during the prudential exit period)
  - (iii) plus the FTR prudential requirement
  - (iv) minus any amount prepaid by the participant that is specified as being for a billing period that either has commenced but remains unsettled or falls within the prudential exit period for the participant (Schedule 14A.1, clauses 6, 7 and 10)
- (d) if an event of default occurs in relation to a direct purchaser and is continuing at the expiry of the direct purchaser's post-default exit period, the Authority may direct the relevant grid owner or distributor to disconnect the defaulting direct purchaser (subclauses 14.49(3) and 14.49(4))
- (e) direct purchasers and their grid owner or distributor must include appropriate terms in their contracts with each other to allow for disconnection of the direct purchaser in the event that the Authority directs a disconnection (subclauses 14.49(1) and 14.49(2))
- (f) if an event of default occurs in relation to a trader, the Authority may assign the trader's customers to another trader, following the process set out in the Code (Schedule 11.5).

## 4 The objectives of the policy

4.1 There are three objectives for this policy. These objectives are:

- (a) **Objective 1:** A participant will continue to be responsible for managing their own business risk regardless of whether they have a shortened post-default exit period or not.
- (b) **Objective 2:** There will be no increase in risk faced by affected parties when a participant has a shortened post-default exit period.
- (c) **Objective 3:** The risk of cascade financial failure in the electricity market does not increase under a shortened post-default exit period.

4.2 An affected party (in relation to a certain participant) is any party that could be adversely affected if that participant has a shortened post-default exit period and an event of default occurs.

4.3 These objectives are consistent with the seven objectives for the Authority's settlement and prudential security arrangements contained in the settlement and prudential security review consultation paper<sup>1</sup>. Three of these objectives are relevant when considering whether to approve a shortened post-default exit period request by a participant. These objectives are:

- (a) provide an incentive for purchasers (and all participants who incur amounts owing to the clearing manager) to manage their own business risks

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<sup>1</sup> Page 5-6, Consultation Paper - Settlement and Prudential Security Review, available here: <http://www.ea.govt.nz/about-us/what-we-do/our-history/archive/dev-archive/work-programmes/market-wholesale-and-retail-work/settlement-prudential-security-review/consultations/#c7641>

- (b) achieve a balance between:
  - (i) encouraging retail competition and market entry by purchasers by making sure that prudential arrangements do not impose an unnecessary barrier to entry
  - (ii) ensuring that purchasers face the cost of their own business risks
- (c) manage the risk of cascade financial failure in the electricity market.

## 5 Criteria for assessing a request for a shortened post-default exit period

5.1 The Authority may approve a shortened post-default exit period request if the shortened exit period meets the following criteria:

- (a) **Criteria 1:** The Authority is satisfied that the shortened post-default exit period is expected to have minimal or no negative impact on the wholesale electricity market (relative to the exit period defined in clause 14A.22(4) of the Code).
- (b) **Criteria 2:** The Authority is satisfied that the interests of any affected parties have or will be suitably dealt with.
- (c) **Criteria 3:** The Authority is satisfied that the risk of negative unintended consequences due to the shortened post-default exit period is low.
- (d) **Criteria 4:** The Authority has no other concerns about the shortened post-default exit period that mean there is a risk the objectives of the policy are unlikely to be met.

5.2 Table 1 shows how each of the criteria relate to the objectives of the policy.

**Table 1: How the criteria relate to the objectives**

Criteria	How it relates to the objectives
<b>1. The Authority is satisfied that the shortened post-default exit period is expected to have minimal or no negative impact on the wholesale electricity market (relative to the exit period defined in clause 14A.22(4) of the Code)</b>	<ul style="list-style-type: none"> <li>(a) the participant is still responsible for managing its own business risks (objective 1)</li> <li>(b) the risk of cascade financial failure in the electricity market is unlikely to increase (objective 3).</li> </ul>
<b>2. The Authority is satisfied that the interests of any affected parties have been suitably dealt with</b>	<ul style="list-style-type: none"> <li>(a) there will be no increase in the risk faced by affected parties (objective 2)</li> <li>(b) the participant is still responsible for managing its own business risks (objective 1).</li> </ul>
<b>3. The Authority is satisfied that the risk of negative unintended consequences</b>	<ul style="list-style-type: none"> <li>(a) the risk of cascade financial failure in the electricity market is unlikely to increase</li> </ul>

<b>due to the shortened post-default exit period is low</b>	(objective 3).
<b>4. The Authority has no other concerns about the shortened post-default exit period that mean there is a risk the objectives of the policy are unlikely to be met</b>	<ul style="list-style-type: none"> <li data-bbox="676 286 1442 360">(a) the participant is still responsible for managing its own business risks (objective 1)</li> <li data-bbox="676 371 1442 445">(b) there will be no increase in the risk faced by affected parties (objective 2)</li> <li data-bbox="676 456 1442 571">(c) the risk of cascade financial failure in the electricity market is unlikely to increase (objective 3).</li> </ul>

5.3 The onus is on the participant applying for the shortened post-default exit period to satisfy the Authority that these criteria are met, as well as providing assurances that its own development plans would not change the outcome of the Authority's decision. The participant is likely to require information and evidence from other parties (such as their grid owner/distributor, or any affected parties) to prove these criteria are met. Obtaining that information and evidence is the responsibility of the applicant.

5.4 The Authority will publish application forms on its website. These application forms will assist participants to provide the information required for the Authority to assess their request for a shortened post-default exit period against the policy criteria. The Authority will request additional information from the participant if it considers further information and/or evidence is required to enable it to fully assess the participant's request.

## 6 Review the post default exit period provisions

6.1 Once the first application has been assessed, the Authority will complete an operational review of the post default exit period provisions.

6.2 The review will look at the provisions in light of the application to ensure they are fit for purpose. The review will also look at the application and assessment process.

## 7 Reassessing a request for a shortened post-default exit period

7.1 The Authority may:

- (a) reassess each approval for a shortened post-default exit period from time to time
- (b) reassess an approval for a shortened post-default exit period if the Authority becomes aware that either:
  - (i) the circumstances under which the Authority approved the shortened post-default exit period have changed

- (ii) the circumstances under which the Authority approved the shortened post-default exit period were not correct.
- (iii) there is a change to the Authority's criteria

- 7.2 Regularly reassessing approvals for shortened post-default exit periods will minimise the risk of a participant having a shortened post-default exit period when it does not meet the policy criteria.
- 7.3 A reassessment of any approval for a shortened post-default exit period will follow the same process as the assessment of the initial request for a shortened post-default exit period.
- 7.4 If the assessment shows that there is a risk the participant may no longer meet the criteria, the participant will be advised and requested to provide further information. If there remains the likelihood the participant may no longer meet the criteria, the Authority will advise the participant it will consider withdrawing its approval and include its reasons.
- 7.5 The participant will be given opportunity to make a submission on the Authority's advice that it will consider withdrawing approval. The Authority will advise the participant of the outcome of its reassessment.

## Appendix A      Relevant sections of the Code

### Schedule 11.5

#### Process for trader event of default

##### 1 Purpose

The purpose of this Schedule is to set out the process that the **Authority** and each **participant** must comply with when the **Authority** is satisfied that a **trader** has committed an **event of default** under paragraph (a) or (b) or (f) or (h) of clause 14.41.

##### 2 Notice to trader who has committed event of default

- (1) If the **Authority** is satisfied that a **trader** ("defaulting trader") has committed an **event of default** under paragraph (a) or (b) or (f) or (h) of clause 14.41 the **Authority** must give notice to the defaulting trader that—
  - (a) the defaulting trader must—
    - (i) remedy the **event of default**; or
    - (ii) assign its rights and obligations under every contract under which a **customer** of the defaulting trader purchases **electricity** from the defaulting trader to another trader, and assign to another trader all **ICPs** for which the defaulting trader is recorded in the **registry** as being responsible; and
  - (b) if the defaulting trader does not comply with the requirements set out in paragraph (a) within 7 days of the notice, clause 4 will apply.
- (2) The **Authority** may require the defaulting trader to provide to the **Authority**, within a time specified by the **Authority**, information about the defaulting trader's **customers**.
- (3) The defaulting trader must provide the information requested by the **Authority** under subclause (2) within the time specified by the **Authority**.

##### 4 Failure by defaulting trader to remedy event of default

- (2) The **Authority** must—
  - (a) give notice to the defaulting trader that the **Authority** considers that this clause applies; and
  - (b) attempt to advise **customers** of the defaulting trader that—
    - (i) the defaulting trader has committed an **event of default**; and
    - (ii) the **customer** should enter into a contract for the purchase of **electricity** with another trader by the date that is 14 days after the day on which the **Authority** gave notice to the defaulting trader under clause 2(1); and

- (iii) if the **customer** fails to enter into a contract with another **trader** by that date, the **Authority** may assign the defaulting **trader's** rights and obligations under the **customer's** contract with the defaulting **trader** to another **trader** under clause 5.

## **5 Authority may assign contracts and ICPs**

- (2) The **Authority** may—
  - (a) exercise its right under a contract under which a **customer** purchases **electricity** from the defaulting **trader** to assign the rights and obligations of the defaulting **trader** under the contract to a recipient **trader** in accordance with the contract; and
  - (b) assign an **ICP** to a recipient **trader** and direct the **registry** to amend the record in the **registry** so that the recipient **trader** is recorded as being responsible for the **ICP**; and
  - (c) specify the recipient **trader** to whom the rights and obligations under the contract or the **ICP** will be assigned.

## **14A.22 Clearing manager to keep register of specified time periods**

- (3) The prudential exit period for a **participant** is the number of **trading days** that elapse over the sum of the following:
  - (a) 1 **trading day**;
  - (b) the post-default exit period for the **participant**.
- (4) The post-default exit period for a **participant** is as follows, unless the **Authority** has approved a shorter period elected by the **participant**:
  - (a) for a **retailer**, 18 **trading days**;
  - (b) for a **direct purchaser**, 7 **trading days**;
  - (c) for a **participant** that is not a **retailer** or **direct purchaser**, 7 **trading days**.
- (5) The post-default exit period for a **participant** begins from the day on which the **participant** advises the **clearing manager** or the **clearing manager** advises the **participant** under clause 14.43 that an **event of default** has occurred in relation to the **participant**.
- (6) A **participant** that has a shorter post-default period approved by the **Authority** may increase the period to no more than the number of **business days** set out in clause (4) by giving 20 **business days'** notice to the **clearing manager**.
- (7) A shorter post-default exit period approved by the **Authority** takes effect 20 **business days** after the date of the **Authority's** approval.

## Schedule 14A.1

### Acceptable security

#### Part 2

#### Minimum security

### 6 Determining minimum security

- (1) The minimum amount for which security is required to be provided by a participant under clause 14A.6 is—
  - (a) the sum of the following amounts:
    - (i) the general prudential requirement calculated in accordance with clause 7;
    - (ii) the **FTR** prudential requirement calculated in accordance with clause 11; minus
  - (b) any amount prepaid by the **participant** under clause 14.30 that is specified by the **participant** as being for a **billing period**—
    - (i) that has commenced but remains unsettled on the day for which the minimum security is being determined; or
    - (ii) any part of which falls within the prudential exit period for the **participant** (if any)
- (2) If the sum of the amounts under subclause (1) is negative, the minimum amount for which security is required to be provided is 0.

### 7 General prudential requirement

The general prudential requirement is the sum of the following amounts calculated in accordance with the methodology approved under clause 8:

- (a) the expected amount of the **clearing manager's** outstanding financial exposure to the **participant**; and
- (b) the exit period prudential margin for the **participant**.

### 10 Exit period prudential margin

- (1) The exit period prudential margin for a **participant** is the **clearing manager's** estimate of the amount that the **participant** will incur and earn during the prudential exit period for the **participant** in respect of the following:
  - (a) the sale and purchase of **electricity**;
  - (ab) **extended reserve**;
  - (b) **ancillary services**;
  - (c) any **hedge settlement agreement** lodged with the **clearing manager** under clause 14.8;
  - (d) any **GST** payable in respect of the above amounts.
- (2) The estimated amounts to be incurred and earned by the **participant** in respect of the sale and purchase of **electricity** under subclause (1)(a) are based on—

- (a) the number of **trading days** in the prudential exit period for the **participant** determined under clause 14A.22(3); and
- (b) the expected value of **electricity** to be purchased by the **participant** minus the expected value of **electricity** to be sold by the **participant** during that period based on the prices in paragraph (c); and
- (c) the sum of the following amounts:
  - (i) the prices of **electricity** expected to apply during the quarter to which the calculation relates in accordance with subclauses (3) and (4):
  - (ii) an amount determined as set out in clause (5).

#### **14.49 Disconnection of direct purchaser**

- (1) Each **direct purchaser** must at all times ensure that the terms of each of its contracts that provide for the connection of the **direct purchaser** to a **network** permit the relevant **grid owner** or **distributor** to disconnect the **direct purchaser** on the direction of the **Authority** if an **event of default** occurs in relation to the **direct purchaser** and is continuing at the expiry of its post-default exit period registered under clause 14A.22.
- (2) Each **grid owner** or **distributor** must at all times ensure that the terms of each of its contracts that provide for the connection of a **direct purchaser** to a **network** permit the **grid owner** or **distributor** to disconnect the **direct purchaser** on the direction of the **Authority** if an **event of default** occurs in relation to the **direct purchaser** and is continuing at the expiry of its post-default exit period registered under clause 14A.22.
- (3) If an **event of default** occurs in relation to a **direct purchaser** and is continuing at the expiry of the **direct purchaser's** post-default exit period registered under clause 14A.22, the **Authority** may direct a **grid owner** or **distributor** to exercise any contractual right the **grid owner** or **distributor** has to disconnect the defaulting **direct purchaser**.
- (4) A **grid owner** or **distributor** that receives a direction under subclause (3) must comply with the direction.

## **Glossary of abbreviations and terms**

<b>Authority</b>	Electricity Authority
<b>Code</b>	Electricity Industry Participation Code 2010
<b>FTR</b>	Financial transmission rights
<b>ICP</b>	Installation Control Point