Insolvent Retailers workstream: Castalia Strategic Advisors report

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QUESTION		COMMENT
Q1:	Do you have any comments or concerns on the summary of standard insolvency arrangements provided in this section?	A key reason why "normal" insolvency arrangements are not sufficient is the multilateral nature of gas transmission arrangements. Costs incurred as a result of insolvency by one retailer may be spread to other parties who do not otherwise have any contractual relationship with the insolvent party.
Q2:	Do you have any comments on the summary of physical and contractual characteristics of the New Zealand gas market set out above?	The statement on page 11 of the Castalia report that "the pipeline operator can exercise options that require producers to inject more gas into the pipeline" is incorrect. Neither MDL nor anyone else can require producers to inject gas into a pipeline. MDL's only option to manage pipeline pressure is to buy or sell balancing gas from or to parties willing to offer such a transaction. The current balancing regime in the Maui Pipeline Operating Code (MPOC) does not allow MDL to charge other parties for the actual costs of balancing gas. (The introduction of a Back-to-Back balancing regime would do so.) MDL's current balancing regime is significantly more complex and indirect. The costs that MDL may eventually be able to recover after expiry of an Imbalance Limit Overrun Notice (ILON) for Accumulated Excess Operational Imbalance (AEOI) at a Welded Point owned by a Transmission Pipeline Welded Party may be significantly different from the costs that MDL itself incurred for taking a balancing action.
Q3:	Are you aware of any reason(s) why a gas retailer may become insolvent in addition to those mentioned in this section?	Yes, we can think of other reasons why a gas retailer may become insolvent. Fraud and incompetency would be listed among those.

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Q4:	Are there other likely scenarios of how a gas retailer insolvency might play out that have not been discussed above?	MDL can terminate a Transmission Services Agreement (TSA) held by any party that is insolvent. An insolvent retailer that had a TSA would therefore no longer be able to make new nominations for transporting gas on the Maui pipeline. To the extent it would have liabilities to MDL for transmission charges from past nominations those should be covered by the prudential requirements arranged with MDL. MDL cannot stop an insolvent retailer, or its customers, from taking gas. If such takings of gas were to flow up through the distribution network, to the Vector transmission system, and on to the Maui pipeline, and if nobody were to make a nomination for the physical flow from the Maui pipeline, then they would manifest as an Operational Imbalance at the Welded Point connecting the Vector and Maui pipelines. If such imbalances accumulate to the extent that they exceed Vector's Running Operational Imbalance Limit at that Welded Point then MDL could eventually charge Vector for the costs of eliminating AEOI at that point. Those costs would consist of a sale of gas by MDL to Vector at the Negative Mismatch Price. Vector would then seek to recover those costs, which would represent a purchase of balancing gas by Vector, under the Vector Transmission Code (VTC).
Q5:	Do you agree with the description of customers' perceptions of the risk of insolvency, and the likely customer experience when their retailer becomes insolvent?	No comment.
Q6:	Do you agree with this discussion of the incentives that apply in an insolvency event?	MDL does not have any incentives to deal with an insolvency practitioner. As mentioned before, MDL can terminate the TSA of any insolvent party and should usually be able to recover any outstanding transmission charges from the prudential requirements. MDL would be unlikely to enter into any new TSA with an insolvency practitioner. If an insolvency practitioner would need to make nominations for gas transmission on the Maui pipeline it would most likely need to enter into an arrangement with a third party shipper.

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Q7:	Do you agree with the market failures identified?	No. A gas retailer, or an insolvency practitioner taking control of it, is unlikely to have any contractual arrangement with MDL that covers costs of taking gas. As discussed before, it if takes gas from the Maui pipeline without nominations this will manifest as an operational imbalance at a Vector Welded Point. Any resulting charges for sales of gas will be made by MDL to Vector, and by Vector to parties to the VTC. This happens regardless of any intentions that the insolvency practitioner may have for the retailer, and may occur even before it has decided what to do. Those costs can be incurred by parties that do not have any contractual relationship with the insolvent retailer. This is the main market failure problem that needs to be addressed.
Q8:	Do you agree that the market failures identified will only eventuate if an insolvency practitioner disclaims customer contracts or if an acquiring retailer does not acquire the whole customer base in a sale process?	It will not make any difference to MDL. The TSA of an insolvent party is likely to be terminated immediately in all circumstances. If an acquiring party needs a TSA (and does not have one) it will have to enter into a new agreement with MDL and meet prudential requirements.
Q9:	Do you agree that contracts provide some ability for gas industry participants to manage the costs that they might bear if their counterparty becomes insolvent?	With respect to transmission arrangements we expect the status quo to be adequate. If an insolvent retailer is a shipper under the MPOC we expect its TSA will be terminated and its prudential requirements should be adequate to cover outstanding charges. This need not affect any other party. With respect to continued taking of gas by customers from an insolvent retailer, however, we believe regulatory intervention should be considered. If effects from taking gas without nominations manifest on the Maui pipeline then MDL will charge Vector (at a Negative Imbalance Price for gas). Vector will seek to recover those costs, but they are likely to exceed prudential requirements that Vector may have for transmission charges. The cost of gas can be an order of magnitude higher than the transmission charge. In the absence of prudential requirements for such a level of costs, which are not covered in bilateral contracts, we believe that issue deserves further consideration.
Q10	Based on the issues discussed above and for the market failures identified, do you consider that there is a need for regulatory intervention beyond using the urgent regulation-making powers in the Gas Act?	