Recommendation to the Acting Minister of Energy & Resources on arrangements for insolvent retailers

May 2011

GAS INDUSTRY COMPANY LIMITED

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About Gas Industry Co.

Gas Industry Co was formed to be the co-regulator under the Gas Act.

As such, its role is to:

- recommend arrangements, including rules and regulations where appropriate, which improve:
  - the operation of gas markets;
  - access to infrastructure; and
  - consumer outcomes;
- administer, oversee compliance with, and review such arrangements; and
- report regularly to the Minister of Energy and Resources on the performance and present state of the New Zealand gas industry, and the achievement of Government's policy objectives for the gas sector.

Authorship

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Executive summary

On 18 October 2010 the E-Gas group of companies went into liquidation. There was concern about whether the liquidator would be able to complete a sale of the customer base to another energy retailer in the time available, and that customers could be adversely affected by not having an effective retailer in place. At the request of the Minister of Energy and Resources, Gas Industry Co assisted the Ministry of Economic Development (MED) and Parliamentary Counsel Office (PCO) to prepare the Gas Governance (Insolvent Retailers) Regulations 2010 ('Regulations').

Regulations

The Regulations provide for the industry body (Gas Industry Co) to transfer the customer contracts of an insolvent retailer to other retailers. The new retailers (termed 'recipient retailers' in the Regulations) must continue to supply gas under the transferred contracts for a transition period of a minimum of 30 days. The transferred customers may switch to another retailer, without any fee or penalty, during the transition period, and otherwise will roll over into a contract with the new retailer at the end of that period.

The liquidator was able to complete a sale of the E-Gas customer base, meaning that the Regulations did not need to be invoked. However, the existence of the Regulations did assist the liquidator by providing a clear backstop in the event that a sale could not be achieved.

Consultation

Because the Regulations were made under urgency, there is a requirement in the Gas Act 1992 for consultation to take place retrospectively and for a recommendation to be made to the Minister of Energy and Resources on whether the Regulations should be revoked, replaced or amended. In addition, the Minister of Energy wrote to Gas Industry Co requesting advice as to "the form and content of backstop regulations should other gas retailers go into liquidation or receivership". Gas Industry Co has interpreted these two requirements as separate, but related, matters.

Gas Industry Co issued a Statement of Proposal for consultation on 22 March 2011and received seven submissions on it. The consultation asked for feedback on the first matter, that is, whether the Regulations should be revoked, replaced or amended; and it broadly canvassed the issues that would need to be considered in determining permanent backstop arrangements.

Consultation with industry participants and stakeholders and analysis of submissions has contributed to the conclusion that the Regulations are not appropriate as an ongoing tool to address the range of potential future retailer insolvencies. This view reflects the fact that the Regulations were tailored for the specific E-Gas situation. In particular, the small size of E-Gas (3% of customers by number and approximately 9% by volume) meant that it would have been relatively straightforward for other retailers to have absorbed a modest increase in their respective customer numbers.

On the issue of permanent backstop arrangements, the majority of industry submissions suggested that this is an issue that should be addressed. Accordingly, Gas Industry Co proposes to undertake further work in this area to assess the most appropriate generic solution. In the first instance this work will focus on establishing the need, if any, for back-stop regulation in the event of the insolvency of a gas retailer. If back-stop regulation is assessed to be the preferred option, then work will be required to design a fit-for-purpose approach suited to the New Zealand situation.

Recommendation

The recommendation to the Acting Minister of Energy and Resources addresses both the existing Regulations and the need to progress work on a permanent set of arrangements.

The recommendation to the Acting Minister of Energy and Resources is to:

- Agree that the Gas Governance (Insolvent Retailers) Regulations 2010 be revoked by the operation of regulation 19 (which provides for the revocation of the Regulations six months after they came into force; that is, 16 May 2011); and
- Endorse a work-stream to consider whether a generic regulatory solution is required to address retailer insolvency, and if so, develop the form of that solution.

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1 Introduction

The Gas Governance (Insolvent Retailers) Regulations 2010 ('Regulations') were made under urgency on 15 November 2010. The Gas Act 1992 ('Act') requires that where regulations are created in reliance on section 43P of the Act (under urgency), the recommending body must, within six months: fulfil the requirements of sections 43L and 43N of the Act; make a recommendation to the Minister of Energy and Resources ('Minister') on whether the urgent regulations should be revoked, replaced or amended; and, no later than ten days after making the recommendation, must publicise the recommendation and the assessment completed under section 43N.[1]

As the objectives of the Regulations were ultimately met by a non-regulated market solution, the Regulations were not required. However the consultation and assessment requirements under sections 43L and 43N of the Act are still required, and the Minister of Energy and Resources requested that Gas Industry Co undertake this as if it had been the recommending body. The Minister also asked Gas Industry Co to provide advice as to the form and content of backstop regulations should other gas retailers go into liquidation or receivership.

1.1 Circumstances leading to urgent regulations

On 18 October 2010, the E-Gas group of companies ('E-Gas') entered voluntary liquidation. BDO New Zealand was appointed as the liquidator.[2] E-Gas at the time had a market share of about 3% of gas customers and about 9% of allocated gas volumes. Its customer base was largely made up of small commercial customers, such as restaurants, bars, and motels; about one quarter of the customers were residential. This profile of the E-Gas customers was influential in the development of the Regulations to ensure those customers continued to receive gas supply from an existing retailer.

If BDO had reached the point where E-Gas was forced to cease trading, then it would no longer have been able to continue its obligations to supply gas under the various contracts with the E-Gas customers. In this situation, E-Gas's customer contracts could have been considered 'onerous property' and disclaimed by the liquidator under the Companies Act 1993. Such a situation could have led to considerable disruption for E-Gas customers and other participants in the gas industry if E-Gas customers had continued to use gas without a valid supply contract. Specifically:

[1] Regulation 19 provides the default position that the Regulations are revoked after six months.

[2] See http://www.bdo.co.nz/content/our-services/business-recovery/E_Gas_Group.aspx

- the gas they used would not have been measured and reconciled as required by the existing gas governance arrangements;
- the gas that those customers used would, therefore, have appeared to be 'unaccounted for gas' (UFG), the cost of which would have been borne by other gas retailers;
- gas distributors would have been concerned that, unless they disconnected the uncontracted E-Gas customers, the gas retailers bearing the burden of that additional UFG would seek to recover the costs of that from the distributors; and
- those gas distributors would, most likely, have sought to manage their risk by moving to disconnect the E-Gas customers.

The Regulations addressed these issues by putting in place a regime to transfer E-Gas's customers to other gas retailers, thereby ensuring that those customers remained contracted and with a gas supplier.

A discussion of the background to the E-Gas insolvency is attached at Appendix C.

1.2 What the Regulations provide

The Regulations provide for the industry body (Gas Industry Co) to transfer the customer contracts of an insolvent retailer to other retailers. The new retailers, termed 'recipient retailers' in the Regulations, must continue to supply gas under the transferred contracts for a transition period of a minimum of 30 days. The transferred customers may switch to another retailer, without any fee or penalty, during the transition period, and otherwise will roll over into a contract with the new retailer at the end of that period.

Under the Regulations, transferred customers are apportioned to recipient retailers by market share. Recipient retailers include large gas retailers (those with more than 10% customer market share), who are required to take on a share of the insolvent retailer's customers, and smaller retailers who opt-in. The Regulations also provide for a transfer of transmission capacity from the insolvent retailer to those recipient retailers who request it.

The Regulations were gazetted and came into force on 16 November 2010. The Regulations include a provision that revokes the Regulations 6 months after they come into force (that is, on 16 May 2011). This provision reflects the view that the Regulations were drafted for a specific set of circumstances and would not be appropriate in all circumstances of retailer insolvency. The provision also supports the recommendation that the Regulations should be revoked and that further detailed work is required to assess options for a generic solution.

2 Legislative Requirements

2.1 Scope of empowering provisions

The Act provides for regulations to be made specifying transition arrangements for insolvent retailers. Section 43G(2)(d) provides that the purposes for which regulations may be made include:

> *Transition arrangements for insolvent gas retailers*
>
> providing a system of transition arrangements for consumers in the event of a gas retailer becoming insolvent, and requiring industry participants to comply with that system, with the objective of protecting consumers or managing the liabilities of other gas retailers:

Section 43P provides that section 43L and 43N (which relate to consultation and assessments) do not apply if the recommending body considers that it is necessary or desirable in the public interest that the proposed regulations be made urgently. The Regulations were made under this provision.

However section 43P also provides that if regulations are made under urgency, within 6 months after they are made the recommending body must:

(i) comply with sections 43L and 43N; and

(ii) make a recommendation to the Minister on whether the regulations should be revoked, replaced, or amended; and

(iii) no longer than 10 working days after making the recommendation, publicise the recommendation and the assessment completed under section 43N.

This recommendation is made in compliance with section 43P. The relevant provisions of the Act are reproduced at appendix B.

2.2 Revocation of regulations

Regulation 19 of the Regulations provides that the Regulations are revoked on the date that is 6 months after the date on which they came into force. That date is 16 May 2011.

3 Assessment Requirements

This section addresses the assessment requirements under section 43N of the Act.

3.1 Objective of the regulation

The Regulations were made to ensure that E-Gas customers would continue to be supplied by a retailer in the wake of E-Gas's liquidation. Under the Regulations, if the liquidator had been able to find a buyer of the E-Gas customer base, then the Regulations could not have been invoked; the regulated transfer of customers would no longer have been necessary. If, on the other hand, the liquidator had been unable to make a sale, despite reasonable efforts to do so, then the Regulations would have empowered the transfer of the customer contracts, provided it was satisfied that there had been a real risk that the gas supplied to those customers would not have been supplied under a valid contract with any retailer.[3]

As it turned out, BDO was able to sell the E-Gas customer base to Nova Energy, and the provisions of the Regulations did not need to be invoked. The objective of the Regulations has been achieved, albeit without the need to invoke the Regulations; that is, gas customers formerly with E-Gas are now supplied by a different retailer.

3.2 Reasonably practicable options

Regulation 43N requires the recommending body to consider all reasonably practicable options for achieving the objective of the regulation. Given the circumstances and urgency surrounding the liquidation of relatively small gas retailer, Gas Industry Co considered there were two reasonably practicable options:

(i) do nothing from a regulatory perspective and rely on the market to respond; or

(ii) regulate to minimise the harm to other retailers and ensure E-Gas customers had continuity of gas supply.

In consulting on the Regulations after they had been enacted, Gas Industry Co similarly considered that there were two options: either to revoke the Regulations or to extend them. The original objective

[3] Reg. 5.

of the Regulations was to address the specific situation of the E-Gas liquidation; the question was whether the Regulations would be suitable in other liquidation situations as well.

3.3 Regulation best means of meeting the objective

In the Statement of Proposal, Gas Industry Co undertook an analysis as to whether or not the Regulations were the best means of meeting the objective. It concluded, because of the unique set of circumstances surrounding the E-Gas situation, that a regulatory response was the best way of ensuring that E-Gas customers would continue to be supplied by a retailer in the wake of E-Gas's liquidation.

A factor in reaching this conclusion was the extent of customer loyalty to E-Gas, which appeared to slow down the rate at which E-Gas customers were switching away from E-Gas once it was placed in liquidation.

3.4 Do the Regulations provide a set of transition arrangements that would be suitable in all cases of retailer insolvency?

In the Statement of Proposal Gas Industry Co also analysed, and sought submissions on, whether the Regulations provide a set of transition arrangements that would be suitable in all cases of retailer insolvency. It concluded that there are a number of issues that suggest these transfer provisions would not be suitable in all circumstances. These issues are potential scale of insolvency, potential timing of insolvency, the compulsory nature of the Regulations, and the tailored trigger provisions.

Potential scale of insolvency

It is not clear that other retailers would be able to absorb an insolvent retailer's customer base in all situations. If the insolvent retailer happened to be one of the largest gas retailers, the transfer process outlined above would require the recipient retailers to accept an additional number of customers that would more than double their original customer base. An increase of this scale is clearly outside the marginal increases that would have been brought about by the transfer of E-Gas customers. Although recipient retailers may be able to gear up to be able to service such an increased number of customers, it would likely be extremely difficult to achieve in the relatively short timeframe envisioned by the Regulations.

Potential timing of insolvency

The Regulations came into force on 16 November, and it was anticipated that, if the transfer provisions were invoked, the transfer of customers would take place either in November or December. These months are associated with relatively low gas consumption. It therefore seemed reasonable that recipient retailers would be able to provide delivered gas for their transferred E-Gas customers within their existing gas wholesale, transmission, and distribution arrangements or could have sourced additional gas relatively easily at a low-demand time of year. Had the liquidation taken place during the winter, in contrast, it is likely that additional customer volume would have had a greater chance of incurring transmission overrun and balancing charges.

Compulsory nature of Regulations

Large retailers are required to take on a proportion of the customers of an insolvent retailer under the Regulations. In this, they differ from many overseas jurisdictions, where regulations to transfer the customers of an insolvent retailer generally consider both the willingness and the capacity of the remaining retailers to take on the affected customers. As noted above, the scale and the timing of any future retailer insolvencies could be such that recipient retailers would be required to take on a large number of new customers, or at a time when gas prices are particularly high (or both). It is not clear that the imposition of such costs on other retailers would be the best way to manage all instances of retailer insolvency. As an extreme example, any insolvent retailer regulations should take care not to cause any other retailers such a degree of financial distress that they themselves become insolvent.

Tailored trigger provisions

Regulation 5 requires that, before Gas Industry Co can transfer the customer contracts of an insolvent retailer, it must be satisfied on reasonable grounds:

> (a) that, if the customer contracts are not transferred to other retailers, there is a real risk that gas supplied to those customers will not be supplied under a valid contract with any retailer; and
>
> (b) that the liquidator of the insolvent retailer has made reasonable efforts to sell or otherwise dispose of the customer contracts.

Again, the wording reflects the circumstances surrounding the E-Gas liquidation, when BDO was actively engaged in seeking a buyer for the E-Gas customer base. In a future liquidation, the liquidator may choose not to sell the customer base and simply disclaim the retail contracts. Similarly, there may be instances of retailer insolvency that involve a receiver rather than a liquidator.

Conclusion

Gas Industry Co has concluded that the Regulations do not represent a system of transition arrangements that would be feasible or desirable in the wide range of possible situations of retailer insolvency. The transfer provisions contained in the Regulations may be unworkable in the case of a large retailer going insolvent or if the insolvency occurred in a period of high gas demand. The transfer requirement would fall on all large retailers, even those who potentially are unable to manage the cost associated with the transfer. Finally, the Regulations cover only a subset of insolvency scenarios, due to the trigger provisions having been tailored to the E-Gas situation. In addition, there is no information that Gas Industry Co is aware of that would indicate any likelihood of a gas retailer becoming insolvent in the foreseeable future.

On the basis of the above assessment, this recommendation is that the Regulations should not be renewed, but rather regulation 19 should trigger their revocation.

3.5 Costs of the options

Gas Industry Co has compared the scenarios as between the options of regulating and not regulating to manage the fall-out from the liquidation of E-Gas. Under the non-regulatory option, Gas Industry Co estimated that, through a combination of retailer competition and pressure from distributors, the E-Gas customers would progressively re-contract with other retailers over a four-month period. When reconciling November gas consumption volumes, 90% of the gas that would otherwise have been allocated to E-Gas would have become UFG that is apportioned among the other gas retailers. The overall cost of this UFG was estimated, conservatively, at $3.66 million.

Under the preferred option of regulation, this 'UFG gap' was avoided, as supply costs became the responsibility of the new or 'responsible' retailers. The unclaimed E-Gas volumes would have been submitted to the allocation agent as consumption volumes for the customers transferred to each of the recipient retailers. This approach would have insulated other retailers from costs associated with those customers.

Further, it was estimated the revenue from the transferred contracts would outweigh the costs, as recipient retailers would receive the income under the transferred contracts during the transition period based on E-Gas' pricing. Once the transition period ended, recipient retailers would receive income based on their own tariff structures.

On the cost side, creating the Regulations has incurred administrative costs in the form of resources expended by Gas Industry Co, PCO, and MED. The Statement of Proposal estimated these costs to be in the order of $30,000. Compared to the net estimated cost of the market option, Gas Industry Co considered the regulated response to be the preferred option from a cost-benefit perspective.

At the time the Regulations were being made, and in the knowledge that the retailer was insolvent, Gas Industry Co considered the benefits of the regulatory option outweighed its costs, and the costs of the non-regulatory option.

With respect to the costs and benefits of either revoking or extending the Regulations, the costs and benefits stack up differently now. There is no current information Gas Industry Co is aware of that would indicate any significant likelihood of a gas retailer becoming insolvent in the foreseeable future. Any benefits that the Regulations would provide would therefore be realised at some time in the future, if ever. Further, these benefits would need to be weighed against the risks that the Regulations present. As noted earlier, the Regulations were drafted for a specific set of circumstances; in another insolvency event, the Regulations may not be able to be invoked (if, for example, a retailer went into receivership instead of liquidation) or may prove unworkable (if, for example, it was a major retailer that went insolvent).In conclusion, Gas Industry Co considers there is no net benefit in retaining the Regulations.

4 Consultation and Submissions

4.1 Consultation requirements

Section 43L of the Act requires the recommending body to consult with persons likely to be substantially affected by the proposed regulations. As noted, consultation is not required at the time of making urgent regulations, but section 43P requires that consultation to be undertaken within 6 months of the regulations being made.

4.2 Statement of Proposal

On 22 March 2011 Gas Industry Co issued, for consultation, a Statement of Proposal on the Regulations. That document sought feedback from industry participants and stakeholders on a number of key questions so as to inform this recommendation on whether to revoke, replace, or amend the Regulations.

Overall, the Statement of Proposal concluded that the Regulations *'…do not represent a system of transition arrangements that would be feasible or desirable in the wide range of possible situations of retailer insolvency.'* As a result, the Statement of Proposal concluded that the Regulations should be revoked on 16 May 2011 as provided for by regulation 19.

Submissions were received from seven parties:

- Contact Energy Limited ('Contact')
- Genesis Power Limited trading as Genesis Energy ('Genesis')
- Maui Development Limited ('MDL')
- Mighty River Power Limited ('MRP')
- Nova Gas Limited ('Nova')
- Powerco Limited ('Powerco')
- Vector Limited ('Vector')

The collated text of the submissions is contained at appendix C, and the original submissions are available on Gas Industry Co's website.

4.3 Questions asked of submitters

The Statement of Proposal asked eight questions of submitters. The key questions for the purpose of this recommendation specifically regarded the Regulations: whether or not submitters agreed that the Regulations should be revoked under regulation 19; if not, what suggestions submitters had for overcoming the shortcomings of the Regulations; and, finally, what were their comments on the customer transfer arrangements under the Regulations.

4.4 Should the regulations be revoked?

Six of the seven submitters agreed, unconditionally, that the Regulations should be revoked. The seventh, Vector, agreed to revocation conditional on the Regulations being 'promptly replaced with permanent regulations to provide regulatory and commercial certainty to market participants and ensure continuity of supply to customers.'

4.5 Comments on the customer transfer provisions of the Regulations

The purpose of was asking about the customer transfer provisions of the Regulations was to elicit whether there were any practical difficulties with the approach mandated in the Regulations.

Genesis, Nova, Contact and Vector reinforced that the regulations were specific to the E-Gas situation and would be unlikely to be appropriate to other events. Nova's main concern with the Regulations was the placement of unknown obligations on other retailers without the opportunity to identify, consider, mitigate or object to them. Vector and Nova pointed out examples of scenarios where the Regulations would not be suitable.

These responses all support the conclusion that the Regulations are not suitable as a general purpose approach (although submitters were generally favourable in their comments about the suitability of the Regulations for the specific purpose for which they were made).

4.6 Remaining questions

The remaining series of questions were as follows:

- Do you have any comments on the provisions of the Regulations themselves?
- In your view, is some form of regulatory intervention required to deal with cases of retailer insolvency?
- Are there other factors to consider that have not been mentioned in the Statement of Proposal?
- Do you agree that the objectives addressed by the Regulations were appropriate?
- Are there any other options that Gas Industry Co should consider apart from a 'retailer of last resort' or reliance on urgent regulation-making powers?

- What are you views concerning alignment with the default arrangements being developed by the Electricity Authority and are there opportunities for harmonisation that we have not identified?

The responses to these questions are set out at Appendix C and will (if the recommendation in this paper is accepted) provide useful inputs into future policy work on options for a longer term approach to retailer insolvency.

5 Risks

A potential risk in revoking the Regulations at this time is that another gas retailer becomes insolvent in the short-term and further regulations may need to be put in place under urgency. Gas Industry Co has no knowledge of any other retailer at risk of failing and is of the view that the risk of this occurring before decisions can be taken on the longer-term is low.

As discussed in Appendix A (background to E-Gas insolvency), E-Gas was subject to increasing financial pressure through 2010. Much of this would appear to be a result of the seriousness of the breaches of the Rules, the emerging financial impact on other industry participants of those breaches, and the consequential prudential requirements that were placed on E-Gas.

The extent of the problem was uncovered during an event audit commissioned by Gas Industry Co as a result of unexplained levels of UFG. The ability to undertake event and performance audits of industry participants is a feature of the Gas (Downstream Reconciliation) Rules 2008. Prior to the introduction of the Rules there were no mandatory audit arrangements in place, and little transparency. There were concerns in the industry about unexplained levels of UFG, but no way of enforcing audits to determine the cause.

With the advent of the Rules, Gas Industry Co has in place a rolling programme of performance audits. The audits undertaken to date have identified some areas of non-compliance, but not to the extent or seriousness of the E-Gas breaches. Further those identified breaches have been able to be settled by the investigator. While these audits do not assess the financial viability of industry participants, they have enhanced transparency, and provide some comfort such that the situation that arose in the E-Gas matter is unlikely to be repeated.

This is not to say that another situation may arise whereby a gas retailer is placed in liquidation. However as noted in this recommendation Gas Industry Co (and submitters) do not consider that the current Regulations would be appropriate to respond to a different set of facts.

On balance, Gas Industry Co considers the risk of retailer insolvency to be sufficiently low that a measured approach to replacing the Regulations is appropriate.

6 Long term solution

Gas Industry Co considers that the need for, and appropriateness of, generic backstop regulations is a policy issue that requires careful consideration. The first question is whether standing insolvency arrangements are needed at all. A number of gas and electricity retailers have exited the market in New Zealand over the past decade, and all of these situations have been resolved without specific insolvency arrangements. These examples are set out below.

Table 1 Exiting gas and electricity retailers, 1998 to present

Energy sector	Exiting retailer	Acquiring retailer	Date	Reason
Gas	Enerco Gas	Contact Energy	1998 (residential customers) 2000 (industrial customers)	Restructuring
Gas	Trans Alta	On Energy / NGC	2000	Exiting New Zealand
Gas	NGC	Genesis Energy	2002	Restructuring
Gas	Fresh Start	Genesis Energy	2003	Not announced
Gas	E-Gas	Nova Energy	2010	Retailer liquidation
Electricity	Empower	Contact Energy	2000	Access to capital
Electricity	Trans Alta	On Energy / NGC	2000	Exiting New Zealand
Electricity	On Energy / NGC	Genesis Energy (North Island customers) Meridian Energy (South Island customers)	2001	Financial distress
Electricity	Energy Online	Genesis Energy	2002	Restructuring
Electricity	Fresh Start	Genesis Energy	2003	Not announced

Whilst these exits have been for a range of reasons, including insolvency, they still provide examples of customer transfers caused by retailer exit. In all of these cases, customers were transferred without the need for special regulatory intervention and the customers were acquired voluntarily by other retailers.[4] This, together with the ability to create urgent regulations under the Act as in the E-Gas case, does raise a question whether a general-purpose regulatory solution is needed to address retailer insolvency. Other possible options include leaving any response to the market, or relying on the provisions in the Gas Act that enable fit for purpose regulations to be made in isolated cases.

If it is determined that backstop arrangements are required, then the next questions to consider are the scope and scale of such arrangements. Other jurisdictions may provide useful models for the design and implementation of a general purpose set of backstop regulations,. This approach is consistent with industry submissions on the Statement of Proposal.

This recommendation does not address these issues. As noted, Gas Industry Co considers further detailed policy work is required, and recommends a work-stream to assess the desirability and possible content of a generic, long-term solution.

[4] Note that some of the takeovers listed above obtained clearance from the Commerce Commission under section 66 of the Commerce Act 1986. However, this regulatory action concerns the competitiveness of markets after the proposed transfer, rather than assuring continuity of supply to customers and the integrity of the wholesale market settlement process, which are concerns relevant prior to the transfer of customers.

7 Recommendation

It is recommended that the Acting Minister of Energy and Resources:

a. **Agrees** that the Gas Governance (Insolvent Retailers) Regulations 2010 be revoked by the operation of regulation 19; and

b. **Endorses** a work-stream to consider whether a generic regulatory solution is required to address retailer insolvency, and if so, develop the form of that solution.

Appendix A Background to E-Gas insolvency

There were a number of issues that contributed to the financial demise of E-Gas. These are summarised briefly in this section.

E-Gas profile

E-Gas was a small, privately-held company that had been operating as a gas retailer for over a decade. There were two retailer companies:

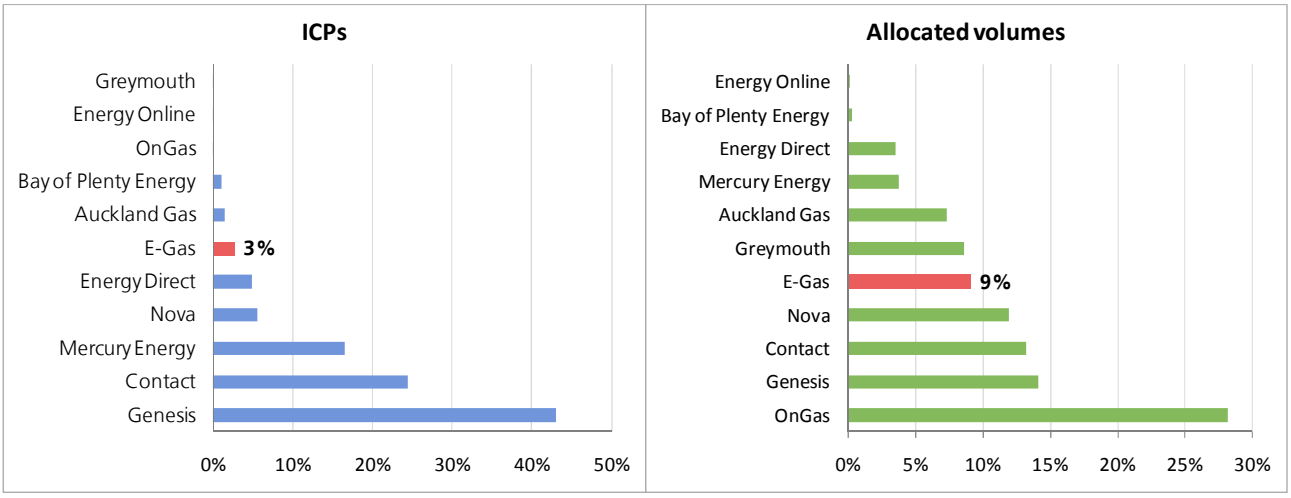
- E-Gas Limited which had the majority of the customers served by the E-Gas group and which also served the larger customers in the E-Gas portfolio; and
- E-Gas 2000 Limited which primarily served domestic and smaller commercial customers.

Both E-Gas retailers sourced their gas supply from an associated company, Multi Gas (NZ) Limited ('Multi Gas') which, most recently, sourced gas from the Pohokura gas field.

E-Gas tended to focus on gaining its customers from the small to medium sector of the commercial and industrial market. However, as indicated above, it drew its customers from the domestic sector as well.

As depicted at chart 1 below, at the time of liquidation the E-Gas retailers accounted for approximately 3% of customer sites by number. However, and reflecting the E-Gas focus on the commercial/industrial sector, E-Gas customers comprised 9% of allocated gas volumes.

Chart 1



Prudential costs

During the course of 2010 other parties in the gas supply chain realised that they had potential financial exposure arising out of the E-Gas behaviour. Downstream reconciliation is a 'zero sum game' among the retailers. This means that all gas flowing through a gas gate meter will be apportioned among the retailers who trade at that gas gate. Thus, when a retailer such as E-Gas fails to correctly declare its consumption submission at a gas gate then all retailers at that gas gate will be affected.

The results of the downstream reconciliation process are used as the basis for a range of financial charges, including wholesale gas supply charges, transmission charges (including balancing costs, throughput and capacity overruns), and distribution charges.

E-Gas also found itself in the position of being asked to put in place arrangements for prudential payments. Gas Industry Co understands these payments amounted to several millions of dollars, and assumes that represented significant outgoings for a relatively small organisation.

Existing litigation

Prior to the Gas (Switching Arrangements) Rules 2008 ('Switching Rules') going live in 2009, E-Gas and Nova Gas ('Nova') were engaged in a dispute concerning over 100 gas customers. Nova had signed-up each of those customers and then requested that E-Gas switch them to Nova. E-Gas considered that it had enforceable term contracts with those customers and, for that reason, the customers were not free to switch to another retailer.

The matter became sufficiently serious that the parties entered into litigation in the High Court with an application for summary judgement in mid-2008. The substantive hearing was deferred to a later date and as Gas Industry Co understands, continued to be a drain on E-Gas' finances.

Compliance with gas governance arrangements

E-Gas was one of only two gas retailers that did not also operate in the electricity market. This may have contributed to the organisation experiencing a number of issues when formal rules under the Act were introduced for both customer switching and downstream reconciliation, due to a lack of experience with these types of arrangements.

Switching arrangements

The Switching Rules ushered in a new era in switching for the gas industry. Prior to the Switching Rules the processes for switching gas customers were unregulated and it was not uncommon for classes of customers to experience difficulty with changing their retailer.

E-Gas featured disproportionately in the breach statistics for switching in the six months following the Switching Rules going live. In part this reflected the fierce competition with another gas retailer that operated in the same market niche targeted by E-Gas. However, following efforts by the Investigator

and the Rulings Panel, E-Gas increased its level of compliance dramatically. In the process E-Gas was faced with fines and orders for payment of compensation and costs.

Downstream reconciliation

The Gas (Downstream Reconciliation) Rules 2008 ('Reconciliation Rules') came into full effect from October 2008. Downstream reconciliation is the process whereby all of the gas that enters a distribution network is apportioned among the retailers who trade on that network.

At the heart of the Reconciliation Rules is a requirement for retailers to disclose their best available information about the consumption volumes of their respective customers. Because the quality of consumption information changes over time (primarily due to retailers having different approaches to the timing and frequency of meter reading), the Reconciliation Rules provide for successive 'wash-ups'.

Audits performed under the Reconciliation Rules in 2009 arising from concerns over data quality identified that E-Gas was not complying with the Reconciliation Rules. Breaches of the Reconciliation Rules were alleged by the auditors and admitted by E-Gas. Those breaches involved E-Gas under-declaring the volumes of gas it was selling to its customers and, as a result, pushing the costs of acquiring and transporting that gas onto other gas retailers.

That matter was unable to be settled and was proceeding towards two anticipated hearings before the Rulings Panel. The first of those hearings was to settle the matter of penalty and was set down for 3, 4 and 5 November 2010. It was anticipated the second hearing to determine compensation payable to the other retailers by E-Gas would be set down for early 2011. However, E-Gas entered into voluntary liquidation on 18 October 2010, and the proceedings were stayed by the Rulings Panel, in accordance with section 248 of the Companies Act 1993.[5]

Summary

E-Gas was subject to increasing financial pressure through 2010. This took various forms as listed below.

- As a result of the seriousness of the alleged breaches, and the alarm expressed by other retailers, E-Gas agreed that from June 2010 all final submissions for consumption periods from May 2009 would be made under supervision, as were interim submissions from March 2010 and initial submissions from May 2010.
- As a result of supervised data submissions E-Gas would also have faced transmission charges for winter 2010 as well as wash-ups of transmission charges for winter 2009.

[5] Section 248 of the Companies Act provides that on the commencement of liquidation of a company, unless the liquidator agrees or the High Court orders, proceedings cannot be commenced or continued against the company or its property.

- E-Gas was required to pay for the winter 2009 volumes as a result of volume wash-ups that would have flowed from the final allocations for May 2009 through August 2009 (subsequent final allocations for 2009 would not have been washed-up until after E-Gas went into liquidation).
- If the E-Gas business model relied on not declaring peak winter volumes then E-Gas could not have avoided declaring those volumes for winter 2010 and would have had to purchase the associated wholesale volumes of gas.
- Gas Industry Co understands that legal costs in excess of $1 million may have been incurred by the E-Gas group of companies in the year prior to liquidation.
- The prudential amounts noted above.

All these factors are likely to have contributed to the inability of E-Gas to trade out of the situation in which it found itself.

Appendix B Extracts from the Gas Act

43L Consultation before making recommendation for gas governance regulations

(1) Before making a recommendation for any gas governance regulations, the recommending body must—

(a) undertake an assessment under section 43N; and

(b) consult with persons that the recommending body thinks are representative of the interests of persons likely to be substantially affected by the proposed regulations; and

(c) give those persons the opportunity to make submissions; and

(d) consider those submissions.

(2) However, subsection (1) does not apply to the Minister if the Minister's recommendation—

(a) implements the effect of a recommendation of the industry body or the Commission; and

(b) does not differ from that recommendation in any material way (for example, other than in matters of drafting style or minor detail).

(3) Before making a recommendation concerning regulations under section 43G(2)(a) to (h) or section 43H, the Minister must consult with the Minister of Consumer Affairs.

(4) This section is subject to section 43P in the case of urgent regulations.

(5) A regulation that is found by a court to be invalid solely because of a contravention of this section may not be declared to be invalid with effect earlier than 6 months after the date of the declaration.

43N Assessment of proposed gas governance regulations

(1) Before making a recommendation to the Minister for a gas governance regulation, the industry body or the Commission must—

(a) seek to identify all reasonably practicable options for achieving the objective of the regulation; and

(b) assess those options by considering—

(i) the benefits and costs of each option; and

(ii) the extent to which the objective would be promoted or achieved by each option; and

(iii) any other matters that the industry body or the Commission considers relevant; and

(c) ensure that the objective of the regulation is unlikely to be satisfactorily achieved by any reasonably practicable means other than the making of the regulation (for example, by education, information, or voluntary compliance) ; and

(d) prepare a statement of the proposal for the purpose of consultation under section 43L(1).

(2) The statement of the proposal referred to in subsection (1)(d) must contain—

(a) a detailed statement of the proposal; and

(b) a statement of the reasons for the proposal; and

(c) an assessment of the reasonably practicable options, including the proposal, identified under subsection (1); and

(d) other information that the industry body or the Commission considers relevant.

(3) The industry body or the Commission is not required to comply with subsection (1) if it is satisfied that the effect of the recommendation is minor and will not adversely affect the interests of any person in a substantial way.

43P Urgent regulations

Sections 43L and 43N (which relate to consultation and assessments) do not apply if the recommending body considers that it is necessary or desirable in the public interest that the proposed regulations be made urgently and, in this case, the recommendation must state that it is made in reliance on this section and then, within 6 months of those regulations being made,—

(a) the recommending body must—

(i) comply with sections 43L and 43N; and

(ii) make a recommendation to the Minister on whether the regulations should be revoked, replaced, or amended; and

(iii) no later than 10 working days after making the recommendation, publicise the recommendation and the assessment completed under section 43N; and

(b) after receiving that recommendation, the Minister must publish a notice in the *Gazette* stating whether or not he or she decides to recommend the revocation, replacement, or amendment of the regulations and explaining the reasons for that decision, or stating where copies of that explanation may be obtained,— and then, within a further 6 months, the Minister must make that recommendation.

Appendix C Submissions Received

Question	Comment
Q1 Do you agree that the Regulations should be revoked under Regulation 19? If not, what suggestions do you have for overcoming the shortcomings outlined above?	**Genesis** Yes – the Regulations are not sufficient generic to apply beyond the particular circumstances of the E-Gas liquidation. **Mighty River Power** Yes **Nova Gas** Yes **Vector** Vector agrees that the Regulations should be revoked under Regulation 19, but only on the basis that they are promptly replaced with permanent regulations to provide regulatory and commercial certainty to market participants and ensure continuity of supply to customers. Risks Vector's experience with the E-Gas liquidation last year highlighted the risks that Vector is exposed to in the absence of backstop regulations and the practical difficulties of simply terminating the supply of services to an insolvent retailer. As a significant provider of transmission, distribution, retail, and metering services in the gas sector, among other services, Vector is exposed to the following risks in the event of a retailer insolvency: • considerable credit risk (even with cash bonds or other credit support in place); • inability to bill the insolvent retailer's customers, who have not been transferred to another retailer, but who cannot be easily disconnected and who therefore continue to consume gas; • inability to recover the costs of site visits to check the insolvent retailer's 'inactive' sites and/or to disconnect or reconnect supply or ensure equipment safety, as required; • inability to recover balancing costs up front (should balancing gas need to be bought due to non-allocated consumption) with no certainty of full recovery; and • risk of disputes with retailer(s) when attempting to recover part or all of the Unaccounted-for-Gas or balancing costs. Permanent regulations The above risks could be minimised, if not avoided, through the complete transfer of the insolvent retailer's

	customers to other retailers within the shortest time possible. We believe this can be provided and can only be achieved through permanent regulations. Importantly, permanent regulations would protect customers by ensuring continuity of supply and avoiding the possibility of 'bill shocks'. This would support the Gas Act objective of ensuring that gas is delivered to customers in an '...efficient and reliable manner'. The permanent regulations could be based on the current Regulations, but amended to ensure that: • all customers of the insolvent retailer (including those with an 'inactive' status in the Gas Registry) are transferred to other retailers expeditiously (i.e. within a certain timeframe); • the meaning of insolvency is broadened to capture receiverships and liquidations and the trigger provisions are amended so that they are not specific to the E-Gas liquidation; and • where a receiver/liquidator endeavours to sell some or all of the customer contracts, any customer contracts that are not sold are transferred to other retailers expeditiously. In relation to the transfer of customers (first point above), we propose that the permanent regulations provide for a process which gives customers the chance to choose a retailer before they are automatically transferred. This would reduce the number of customers that need to be transferred eventually and the burden on retailers whose capacity to absorb additional customers may be limited. We do not consider the shortcomings outlined in paragraph 2.2 of the Statement of Proposal to be of such a nature that they would prevent permanent regulations to be put in place: • *Potential scale of insolvency*. The current regulations require a recipient retailer to have at least 10% of the total ICPs. This could be further developed to require recipient retailers to have more than 10% of the relevant load group. • *Potential timing of insolvency*. We believe it is essential to consider this against the counterfactual of no regulations and customers continuing to draw gas, in which case, market participants would bear the costs of the customers drawing gas, but with no ability to recover these costs. Permanent regulations can be drafted to address the recovery of costs, including any additional transmission/balancing charges. The permanent regulations should require a high degree of co-operation between the GIC and the liquidators throughout the liquidation process to ensure a timely transfer of all the insolvent retailer's customers (whether through a sale by the receiver/liquidator and/or regulation). **Contact** Yes, agree. There is risk that the Regulations do not provide a set of transition arrangements that would be suitable in all instances of retailer insolvency. **MDL** MDL agrees with the conclusion reached by GIC, that Gas Governance (Insolvent retailers) Regulations 2010 (The Regulations) should be revoked. The Regulations, in their current form, fail to provide a regulatory

	solution which is applicable to every retailer insolvency circumstance which may occur (most notably the insolvency of a large retailer). **Powerco** Powerco agrees that the Regulations as they stand should be revoked by 16 May 2011 as per regulation 19. The current regulations are too specific to the E-Gas case – given the potential variability in situations where a retailer might become insolvent these emergency regulations are not appropriate.
Q2 Do you have any comments on the provisions of the Regulations themselves?	**Genesis** The Regulations were specific to the E-Gas situation and are unlikely to be appropriate to other events. We also consider that further thought should be given as to whether regulated bulk transfer of customers from distressed to stable retailers is a desirable intervention. This is likely to raise costs for consumers in the long run. **Mighty River Power** No **Nova Gas** Nova's main concern with the regulations was the placement of unknown obligations on other retailers without the opportunity to identify, consider, mitigate or reject them. We also have concerns with the practical application of the regulations in different circumstances. In our view the regulations as currently written would not be appropriate in such scenarios where gas supply is constrained leading to a retailer insolvency event. In such scenarios the ability of other retailers to absorb another retailers customer load could put them at risk of insolvency as well – especially if there is any requirement to take on the insolvent retailers contractual terms with its customers. **Vector** The Regulations need to be made more general to capture different circumstances during liquidation rather than being tailored to the E-Gas liquidation. The Regulations need to clearly provide for the situation where some but not all of an insolvent retailer's customers are sold by the liquidator. Regulations 8 and 9 should provide arrangements to deal with 'inactive' customers in the Gas Registry, including giving the GIC the power to allocate these customers to retailers where it is not clear if they have been properly disconnected and are truly 'inactive'. The Regulations also need to allow for co-operation between the GIC and the receiver/liquidator to ensure that customer transfers are timely. Regulation 10 should provide clear timeframes for the transfer of all the

	insolvent retailer's customers. The timeframes will need to be set to ensure that costs to relevant market participants are minimised. We propose that customers be transferred from the date a receiver/liquidator ceases to trade the insolvent retailer's business and the date the relevant customers' contracts are disclaimed by the liquidator. As indicated above, we propose that permanent regulations provide for a process by which customers are given the chance to choose a retailer before they are automatically transferred. Vector would further support certainty in the allocation of costs related to Unaccounted-for-Gas during the customer transfer period. Vector's exposure to retailer disputes in this regard could be clarified and minimised. We propose that the above amendments be included in the development of permanent regulations. **Contact** We consider the regulations were suitable for the context within which they were developed. **MDL** **Powerco**
Q3 In your view, is some form of regulatory intervention required to deal with cases of retailer insolvency?	**Genesis** We support further work on this question. We expect that some form of ex ante regulatory provision may prove more desirable than ad hoc regulatory intervention. **Mighty River Power** No, the occurrence of insolvency of retailers is rare and should be dealt with case by case as each would present its own issues. With only 5 insolvencies in the last 11 years, current regulations would have changed over the time which would possibly cause more work keeping the regulations up to date and valid, with the possibility that it might never be used. Although we do need something in place to protect the other Gas retailers, this could be done through a pre-trading audit with 6 month surveillance audit (see more details in Q7). **Nova Gas** Yes. Regulations or changes to existing regulations such as switching arrangements in particular are necessary. Also the critical contingency regulations and reconciliation rules should be reviewed to ensure that retailer insolvency events do not interfere with their operation. Based on our experiences following the E-gas liquidation, management of the situation was hampered by a number of issues:

	1. Even though E-gas went into voluntary liquidation, customers were unable to terminate their contracts with E-gas so they could make alternative arrangements. While other retailers were approaching and being approached by E-gas customers, E-gas (on instruction of the Liquidators) was not releasing customers from their contracts. Nova believes that once a retailer becomes insolvent (voluntarily or otherwise), and there is a prospect that other retailers must absorb the insolvent retailers customers, there should be no such impediment to customer switching. In some commercial arrangements, insolvency is often an event of default allowing the other party to terminate. Such a provision allows either party to not be hampered by supply/consumption issues of the other party. Regulating for this outcome may be to the detriment to creditors of an insolvent organisation but is appropriate given that other competing retailers are expected to rearrange their affairs at short notice to continue to supply consumers without interruption. 2. If a retailer is insolvent and cannot or does not continue to manage its obligations under the switching rules then even if customers make alternative arrangements for supply, there is no process for updating the registry to record this. Nova believes that in the event of retailer insolvency and where the insolvent retailer is not in a position to complete switches in accordance with the rules, then there must be some mechanism for completing switches. Nova believes that the registry process should be modified to deal with such a situation and allow the completion of switches on behalf of an insolvent retailer by the GIC or an agent of the GIC. 3. If there are to be 'retailer of last resort' provisions then: a. All retailers should be provided with the opportunity to opt in; b. There must be clear processes for transfer of customers including: i. the provision of all information necessary for a new retailer to supply and bill the customer; ii. Any property or contractual rights necessary to supply the customer (eg transmission capacity rights) c. Customers should be given the reasonable opportunity to select a retailer of their choice otherwise they should be transferred to a default retailer and on the default retailers terms and conditions; d. Retailers of last resort should be able to claim reasonable costs from the insolvent retailer (although that would likely be subject to a high level of credit risk but nonetheless they should have the opportunity to make a claim to the receiver/liquidator); 4) The regulations should contemplate the worst case scenario of insufficient supply capacity to meet the requirements of all consumers including those of an insolvent retailer. **Vector** Vector strongly believes that regulatory intervention, in the form of permanent regulations, is required to deal with cases of retailer insolvency. We note that the current Regulations, made under urgency following the liquidation of E-Gas last year, effectively served as backstop regulations, which greatly facilitated the sale of E-

	Gas customers to Nova Gas. However, we note that enormous costs, including Vector staff time and external legal cost, were incurred in endeavouring to get the Regulations passed and in planning for actions that could be taken had the Regulations not been passed. Having permanent regulations in place would provide certainty and would no doubt minimise costs for market participants. We are happy to engage with the GIC in the development of permanent insolvency regulations. **Contact** We consider that the GIC needs to be prepared for retailer insolvency, but not necessarily have standing retailer insolvency regulations. Standing regulations would need to be extremely broad to cover the spectrum of circumstances that may arise. Contact considers that the regulations promulgated for the E-Gas event provide a sound basis for a future event, and could be used as a starting point (with appropriate amendments) for future events. The key issue with this could be the Government's appetite to allow them to be promulgated under urgency without a standard consultation process. Consideration could be given to identifying agreed principles ahead of such insolvency events. **MDL** Though MDL does not supply direct to any gas retailers, it maintains a vested interest in a prompt solution to the uncertainty brought about by the insolvency of a gas retailer. MDL believes that it is neither practical, no acceptable, to simply 'turn off' those customers supplied by a newly insolvent retailer. Because these customers will continue to consume gas which may be neither nominated for, nor paid for, their consumption (as GIC asserts) may manifest itself as Operational Imbalance at the TP Welded Point. This could lead to a pipeline imbalance situation that would very quickly become unacceptable. In order to prevent the above situation eventuating MDL believes that GIC needs to be placed in a position where it can ensure that the customers of an insolvent retailer continue to receive a supply of gas that has been properly ordered and paid for. **Powerco** The consultation paper provided a list of past cases where retailers have exited the market and notes that regulatory intervention has not yet been required to resolve these cases. However, this does not mean regulatory input will not be required in the future. The probability of needing regulatory intervention should be part of the cost benefit analysis of different regulatory options.
Q4 Are there other factors to consider that	**Genesis**

have not been mentioned?	**Mighty River Power** 1. Any pre-existing or historical market liabilities (eg UFG) should not become the responsibility of a subsequent retailer. 2. Give retailers options to nominate areas or segments which they operate in or can take extra load. 3. Waive off any penalties caused due to insolvent retailer. **Nova Gas** See Q3 response **Vector** It is important not to lose sight of the fact that Vector has very few practical options in the event of retailer insolvency. It is not physically possible to simply 'cut off' the supply of services to the insolvent retailer (or its customers) with the flick of a switch. If the insolvent retailer ceases to inject gas into the transmission system, Vector would need to provide balancing gas to preserve the integrity of the pipeline (or else a critical contingency could arise). To stop the insolvent retailer's customers from drawing gas, each customer site would need to be visited. Aside from the practical difficulty of visiting properties, disconnecting customers as a result of retailer insolvency is not a desirable outcome for the gas industry in general. Disconnections on short notice could have a negative impact on customers' attitude towards natural gas as a fuel of choice. Many affected customers may not be up to date with the latest developments in the gas market. Having permanent regulations that automatically allocate these customers (inactive and active) will ensure they receive continuous gas supply and avoid the cost and hassle of having to make fuel or retailer choices. In some instances, the party who chooses the retailer is not the customer/end user (e.g. a landlord and tenant) and it could be time-consuming for a customer to get the landlord to make decisions, further adding to the uncertainty surrounding supply. As a matter for practical consideration, we propose that the GIC take into account how asset owners may be able to access the properties of an insolvent retailer's customers to disconnect or reconnect supply or ensure equipment safety. This issue will be largely mitigated if regulations provide for the expeditious and complete transfer of all the affected customers. As a consequential commercial consideration, we suggest that the GIC make the distinction between 'distribution' and 'metering' functions, which involve separate contracts. Distributors and meter owners face different risks in the event of a retailer becoming insolvent and may respond to the situation in different ways. **Contact** No

	MDL **Powerco**
Q5 Do you agree that the objectives addressed by the Regulations were appropriate?	**Genesis** The objectives are generally appropriate. However there is likely to be some trade-off between the objectives. The overriding objective should be to provide arrangements consistent with the long-term benefit of consumers. This may entail not providing an absolute guarantee of supply continuity for customers who choose to contract with a retailer that subsequently becomes financially stressed. **Mighty River Power** Yes, these were relevant for the E-Gas situation. **Nova Gas** No. We do not believe that it is appropriate for a retailer to be forced to assume the obligations of contracts they have not entered into. In cases of supply shortage that also gives rise to a retailer insolvency situation, the objective of maintaining supply to all customers is not practicable. Consideration should also be given to linkages with the Critical Contingency and reconciliation regulations and what impact there is in the case of retailer insolvency. **Vector** Vector generally agrees that the objectives addressed by the Regulations (continuity of supply, customer protection, protection of other market participants, and the provision of information by the insolvent retailer to the industry body) were appropriate. However, we do not consider that the existing provisions are sufficient to ensure that all customers are transferred in a timely manner. Regulations made in urgency do not provide a stable solution or comfort to affected parties. Permanent regulations that ensure the efficient and timely transfer of customers not only provide certainty for affected market participants but support the objective of protecting customers by ensuring continuity of supply and preserving their ability to switch to other retailers (i.e. customers are free to switch to other retailers once they have been transferred). Our view is informed by our experience with the E-Gas insolvency, where we faced and continue to face the risks we identified above. **Contact** Yes, agree.

	MDL In principle MDL supports the objectives contained within the Regulations. Objective one states that the Regulations should: 'Ensure the continuity of energy supply to all customers, **by prescribing a means of transferring customers** from insolvent retailers to recipient retailers' (emphasis added) MDL is concerned that, as well as being difficult and costly, prescribing an exhaustive list of means by which customers of an insolvent retailer are transferred to a solvent retailer may not provide the best solution when the details of specific insolvency come to light. GIC may also be committing itself to constraint revision of these regulations as the gas market evolves; new products and providers enter, and so on. Considering this, MDL believes that any regulations put forward by GIC should be sufficiently flexible to allow the GIC to respond to the individual circumstances of a particular insolvency as details come to light; without prescriptive regulation forcing action in a way which may be contrary to the best solution in a particular case. MDL is generally in support of the goals contained within objectives two, three and four. MDL does not support reliance on regulation created from scratch under urgency. Action under these circumstances is not certain and cannot usually be commenced until the situation is seen to be serious. It can also be expected to take some time even if all the parties are willing. However as noted above, for a large retailer the situation with unpaid gas bills may become serious quite quickly. **Powerco** The E-Gas situation highlighted the importance of having a regulatory back-stop. The regulations helped ensure the process was resolved quickly and provided more certainty - this was very reassuring to Powerco. The gas industry is battling with persuading people to switch or stay on reticulated gas. We must give consumers confidence that when they buy a gas appliance and make an investment for 10 or more years, they will continue to receive a high quality of service. The gas industry cannot afford reputational damage and confidence in the gas industry being undermined. All risks must be carefully managed – and we see retailer insolvency as a very real risk. We recognise the GIC's concern that it is difficult, and potentially costly, to make regulations that cater for small and large retailers becoming insolvent. However, we do not think it is impossible and request that the GIC at least examine the issue in more detail. At this time, Powerco does not have suggestions on the content of regulations, but the outcomes we would be looking for are: • regulations as part of a process which ensures a quick and assured transfer of customers to recipient retailers, providing certainty as to how the situation will be resolved; • customer interests are protected;

	• the carry-on of business as usual processes as much as possible; • minimise incentives for parties to „game" the system; and • clear communication of information between affected parties.
Q6 Are there others that an insolvent retailer policy should address?	**Genesis** Genesis Is not convinced that the case for backstop regulations of this nature has been establish and are concerned that such regulation may not be in the long term interests of consumers. [Any]Regulations should provide any necessary administrative provisions such as allowing the GIC to stand in the shoes of an insolvent retailer with respect to switching requests. Genesis expects there may be a case for regulations of some type to deal with issues surrounding retailer insolvency; however, there is a need to tread carefully to avoid unintentionally raising costs that will ultimately be borne by all gas consumers. Genesis considers that a constructive approach to dealing with stranded customer issues could be to establish clear processes for distributors to disconnect stranded customers. **Mighty River Power** Financial risk – GIC to other retailers, a retailer may not be ready to trade in an area which may prove to be costly (in the case of retailers being allocated customers of a type or area they don't normally service). **Nova Gas** **Vector** Vector believes that lessons have been learned from the E-Gas insolvency. It would be unfortunate if these lessons and the current Regulations were not utilised to the fullest extent to form the basis of a robust set of amended permanent regulations. In addition to the proposals identified above, permanent regulations should cover the prospect of added complications that would occur in the case of a large retailer becoming insolvent (i.e. capacity of other retailers to absorb customers) and over peak periods such as winter. We further propose that the GIC prioritise its work on improving the integrity of the Gas Registry, including ensuring that the Registry accurately reflects the on-site status of ICPs. This will ensure a smooth transfer of the insolvent retailer's customers to other retailers. **Contact** No. **MDL**

	Powerco
Q7 Are there any other options that Gas Industry Co should consider?	**Genesis** GIC should consider making clear provision for a robust credit disconnection process by distributors. Refer Q4 and cover letter. GIC could also consider applying different provisions for different types of customer. For example, regulatory transfer of large customers poses a different type of problem for receiving retailers than regulatory transfer of large numbers of small customers. **Mighty River Power** 1. It is not practical to require a subsequent retailer to honour the exact contract terms of the insolvent retailer. 2. Important to build customer choice into a process. Broadly the process would be: a) Insolvent retail looks for buyer of retail book b) Consumers not on sold are given communication to look for retailer of their choice (obviously exact mechanisms would need further discussion but detail not necessary for legislation c) Allocated (forced) transfer of remaining customers to suitable alternative retailers Important to not leap straight from step a to c with no regard for consumer choice. 3. Pre trading Audit : Follow a similar process to the Health sector, audits should carried out before a retailer is given approval to trade (making sure there are systems and processes in place prior to trading) and after six months a surveillance audit to ensure that the new retailer is following the systems and processes – all new retailers need to prove they are compliant within the first 6 months of trading or should need to stop trading till they are fully compliance because of the impact to the rest of the market. **Nova Gas** Ideally, industry arrangements should support commercial arrangements between customers and suppliers that reflect risk of non supply through events such as insolvency. Customers should face incentives to consider the risk of supplier default when contracting and suppliers should be incentivised to manage their risks appropriately. Regulatory solutions tend to protect suppliers and customers and dilute these considerations in normal day to day market conditions and that is why Nova prefers a minimalist regulatory approach so that the consumers bear some of the risk of their retailer selection forcing suppliers to deal with their concerns about ability to deliver on the contractual commitments and manage their business accordingly.

	Vector A desirable outcome would be an alignment between the insolvency regulations for the gas market and the default arrangements being developed by the Electricity Authority ('EA'). We note that the issue of retailer defaults has been a long-standing item on the EA's work plan. Although the EA recognises the 'low probability of occurrence' of retailer defaults and that retailers exiting the electricity market in the past have all involved orderly customer transfer between retailers, Vector would encourage the GIC to proactively seek harmonisation with the EA on this subject, which is important to both industries. The EA has recognised that the Electricity Industry Participation Code could be amended relatively quickly to allow for such default arrangements. The lack of insolvency regulations for electricity, however, should not prevent the GIC from developing permanent regulations that address the unique needs and features of the gas market and its participants. **Contact** No. **MDL** **Powerco** During the E-Gas case, emergency regulations were able to be passed within two weeks from their inception. The GIC suggests that creation of regulations in this manner may be a feasible back-stop option. Powerco has four concerns with using emergency regulation powers: • there is a risk that regulations may not be able to made under urgency in the future; • there are many advantages of regulations being made in advance – eg once the event happens, companies are trying to manage a number of risks and it is very hard to get an industry consensus as companies may start 'game playing'; • just because relatively good quality regulations were able to be written in two weeks, does not mean this will happen in the future – eg people with the level of expertise may leave the GIC or there may be less time; and • finally, and most significantly, the philosophical basis of Government being able to impose laws and regulations on citizens requires a process to be followed. For example the Cabinet Manual provides a robust and democratic process to make regulations, including widespread consultation and a 28 period of notification. A decision that undermines this process must be made with caution.
Q8 What are your views concerning	**Genesis**

alignment with the default arrangements being developed by the Electricity Authority? Are there opportunities for harmonisation that we have not identified?	Ideally, we would welcome alignment between the Electricity Authority and the GIC. The policy problem is essentially identical and may parties are participants in the gas and electricity markets. It could prove problematic if insolvency of a dual-fuel retailer was covered by two incompatible regulatory regimes. Mighty River Power It will be ideal to have the Electricity and Gas aligned. **Nova Gas** It would be useful at a practical level (if not regulatory) given the fact that many gas consumers (residential in particular) are supplied with electricity by the same retailer. 'Dual fuel' arrangements are very common in today's energy market so there would be some efficiency benefits of alignment of retailer insolvency arrangements. Apart from On Gas and Greymouth Petroleum (who we believe has also signalled an interest in retailing electricity) all other gas retailers are also electricity suppliers so an insolvency event is the gas industry is likely to also involve electricity consumers. **Vector** **Contact** Given the links between the gas and electricity markets, and the presence of some participants in both markets, it would be sensible to provide for alignment where it was appropriate and where it provided certainty for participants and consumers. It is acknowledged that the difference in governing regulation may limit the ability for high levels of alignment. **MDL** **Powerco**