

Memo

To
Settlement and Prudential
Security Technical Group

From
Tony Dellow
Anna Parker

Date
4 December 2012

Settlement and Prudential Security Review - further questions to be considered by Buddle Findlay

1. This memo sets out further questions that are going to be considered by Buddle Findlay in relation to the Electricity Authority's Settlement and Prudential Security Review project.

Access to future generation revenue of an insolvent generator

2. Question 7 of the questions circulated to SPSTG members on 27 November 2012 states:

Suppose a purchaser has some generation that partially offsets their purchases. Suppose prices go high and the purchaser becomes insolvent and defaults. What is the risk that the clearing manager will not have access to future generation revenue associated with those generators to offset the clearing manager's exposure to the purchaser over the 21 day exit period? What are the implications for the calculation of the clearing manager's future exposure to the participant for prudential purposes?

3. In the above question, if the insolvent generator's generation is sold or controlled by a receiver, there is a risk that the clearing manager will not be able to set off the generation revenue against purchases being made by the generator. Given the clearing manager takes into account future generation revenue when assessing prudential security, one of the key questions that is related to the above question is whether or how the clearing manager can safeguard that generation revenue for the 21 days of the initial margin period. For example, can the clearing manager's interest in the future generation revenue be protected by some sort of charge or security interest over 21 days of future generation revenue? Buddle Findlay is going to further consider these questions.

Forms of security

4. Buddle Findlay is also going to consider the extent to which the measures described as acceptable security in the Electricity Industry Participation Code actually provide security. Under the current Part 14 of the Code, the following are included in clause 14.5 ("Acceptable forms of security"):

LAWYERS

WELLINGTON

State Insurance Tower
1 Willis Street
PO Box 2694
Wellington 6140
New Zealand
DX 5P20201
Tel 64-4-499 4242
Fax 64-4-499 4141

AUCKLAND

PricewaterhouseCoopers Tower
188 Quay Street
PO Box 1433
Auckland 1140
New Zealand
DX CP24024
Tel 64-9-358 2555
Fax 64-9-358 2055

CHRISTCHURCH

245 St Asaph Street
PO Box 322
Christchurch 8140
New Zealand
DX WP20307
Tel 64-3-379 1747
Fax 64-3-379 5659

- (a) Cash deposits;
 - (b) Guarantees and letters of credit;
 - (c) Security bonds;
 - (d) Hedge settlement agreements for settlement by the clearing manager.
5. Another issue that arises in this regard is that an acceptable credit rating means that a participant does not need to provide any security.
6. It is proposed that further consideration will be given to the extent to which the above satisfactorily secure performance of the obligation of payers to the clearing manager under Part 14 of the Code. In particular, Buddle Findlay will further consider the nature of hedge settlement agreements and the rights of the clearing manager under such agreements.

Other matters

7. As part of drafting the proposed new Code provisions, Buddle Findlay will also consider the relationship between general insolvency law and the Code.
8. Buddle Findlay will also consider other matters as necessary as they arise during the project.

Tony Dellow / Anna Parker