



Trustpower Limited

Head Office  
108 Durham Street  
Tauranga

Postal Address:  
Private Bag 12023  
Tauranga Mail Centre  
Tauranga 3143

F 0800 32 93 02

Offices in  
Auckland  
Wellington  
Christchurch  
Dunedin

Freephone  
0800 87 87 87

[trustpower.co.nz](http://trustpower.co.nz)

18/05/2021

Submissions  
Electricity Authority  
Level 7, ASB Bank Tower  
2 Hunter Street  
P O Box 10041  
WELLINGTON

By email: [wholesaleconsultation@ea.govt.nz](mailto:wholesaleconsultation@ea.govt.nz)

## TRUSTPOWER SUBMISSION: INTERNAL TRANSFER PRICES AND SEGMENTED PROFITABILITY REPORTING

### 1. Introduction and overview

- 1.1. Trustpower Limited (**Trustpower**) welcomes the opportunity to make a submission to the Electricity Authority (**Authority**) on its *Internal transfer prices and segmented profitability reporting* consultation paper (**the Consultation Paper**).
- 1.2. The Authority is consulting on its proposed changes to the Electricity Industry Participation Code 2010 (**Code**) to:
  - a) mandate that large integrated generator retailers publish their internal transfer price (**ITP**) and ITP methodology annually; and
  - b) require reporting of segmented gross-profitability of electricity retail businesses.
- 1.3. These proposed changes are intended to progress the implementation of the Electricity Price Review, D3 recommendation (**D3 recommendation**), which addresses the mandatory reporting of ITPs by generator retailers and segmented profitability reporting by retailers.<sup>1</sup> We support the progression of the D3 recommendation.
- 1.4. We, however, have issues with the detail of the implementation of the D3 recommendation. We focus on the drafting of a number of clauses included in the proposed Code attached to the Consultation Report, which we consider exceed the requirements of the D3 recommendation; risks increasing compliance costs; and risks reducing the incentive to invest and the level of competition.

---

<sup>1</sup>Ministry of Business, Innovation & Employment, *Electricity Price Review: Final Report*, 21 May 2019, page 45.  
<https://www.mbie.govt.nz/dmsdocument/6932-electricity-price-review-final-report>



- 1.5. Our submission addresses the following key points:
  - a) The specification of the ITP information disclosure should be more precisely defined;
  - b) The Code should not require the public disclosure of commercially sensitive information; and
  - c) Requiring either a director's, chief executive officer's or chief financial officer's assurance that the information submitted complies with the Code would be more effective and efficient than the process specified in the proposed Code.
- 1.6. We note for completeness that we consider that the requirements for the reporting of the electricity-specific retail gross margin as drafted in the proposed Code implements the D3 recommendation. We would not support further amendments that would require the reporting of additional or more detailed information.
- 1.7. We will address points a) to c) listed above in more detail in the remainder of this submission and attachment.

## 2. Mandatory disclosure of ITP information by generator retailers

### Definition of ITP information disclosure

- 2.1. Trustpower supports the disclosure of information that is necessary for the calculation of a generator retailer's ITP for the previous financial year as specified by clause 13.256(2)(a) of the proposed Code. We envisage that this information would enable a comparison of generator retailers' ITP similar to the comparison between the ITPs of the 5 largest generator retailers presented in Figure 2 of the Consultation Paper.
- 2.2. We, however, have issues with clause 13.256(2)(b) of the proposed Code, which would require the ITP information disclosure to also include:
 

*"(b) information on how the generator retailer has determined the retail ITP at a sufficient level of detail to enable a reasonable person to determine whether or not the generator retailer's retail ITP is a fair reflection of the cost of electricity to the generator retailer."*
- 2.3. Of particular concern is the statement "... fair reflection of the cost of electricity ...". This statement has not been defined in the paper nor in the proposed Code. No transparency or certainty has therefore been provided as to how this statement should be interpreted or applied to the calculation of the ITP.
- 2.4. This lack of transparency and certainty creates regulatory risk that exposes the industry to an ongoing reinterpretation of clause 13.256(2)(b). For instance, the statement does not address the appropriate cost standard that should be applied when determining whether a generator retailer's ITP is fair.
- 2.5. Economic regulators in other industries and jurisdictions have implemented a wide range of different cost standards when addressing similar regulatory problems. Best regulatory practice in these cases suggests that a decision regarding the cost standard requires a clear assessment of market conditions; the identification of any issues; an assessment of options for addressing issues; and then consideration of methodological questions regarding the choice of cost standard. The Authority has not consulted on any such matters previously and does not provide sufficient evidence on these matters in the Consultation Paper for comment.
- 2.6. Of greater concern, though, is that the statement can be interpreted as providing a guiding purpose. That is, it raises the potential interpretation that the purpose of the ITP information



disclosure is to determine whether generator retailer's retail ITP is a fair reflection of the cost of electricity.

- 2.7. If this interpretation is applied to the ITP information disclosure, then it would amount to a significant regulatory intervention requiring a generator retailer's ITP to be cost orientated. The Authority has not provided evidence to support such a significant regulatory intervention. This interpretation would amplify the regulatory risk and increase the industry's exposure to unintended adverse consequences.
- 2.8. As currently drafted, clause 13.256(2)(b) may result in the emergence of the regulation of ITPs. We acknowledge that this outcome may not be the Authority's intent.
- 2.9. This concern is highlighted by the benchmark study reported in Figure 2 of the Consultation Paper. Figure 2 with the associated explanation suggests that the purpose of the ITP information is to determine whether generator retailer's ITP is a fair reflection of the cost of electricity as determined by a range of external benchmarks.
- 2.10. Two comparisons are made in benchmark reported in Figure 2. As already noted, firstly, Figure 2 provides a comparison between the ITPs of the 5 largest generator retailers. Secondly, it provides a comparison between the ITPs and an "external benchmark" price range deemed to be available to independent retailers through the ASX futures market.
- 2.11. It is this second comparison included in Figure 2 that amounts to a regulatory intervention aligned with clause 13.256(2)(b). The prices available to independent retailers through the ASX futures market are used here to determine whether ITPs of the 5 largest generator retailers provide a fair reflection of the cost of electricity. Yet, no evidence has been provided to support whether this approach to benchmark ITPs is appropriate. This lack of evidence means that we are not able to comment on whether the benchmark is appropriate.
- 2.12. We therefore submit that the drafting of clause 13.256(2)(b) should be amended to read:
 

“(b) information on how the generator retailer has determined the retail ITP at a sufficient level of detail to enable a reasonable person replicate the calculation of the average load weighted retail ITP.
- 2.13. This drafting would require generator retailers to provide the necessary transparency to explain the derivation of their ITPs.

### Public disclosure of commercially sensitive information

- 2.14. Trustpower agrees with the statement made in the Consultation Paper (para. 3.80):

*“Requiring the disclosure of information which is commercially sensitive could undermine confidence and result in reduced investment and competition, thereby forgoing the attendant consumer benefits that implies.*

- 2.15. This statement correctly highlights the risks and issues associated with publicly disclosing commercially sensitive information. It is for this reason that we expect the Authority to treat any commercially sensitive information it receives appropriately and takes all appropriate actions to preserve its confidential status.
- 2.16. The Consultation Paper, however, goes on to state (para. 3.81):
 

*“The Authority is confident that nothing which is being requested with respect to ITP disclosures is confidential as:*

  - (a) much of the information is disclosed voluntarily already*
  - (b) generator-retailers have stated that their ITPs are not core to their comparative advantage*
  - (c) the methodologies draw on public prices, historic data, and load characteristics.*



- 2.17. We disagree with the Authority's assessment and note that a significant proportion of the information that would be required to be disclosed publicly is commercially sensitive.
- 2.18. The disclosure of this commercially sensitive information would place Trustpower at a significant comparative disadvantage in commercial negotiations. We, therefore, do not expect to be required to disclose this information because it would *"undermine confidence and result in reduced investment and competition, thereby forgoing the attendant consumer benefits that implies"*. The relevant clauses that should be removed from the proposed Code, because they would result in public disclosure of commercially sensitive information, include:
- 13.256 (3)(a)(iv) &(v);
  - 13.256 (3)(c)(i) (A), (B), (C) & (D); and
  - 13.256 (3)(c)(v) & (vi).
- 2.19. The attachment to this letter gives the reasons that the information covered by these clauses is commercially sensitive.

### Information that is not relevant to determine the ITP

- 2.20. Clause 13.256(3)(e) requires the generator retailers to disclose the purpose of the ITP, as it affects *"... the price of electricity sold to mass market customers by the generator retailer"*.
- 2.21. Whether or not the derivation of the ITP as specified by cl. 13.256(2)(a) affects the price of electricity sold to mass market customers will depend on the commercial strategies of individual generator retailers. In other words, the ITP may be relevant to some generator retailers and may be irrelevant to others. Furthermore, these strategies may be commercially sensitive for some generator retailers. Requesting such information from generator retailers may not provide the Authority with what it had envisaged.
- 2.22. We therefore submit that clause 13.256 (3)(e) should be deleted from the proposed Code.
- 2.23. We recognise, though, the value in monitoring and identifying any relationship between the retail ITPs and retail prices. We suggest that a more objective approach to do this would be to monitor for any relationship between retail ITPs and retail prices directly.
- 2.24. Such a monitoring regime would require retail price data that would complement the retail ITP data. The MBIE's electricity cost and price monitoring series might be a source for this retail price data.<sup>2</sup> We note that the published retail prices are an average for the whole industry rather than for each retailer. We assume, though, that MBIE has the price data for each individual retailer, as it has had to calculate the weighted average.
- 2.25. Another clause that we consider redundant to the determination of the retail ITP, and which we submit should also be removed, is clause 12.258(2) in the proposed Code. It sets out the information that a generator retailer would be required to report when it makes a change to the methodology used to determine its retail ITP for the current financial year.
- 2.26. Clause 12.258(2) requires the generator retailer to calculate and disclose the impact of the new methodology on the average load weighted retail ITP for the previous three financial year as if the new methodology had been used to determine the retail ITP for those previous years. It is very likely, however, that such a disclosure will be misleading as the change circumstances or market

---

<sup>2</sup> <https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-statistics-and-modelling/energy-statistics/energy-prices/electricity-cost-and-price-monitoring/>



conditions that resulted in the new methodology may not be applicable or relevant to the preceding years.<sup>3</sup>

### 3. Compliance with the Code

- 3.1. Trustpower supports the requirement that generator retailers and retailers provide an assurance that their disclosed ITP information and their reported retail gross margin comply with the Code.
- 3.2. We submit that the first step in assuring compliance with the Code is to ensure that the Code itself clearly specifies disclosure and reporting requirements. If the Code is not clearly drafted, then there will be uncertainty regarding whether a report or disclosure complies. This would expose the generator retailers and retailers to an uncertain interpretation of the Code, regulatory risk, and ongoing rework, which would raise the cost of compliance.
- 3.3. Our submitted amendments to the proposed Code are intended to provide clarity and reduce the uncertainty in the current drafting.
- 3.4. We submit that the next step to assure compliance with the Code should be for either a director, chief executive officer, or chief financial officer to provide a representation that the report or disclosure is complete, accurate and complies with the Code. This would be the same as the sign off process that has recently been implemented for the quarterly wholesale market information disclosure requirements under the Code. We highlight here that the director, chief executive officer or chief financial officer takes their duties under the Code very seriously, and acts with diligence and care when providing a representation.
- 3.5. The final step in assuring compliance is that should the Authority find evidence to suggest that a disclosure or representation might not comply with the Code, then the Authority currently has the power to undertake a compliance investigation.
- 3.6. The proposed Code would also raise a substantial ongoing regulatory risk and have the potential to increase compliance costs across the industry.
- 3.7. Clause 13.262 in the proposed Code states:
  - (1) *The Authority may, in its discretion, require a review by an independent person of whether—*
    - (a) *a generator retailer may not have complied with any or all of clauses 13.256 to 13.258; and*
    - (b) *a retailer may not have complied with clause 13.260.*
- 3.8. We have concerns with the proposed discretion that the Authority would grant itself. The Authority does not provide any transparency here as to the criteria or threshold that it would apply to determine whether it would require a review.
- 3.9. This lack of transparency means that the industry does not know when or why one generator retailer or retailer might expect to be reviewed and not another. If no criteria were provided *ex ante* to guide the decision between information submissions that may require review and those that would not, then this may lead to the outcome where the Authority simply requires all information disclosures to be reviewed.
- 3.10. This situation, at a minimum, would substantially raise the cost of compliance across the industry as each generator retailer would be required to undertake their own review and engage its own independent expert. Alternatively, it may not be feasible to implement such an industry wide review given the limited number of experts who have the capability to conduct such a review.

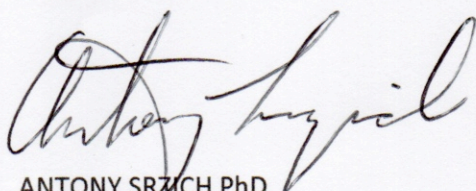
---

<sup>3</sup> We note that the Authority might have an alternative interpretation for clause 13.258(2). If that is the case, we would be grateful for the opportunity to clarify this point.



- 3.11. An additional concern that we have with the approach the Authority has proposed to assure compliance follows from the first step in assuring compliance as noted above – i.e. to ensure that the Code itself clearly specifies disclosure and reporting requirements.
- 3.12. We have identified above a number of clauses that should be amended or removed completely because amongst other things they have not been precisely drafted. If these clauses remain in the final draft of the Code, then an independent person conducting the review would be required to provide their view as to whether an information submission complies.
- 3.13. This situation could create the potential for several competing interpretations of compliance to emerge. That is, the Authority, the independent person, and the generator retailer or retailer could have differing views regarding the specific requirements that should be met in order comply with a clause.
- 3.14. In conclusion, we submit that clauses from 13.262 to 13.266 in the proposed Code should be removed because they may result in several competing views regarding the requirements for compliance, they may increase compliance costs across the industry, and they introduce a process that differs from compliance mechanisms that has been recently implemented in the Code.
- 3.15. For any questions relating to the material in this submission, please contact me on 027 305 8802.

Regards,



ANTONY SRZICH PhD

ADVISOR – STRATEGY & REGULATION



## Attachment – Identification of the commercially sensitive information

Proposed Code Clause 13.256(3)	Reason information is commercially sensitive
<p>(a) a breakdown of the key components or factors which make up the retail ITP expressed as an amount in dollars and cents per MWh that each key component or factor comprises of the average load weighted retail ITP required by subclause (2)(a), and which must include, (if relevant) the following components or factors:</p> <p>...</p> <p>(iv) the level of discretion the generator retailer exercised to amend or otherwise modify the draft retail ITP before it was finalised:</p> <p>(v) all other key components or factors the generator retailer relied on to determine the retail ITP, and any other material information used by the generator retailer to determine the retail ITP that is not publicly available:</p>	<p>This clause would require the public disclosure of management's views regarding exposure to market risk which would place Trustpower at a competitive disadvantage in the retail market.</p> <p>Furthermore, this clause would explicitly require the public disclosure of information that is not publicly available, which may include commercially information, or third party information (e.g. expert reports) that Trustpower may not be able to disclose due to contractual limitations.</p>
<p>(c) an explanation of the methodology the generator retailer used to determine or to assist in determining the retail ITP, and which must include (if relevant) the following:</p> <p>(i) the assumed process used by the generator retailer to build the hedge book of ASX NZ electricity futures, including the following:</p> <p>(A) the proportion of ASX NZ electricity futures the generator retailer assumed would be purchased and the assumed timing of those assumed purchases:</p> <p>(B) the relative weighting of ASX NZ electricity futures relating to Benmore as compared to those relating to Otahuhu:</p> <p>(C) the types of ASX NZ electricity futures the generator retailer assumed to be purchased and the maturities purchased:</p> <p>(D) the basis on which the ASX NZ electricity futures are priced:</p> <p>...</p> <p>(v) the basis for and rationale behind any discretion the generator retailer exercised:</p> <p>(vi) any other details the generator retailer considers material to explain the methodology the generator retailer used to determine or assist in determining the retail ITP:</p>	<p>This would require the disclosure of management's views of Trustpower's exposure to the risk in meeting future demand for electricity. Disclosing this information would place Trustpower at a disadvantage when negotiating electricity supply agreements with other generators.</p>