

Internal Transfer Price and Retail Gross Margin post implementation review

7 November 2024

Executive summary

From 30 November 2021, the Electricity Industry Participation Code (Code) has required generator-retailers (gentailers) to disclose their internal transfer price (ITP) figures and methodology and certain retailers to submit their retail gross margin (RGM) figures to the Authority on an annual basis. This was in response to recommendation D3 from the 2019 Electricity Price Review.

The Electricity Authority Te Mana Hiko (Authority) carries out post-implementation reviews to establish whether Code amendments or market facilitation measures deliver intended benefits and impacts on market behaviour. The Authority has carried out a post-implementation review of the ITP and RGM Code provisions.

This paper provides a summary of feedback received about the disclosure of ITP and RGM information, and particularly about whether those disclosures have improved participant confidence in electricity retail market competition.

Feedback was collected from the 10 participants required to submit this information. There was a general consensus that the current ITP and RGM reporting had limited usefulness. Gentailers reported they use ITP for accounting purposes, and do not use ITP to set retail prices. Non-integrated retailers believe ITP and RGM disclosures (in their current form) have little practical importance to them, although some participants indicated they believe publishing ITP figures has helped improve information transparency.

Non-integrated retailers consider the original intent behind the ITP and RGM sections of the Code has not been achieved since neither metric has provided assurance about the competitive operation of the electricity market (in this case, in relation to gentailer retail pricing) or increased participant trust and confidence. For gentailers disclosing those figures it appears to be a compliance obligation and the disclosed figures have little impact on their operations.

The Authority has considered the impact of ITPs on retail competition, in the context of the availability and pricing of risk management options, in our risk management review issues paper, published alongside this post-implementation review. While the Authority does not consider the ITPs are causing any specific competitive harm, it seems clear that some change should be made, ie, that disclosing ITPs and RGMs (which are based on ITPs) in their current form has not had the impact that the Electricity Price Review intended and is a regulatory requirement of limited, if any, benefit.

We appreciate some participants have made suggestions about how the ITP/RGM disclosure regime could be improved. Subject to considering stakeholder feedback in response to its risk management reviews issues paper, the Authority intends to reconsider the role of ITPs and the ITP/RGM disclosure regime, directly after it finalises its findings from that review. However, given the current disclosure regime imposes compliance costs with limited apparent benefit to participants or consumers, the Authority intends to develop a proposal to remove and/or replace the current disclosure rules.

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1. The disclosure requirements were put in place to reduce information asymmetry

- 1.1. The 2019 Electricity Price Review noted concerns raised by some stakeholders that gentailers may “be making excessive profits and favouring their retail arms to undermine competition”,¹ with a specific focus on the price for transferring electricity between their generation and retail businesses.
- 1.2. The 2019 Electricity Price Review recommended making gentailers release information about the profitability of their retailing activities, including disclosing their ITPs (Recommendation D3). In response, the Authority looked at solutions to improve participant information disclosure, aiming to reduce information asymmetry in the market and increase transparency around retailer pricing practices.
- 1.3. The Authority amended the Code, which took effect on 30 November 2021, to require the disclosure of retail ITP information by gentailers. That Code amendment also included a requirement to disclose RGMs by all retailers with over 1% of ICPs, which in the Authority’s view at the time was likely to improve all parties’ understanding of the competitive behaviour of retailers.²
- 1.4. The ITP is the price gentailers use for accounting purposes to split out their wholesale and retail functions, ie, the price of the electricity that their wholesale function “sells” to their retail function. The ITP section of the Code requires gentailers to disclose ITP information, with sufficient detail, to enable a reasonable person with an understanding of the wholesale market to determine how ITP prices are set.
- 1.5. The RGM is the remainder from electricity retailer revenue left over once the cost of electricity, metering, distribution, transmission services and levies have been subtracted. For gentailers, the cost of electricity is based on their ITP. The resulting RGM therefore includes the retail cost of service and any retail profits (based on the assumed cost of electricity). The Authority said in its 2021 [decision paper](#) that “This will inform the Authority on the pricing practices used within gentailers and establish whether they are providing electricity at below efficient market prices to their own retail arms”.³
- 1.6. The aim of both sets of information disclosure requirements was to help the Authority identify whether electricity markets are functioning competitively so trust and confidence in the wholesale market is strengthened. The Authority also aimed to provide assurance to participants about the competitive operation of the electricity market through improved transparency, by publishing key metrics on a centralised disclosure platform and facilitating their interpretation through appropriate benchmarks.
- 1.7. The purpose of this review is to see whether these sections of the Code have delivered on these objectives.

¹ *Electricity Price Review*, May 2019, 19 <https://www.mbie.govt.nz/assets/electricity-price-review-final-report.pdf>

² Sections 13.256 to 13.260 under Clause 5 of the Code were inserted.

³ https://www.ea.govt.nz/documents/2592/Wholesale-markets-Internal-transfer-prices-and-segmented-profitability-reporti_Onm0Deh.pdf

2. Participants have submitted the required data on time

- 2.1. Gentailers are required to submit ITP data and RGM data. Retailers with a market share of 1% or more of active ICPs for the preceding 12 months are required to submit RGM data. These participants are required to submit their data within 90 days of the end of their financial year. Information is submitted through the Authority's Information Provision platform.
- 2.2. Affected participants have submitted their ITP and RGM data twice, for the years of 2022 and 2023. In 2022 gentailers provided ITP data from 2018 to 2022.
- 2.3. Ninety percent of submissions were submitted on time, with late submissions resulting from issues connecting with the Information Provision platform.⁴

3. Published data could be more timely, but is an accurate reflection of the current requirements

- 3.1. To protect the anonymity of non-integrated retailers, RGM data is only published once all submissions are received. As retailers follow different financial years this means the publication of some data is delayed. The combination of different financial years also reduces the comparability of the data.
- 3.2. After RGM data is submitted, information from retailers with less than 5% of ICPs is anonymised and RGM data is published in the Authority's Retail Gross Margin public dashboard.⁵
- 3.3. ITP data is also only required to be submitted after the end of each gentailer's financial year (ie, at the same time RGM data is required to be submitted). While most gentailers have the same financial years,⁶ the Authority has so far published the ITP data at the same time as the RGM data. One concern raised by participants is that ITP data is not published in a timely manner.
- 3.4. The way in which the Code outlines the method retailers should use to calculate their RGM does not necessarily align with the method retailers use in their financial reporting due to different cost categories specified in the Code. However, retailers have indicated that the methodology in the Code broadly aligns with their own methods. Reasons for discrepancies between public financial reporting and submissions are known to the Authority, and the Authority is satisfied the currently reported figures are consistent with what is requested in the Code.⁷

⁴ When asked for their feedback on the submission process, participants responded that the submission process was fairly smooth. Some participants commented that the platform requires participants to disclose information using fixed form fields that do not always match their internal reporting style and would prefer to submit their own documents instead.

⁵ <https://public.tableau.com/app/profile/electricity.authority/viz/Retailgrossmargin/Retailgrossmargin>

⁶ The exception being Manawa.

⁷ To check the accuracy of RGM submissions, Authority staff cross-referenced RGM information with relevant data found in publicly available reporting on retailers' websites. This was primarily done using gentailers' quarterly and annual financial disclosures as non-integrated retailer financial information was

- 3.5. Volume, revenue, cost, and other buckets to be used to calculate a retailer's RGM in the Code are defined in such a way that there is room for interpretation from retailers as to how best to fit their figures into the categories provided by the Authority. Retailers' RGMs may not be directly comparable as a result, so some caution should be exercised when directly comparing them. RGMs also do not necessarily account for retail operating expenses such as staff costs, property, bad debt or other overheads.

4. Participant feedback suggests the disclosure obligations have limited usefulness

- 4.1. As part of the review, interviews were conducted with affected participants to gather their feedback on the ITP and RGM sections of the Code. Questions were asked about the participants' perspectives on the effectiveness of those metrics, the process of reporting and specifics around the methodology used to calculate figures.
- 4.2. Ten participants (non-integrated retailers and gentailers) were interviewed between 2 October 2023 and 8 December 2023. This section provides a summary of some of the findings from these interviews.

ITPs are accounting measures only

- 4.3. Gentailers said that the ITP section of the Code broadly reflects the approach they use to calculate their ITP figures. Most gentailers use historical ASX prices to calculate a 3-year rolling average, adjusted for locational and seasonal factors with some other minor adjustments. The choice to use a 3-year average of ASX prices is for simplicity as it provides an independent market-based price (as though the business has two separate units).
- 4.4. Gentailers have stated (both in our interviews with them and in response to clause 13.256(3)(e) in the Code)⁸ that ITPs are designed to be used for internal accounting, as a performance measure, eg, as an internal benchmark to standardise the viewpoint on retail profitability, and/or for financial reporting purposes.
- 4.5. Gentailers said that ITPs are used as one input – alongside other inputs - for decision-making purposes and to inform mass-market prices. They said they are used as an indicator to assess *general trends* in the cost of energy but are *not* used as the definitive cost of energy.
- 4.6. To determine retail prices, gentailers said they also analyse and assess market conditions, geographical conditions, consumption profiles, competitor behaviour, market share, customer churn, regulatory conditions, and the balance of their

not as readily available. Staff also checked the accuracy of ITP submissions by using available data and following the ITP methodology provided by gentailers. Final figures were all found to be within an acceptable range of gentailer-provided ITP figures.

⁸ Clause 13.256(3)(e) requires gentailers to disclose “the purposes for which the retail ITP is used by the generator retailer, including whether the retail ITP is used as part of setting the price of electricity sold to mass market customers by the generator retailer”.

overall portfolio among other related factors. Gentailers said that ITPs are not used as a price point to sell to third parties.

- 4.7. According to gentailers, the price of Over-the-Counter (OTC) financial contracts (ie, bilaterally negotiated contracts) do not necessarily reflect ITP prices, instead they depend on a gentailer's capacity to provide the volume requested and offset the exposure through generation, wholesale market conditions, ASX prices, and locational and shape factors. The Authority's view on the use of these factors to determine OTC contract prices is discussed in more detail in the risk management review.

ITPs cannot be used to understand retail prices

- 4.8. Some participants indicated that they believe publishing ITP figures has helped improve information transparency by improving the general understanding of how ITPs are calculated and helped dispel misconceptions concerning their use. A few participants have said ITPs in some cases have provided another benchmark by which to assess their own wholesale electricity purchases. However, all participants showed some level of agreement that there is limited usefulness in having ITPs reported (as they are currently reported).
- 4.9. Criticisms of the current ITP reporting include that the differences between each gentailer's ITP calculation methodology make the ITP figures incomparable and reduce the functionality of the Authority's reporting. Some participants have expressed the belief that the current ITP methodology is flawed as it is backwards looking for a purpose that is ultimately forward-looking. Since ITPs are based on average historical baseload ASX electricity futures prices, they argue that ITPs are not a suitable measure for the *current* cost of buying wholesale electricity.
- 4.10. Some participants also mentioned that the current ITPs, besides being backwards-looking, also do not include any additional cost that non-integrated retailers would face if buying contracts more suited to their customer load profile. They are therefore not suitable for understanding retailer price setting practices.
- 4.11. Most non-integrated retailers indicated they would prefer to see a metric that was more representative of gentailers' retail price setting practices as the current ITP reporting has not fulfilled the purpose of increasing transparency around retailer pricing practices.
- 4.12. The gentailers are required in the Code to submit as part of the disclosure of ITPs "the purposes for which the retail ITP is used by the generator retailer, including whether the retail ITP is used as part of setting the price of electricity sold to mass market customers by the generator retailer". The answers to this question are published on the Authority's dashboard.
- 4.13. All gentailers said that they use the ITPs to provide segmented reporting for general reporting purposes, and to monitor general performance against others. Mercury said their ITP has "limited application in commercial decision making", Contact said that it is used for general reporting purposes "rather than necessarily the pricing decisions by Retail for its customers", and Meridian said that its "ITP is not used to price mass market retail customers".
- 4.14. The above statements all reinforce the conclusion above that the disclosed ITPs do not improve participants' understanding of the price setting processes of gentailers.

RGMs do not reflect a meaningful split in a gentailer's profits between wholesale and retail functions for any competition analysis

- 4.15. Given RGMs are based on ITPs for gentailers, feedback received on the RGM disclosure from non-integrated retailers mentions that the current RGM disclosure does not reflect a meaningful split between a gentailer's retail and wholesale profits. This is the same concern as reflected for ITPs – that is, current ITPs do not reflect how gentailers set their retail prices.
- 4.16. Non-integrated retailers also had concerns with how costs are reported in the RGM disclosures. There was concern that participants could impact competition through cost allocation decisions between bundled services if they are only asked to report margins for electricity.

There was not much feedback received on the ITP benchmarks

- 4.17. The Authority also publishes a series of benchmark ITPs alongside the disclosed ITPs.⁹ Benchmarks are calculated in the same way as the disclosed ITPs, from historical ASX prices adjusted for seasonal and location factors (the ITP dashboard provides more detail on these calculations). A total of nine benchmarks are calculated using historical data following methodologies meant to imitate the ones used by gentailers.
- 4.18. The rationale behind providing these benchmarks was to “facilitate the interpretation of the disclosed information and seek to improve participants’ understanding of the price setting processes of integrated generator retailers”.¹⁰ The benchmarks provide a broad range of possible objective costs of energy, although all based on historical baseload contracts, so only provide limited assurance. If a gentailer’s actual ITP falls outside the range set by the benchmark ITPs, this may indicate the ITP did not realistically reflect the cost of energy during that financial year.
- 4.19. All disclosed ITPs so far have fallen within the range generated by the benchmarks,¹¹ indicating that they are not outside of a broad range of objective measures of the cost of electricity (although backwards looking). One non-integrated retailer questioned the validity of using historical ASX prices in benchmark calculations. However, feedback was mainly focussed on the disclosed ITPs themselves.
- 4.20. While the benchmarks may have facilitated interpretation of ITPs (although no participants mentioned this to be the case), since they use the same methodology as the disclosed ITPs, they do not improve participants’ understanding of the price setting processes of gentailers, and there was no indication that the benchmarks provided any material positive reassurance to participants regarding electricity retail market competition.

⁹ https://public.tableau.com/app/profile/electricity_authority/viz/ITPbenchmarks/ITPbenchmarks

¹⁰ https://www.ea.govt.nz/documents/2592/Wholesale-markets-Internal-transfer-prices-and-segmented-profitability-reporti_Onm0Deh.pdf

¹¹ While the benchmark range is broad, all disclosed ITPs have been closer to the middle of the range rather than at the extremes.

Bundling makes RGM reporting more difficult

- 4.21. Feedback on RGM reporting has been mixed, but the majority of retailers indicated the methodology outlined in the Code is roughly reflective of the methodology they use to report their RGM figures. Most participants found the RGM reporting process to be relatively straightforward.
- 4.22. Some of the difficulty in reporting correct RGM figures has come from when participants offer an additional service to electricity and find it difficult to split out costs exclusively related to selling electricity from other parts of the business.
- 4.23. As a large percentage of RGM data is usually made publicly available by participants before they are published on the Authority's dashboard, RGM reporting tends to not benefit the market by introducing any new information. Most participants agree that the benefits of RGM reporting have come from having a centralised platform which gathers all the RGM figures in one place making it a convenient reference source.

Some participants gave recommendations for improvements

- 4.24. To improve current reporting some participants have recommended changes. Some suggestions include increasing ITP reporting frequency to present information in a timelier manner, shortening ITP and RGM figure publishing deadlines, splitting ITP reports by commercial or residential ICP types, clarifying RGM reporting guidelines on how participants should report their costs, with a more refined split of costs, and deanonymising RGM reporting to improve transparency and comparability between retailers.
- 4.25. A few non-integrated retailers expressed that ITP reporting should follow an exact methodology stipulated by the Authority to ensure replicability and consistency to improve comparability. However, when asked about the possibility of introducing a methodology requirement, retailers indicated this did not suit the purpose of what an ITP is intended to be used for and so would not be a suitable change to make.
- 4.26. One participant suggested that the Authority should require generators to disclose generation margins, as a way of enabling further comparability and transparency in the industry. The Authority has collected information on [energy margins](#) this year (from the start of July) after it opened an investigation into the high prices which occurred over winter. It is still to be decided how long this data collection will continue .
- 4.27. Many retailers have relayed that they do not see how ITP and RGM can be substantially changed to benefit the market without requiring consultation and fundamentally changing the ITP and RGM disclosure sections of the Code.

5. The initial intent behind the disclosure requirements has not been achieved

- 5.1. While the ITP and RGM disclosure requirements in the Code have been successfully implemented in the sense that ITP and RGM figures have been published and collected, the initial intent behind the 2019 Electricity Price Review's recommendation D3, and the subsequent introduction of the new section of the Code, has not been achieved. The main goal was to improve transparency around

gentailers' pricing practices between their retail and wholesale businesses to increase confidence in market competition.

- 5.2. Non-integrated retailers sought the disclosure of ITP and RGM information to provide transparency around retail pricing practices, but neither metric has met non-integrated retailer expectations for insight into what gentailers' retail prices are based on. Feedback from non-integrated retailers told us that the current ITP and RGM disclosure has little practical use to them. Additionally, the lack of timeliness of these disclosures makes them in any case less useful for current benchmarking.
- 5.3. Non-integrated retailers indicated they would like to see more transparency around wholesale contracting and retail price setting to increase their confidence in the market. As gentailers have indicated, ITPs do not play a major role in retail pricing practices, so a new metric or indicators, methodology or form of monitoring would be needed to satisfy demands for transparency.
- 5.4. The Authority has been working to improve transparency for wholesale contracting. New hedge disclosure obligations are being implemented in October 2024, and an OTC working group that was established facilitated a Code of Conduct for the OTC market and agreed to provide information for improved monitoring. However, ITPs fit outside of those regime improvements.
- 5.5. We accept the consensus from all parties that provided feedback to us that the current ITPs are not a useful measure for any assessment that is seeking to better understand competition in the retail electricity market. The ITP and RGM disclosure requirements have therefore not had the impact that the Electricity Price Review intended.
- 5.6. The question remains as to what changes should be made to the disclosure regime, or to the ITPs themselves (which are a critical input to the RGM disclosures). The Authority intends to reconsider this question – the role of ITPs and the ITP/RGM disclosure regime – directly after it has considered stakeholder feedback on its risk management review issues paper and finalised its review findings.