

To
Electricity Authority

For
Greg Williams
Advisor Wholesale

From
Sacha Judd
Matthew Farrington
Anna Parker

By
Email

Date
24 August 2011

Dear Greg

Impact of proposed stress test regime on continuous disclosure requirements

1. You have asked for advice as to whether continuous disclosure requirements mean that disclosing participants will be required to publicly disclose information prepared in accordance with the Electricity Authority's proposed stress test regime.
2. In summary, we do not consider the proposal to introduce risk disclosure statements should result in disclosing participants being obliged to make announcements under the NZX Listing Rules or the SOE Continuous Disclosure Rules, as (to the extent that risk disclosure statements even include material information):
 - (a) unless an exception to continuous disclosure applies, the material information should already have been publicly disclosed; and
 - (b) if an exception to continuous disclosure does apply, then merely reporting the material information to the Electricity Authority would not prevent the exception from applying.

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Background

3. The Authority is proposing to amend the Electricity Industry Participation Code to require "disclosing participants" to prepare risk disclosure statements. It is proposed that the following participants will be included in the definition of disclosing participants under the Code:
 - (a) a generator;
 - (b) a retailer;
 - (c) a person who consumes electricity that is conveyed to the person directly from the national grid; and
 - (d) a person who buys electricity from the clearing manager.

4. Under the proposed regime, disclosing participants will be required to apply a set of standard stress tests to their electricity market positions, and report the results of the tests to the Authority on a confidential basis in a risk disclosure statement. One of the reasons for the proposed stress test regime is that it will reduce the scope for disclosing participants to credibly claim that they were unaware of the risks associated with their chosen level of spot market exposure. Another reason is that it will provide information to the Authority as to the resilience of the system to possible shocks. The proposed content of risk disclosure statements is set out in the appendix to this letter.
5. In relation to the confidentiality of the risk disclosure statements, clause 13.236G of the proposed Code amendments provides:
 - (1) *subject to the Official Information Act 1982, the Authority must keep all risk disclosure statements submitted to the Authority confidential; and*
 - (2) *despite subclause (1), the Authority may publicise information regarding the risk disclosure statements in a form that does not associate specific information with any disclosing participant.*
6. Some participants have expressed concern that the proposed amendments to the Code will mean that they will be required to release their risk disclosure statements due to continuous disclosure requirements.

Continuous disclosure

Material information

7. Disclosing participants listed on the NZX and disclosing participants that are State-owned enterprises are obliged to publicly report "material information" under, respectively, the NZX Listing Rules and the SOE Continuous Disclosure Rules (collectively, the "**Continuous Disclosure Rules**").¹ "Material information" is defined (in summary) as information that is not already public, and that a reasonable person would expect to have a material effect on (respectively) the price of a listed issuer's quoted securities, or the current commercial value of a State-owned enterprise. Materiality is a question of fact that must be judged by on a case-by-case basis and decisions relating to materiality are ultimately a matter for the disclosing participant.
8. Stress test results will not automatically be "material information". For example, a disclosing participant may decide that the information contained in a risk disclosure statement is not material if:
 - (a) the information was already publicly available (e.g. it had been previously released);
 - (b) a stress test result would not have a material impact on the price/value of the disclosing entity, as the information was already priced-in to the price/value of the disclosing entity (e.g. "we have a policy of not hedging");

¹ The SOE Continuous Disclosure Rules are almost identical to the NZX Listing Rules, other than the definition of material information, as State-owned enterprises do not have quoted securities.

- (c) the results of the stress test are, in the disclosing entity's view, so unlikely to eventuate that no reasonable person would expect there to be a material impact on the price/value of the disclosing entity (e.g. the effect of a significant oil spike on a renewables-only generator).
9. We emphasise that the above are by way of example only; materiality must be judged by the disclosing participant.

Obligation to disclose

10. The continuous disclosure regimes adopt a "disclosure, unless..." principle. The presumption is that material information must be disclosed, unless an exception applies. To the extent that a stress test reveals, or a risk disclosure statement contains, material information, then a disclosing participant would be obliged to disclose that information under the Continuous Disclosure Rules, unless an exception applies.
11. This obligation applies regardless of whether or not the Authority also requires the material information to be disclosed to it. Unless an exception to continuous disclosure applies, the material information should already have been publicly disclosed.

Exceptions

12. The obligation to disclose is subject to certain exceptions. The obligation to disclose does not apply where:
- (a) a reasonable person would not expect the information to be disclosed; and
 - (b) the information is confidential and its confidentiality is maintained; and
 - (c) one or more of the following applies:
 - (i) the release of the information would be a breach of the law; or
 - (ii) the information concerns an incomplete proposal or negotiation; or
 - (iii) the information comprises matters of supposition or is insufficiently definite to warrant disclosure; or
 - (iv) the information is generated for the internal management purposes of the issuer; or
 - (v) the information is a trade secret.
13. The onus is on the disclosing participant to be satisfied that an exception applies. We note in this regard that all of (a), (b) and one element of (c) above must be satisfied; it is not enough that (for example) merely (a) or (b) are satisfied.
14. Paragraph (b) above requires that the material information be confidential and that confidentiality be maintained. However a proviso to this requirement specifically deems that confidentiality is not waived by providing information to a regulatory

authority. Therefore if a disclosing participant were able to rely on an exception to continuous disclosure, then merely reporting the material information to the Authority would not prevent the exception from applying.

Conclusion

15. In our view, the proposal to introduce risk disclosure statements would not result in disclosing participants being obliged to make announcements under the Continuous Disclosure Rules, as (to the extent that risk disclosure statements even include material information):
 - (a) unless an exception to continuous disclosure applies, the material information should already have been publicly disclosed; and
 - (b) if an exception to continuous disclosure does apply, then merely reporting the material information to the Electricity Authority would not prevent the exception from applying.
16. Therefore, the proposed amendments to the Code in relation to the stress test regime do not change the requirement for disclosing participants to disclose material information. On the contrary, the new stress test/risk disclosure statement obligations may well assist disclosing participants to comply with the continuous disclosure obligations by ensuring that disclosing participants turn their minds to such risks as they prepare the risk disclosure statement. This may assist in ensuring that there are no inadvertent breaches of the continuous disclosure rules through ignorance of risk situations.

Yours sincerely



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Appendix - Content of risk disclosure statements

Clause 13.236C of the proposed Code amendments provides that a risk disclosure statement submitted to the Authority must include the following:

- (a) for each stress test event, the change (as compared with the base case) in net cash flow from operating activities that the disclosing participant has calculated that it would experience if the circumstances set out in the stress test arose in the period specified in the stress test;
- (b) the disclosing participant's annual net cash flow from operating activities as set out in the disclosing participant's most recent set of audited annual financial statements;
- (c) the disclosing participant's level of shareholders' equity as set out in the disclosing participant's most recent set of audited annual financial statements;
- (d) the disclosing participant's forecast of the amount of electricity that the disclosing participant expects to purchase and sell on the wholesale market in the quarter to which the statement relates;
- (e) a statement certifying that the disclosing participant has provided to each of the disclosing participant's customers who, in the quarter to which the risk disclosure statement relates, has entered into or renewed a contract with the disclosing participant that results in any electricity supplied to the customer being determined directly by reference to the final price at a GXP, information to enable the customer to consider the outcomes of applying the stress test or stress tests to the customer; and
- (f) a statement certifying that the board of the disclosing participant has considered the risk disclosure statement.