APPENDIX 1

Extending the Mixed Ownership Model - Regulatory Impact Statement

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by The Treasury.

Cabinet agreement is being sought to extend the Mixed Ownership Model, with final decisions on implementation to be confirmed after detailed scoping study analysis.

In preparing its analysis, The Treasury has been constrained by the instructions from the Minister of Finance and the Minister for State Owned Enterprises to limit its analysis and advice to the merits and viability of:

- extending the Mixed Ownership Model to the following four State Owned Enterprises with the Crown retaining a majority stake in these companies:
    - Mighty River Power Ltd;
    - Meridian Energy Ltd;
    - Genesis Energy Ltd; and
    - Solid Energy Ltd;
- reducing the Crown's shareholding in Air New Zealand, with the Crown retaining a majority stake.

A copy of the Ministerial instructions to Treasury is available at http://www.comu.govt.nz/publications/information-releases/mixed-ownership-model/.

In addition, the Government has stated that it will only proceed with an extension of the Mixed Ownership Model if it meets the following tests:

- the Government would have to maintain a majority controlling stake by owning more than 50 per cent of the company;
- New Zealand investors would have to be at the front of the queue for shareholdings, and we would have to be confident of widespread and substantial New Zealand share ownership;
- the companies involved would have to present good opportunities for investors;
- the capital freed up would have to be used on behalf of taxpayers to fund new public assets and thereby reduce the pressure on the Government to borrow; and
- the Government would have to be satisfied that industry-specific regulations adequately protected New Zealand consumers.

These instructions have limited the range of potential options that The Treasury has analysed. Only the regulatory options that meet the Government's objectives and tests are covered by this Regulatory Impact Statement. Treasury has previously undertaken more detailed analysis of the pros and cons of Crown ownership, in advice now publicly available at the link above.

Extending the Mixed Ownership Model to the four State Owned Enterprises detailed above will involve some additional costs for these businesses. However, The Treasury considers that these additional costs will be more than offset by the potential to reinforce efficiency, fiscal, and capital market development policy goals providing moderate gains to the New Zealand economy as a whole.

Nic Blakeley, Manager – Sector Performance and Balance Sheet, COMU

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Status Quo

Genesis Energy, Mighty River Power, Meridian Energy, and Solid Energy are currently governed by the provisions of the State-Owned Enterprises Act 1986 and the Companies Act 1993. Section 11 of the State Owned Enterprises Act provides that Ministers are to hold all shares in State Owned Enterprises.

Air New Zealand is governed by the provisions of the Companies Act 1993. The Government currently owns 74.32% with the remaining 25.68% being available for private investment through listings on NZX and ASX. There are no legislative impediments to the Government reducing its shareholding in Air New Zealand.

Objectives

In his 26 January 2011 speech, the Prime Minister outlined the Government's desire to change the mix of assets the Government owns as an alternative to continued borrowing, and identified three main benefits from extending the Mixed Ownership Model similar, but not necessarily identical, to that currently applying to Air New Zealand:

i. broadening the pool of investments for New Zealand savers and deepening capital markets;
ii. sharper commercial disciplines, more transparency and greater external oversight for the companies involved; and
iii. providing the opportunity for the companies involved to obtain more capital to grow further, without depending entirely on a cash-strapped government to support them.

The Prime Minister also set out five tests in his speech that Government would need to be satisfied could be met before extending the Mixed Ownership Model:

iv. the Government would have to maintain a majority controlling stake by owning more than 50 per cent of the company;
v. New Zealand investors would have to be at the front of the queue for shareholdings, and Ministers would have to be confident of widespread and substantial New Zealand share ownership;
vi. the companies involved would have to present good opportunities for investors;
vii. the capital freed up would have to be used on behalf of taxpayers to fund new public assets and thereby reduce the pressure on the Government to borrow; and
viii. the Government would have to be satisfied that industry-specific regulations adequately protected New Zealand consumers.

On 27 January 2011 the Minister of Finance and the Minister for State Owned Enterprise wrote to the Secretary of the Treasury requesting advice on the merits and viability of:

- extending the Mixed Ownership Model to Mighty River Power, Meridian Energy, Genesis Energy, and Solid Energy, with the Crown retaining a majority stake in these companies; and
- reducing the Crown's shareholding in Air New Zealand, again while maintaining a majority stake.

Treasury's analysis has been limited to options that meet these objectives for the companies outlined above. However, within these options we have considered some other factors such as the impact on economic efficiency, additional costs for the businesses involved, and potential areas of risk.

Problem Definition

Achieving the Government's capital market development, fiscal, and commercial discipline objectives is not possible under the status quo because the State Owned Enterprises Act prevents private ownership of State Owned Enterprises.

Options

Treasury undertook a detailed examination of the pros and cons of Crown ownership of commercial entities in late 2010. This analysis considered the full range of ownership arrangements and is publicly available at http://www.comu.govt.nz/publications/information-releases/mixed-ownership-model/. In particular, the 3 December 2010 paper titled 'Crown ownership of commercial entities' sets out the impacts of various ownership arrangements. The Government's request for a more limited set of advice means many of the options in Treasury's 2010 analysis are outside the scope of this RIS, e.g. options involving full private ownership of any companies currently listed in Schedules 1 and 2 of the State Owned Enterprises Act.

Option 1 – the status quo

Retaining the status quo of Genesis Energy, Mighty River Power, Meridian Energy, and Solid Energy being governed by the State-Owned Enterprises Act 1986 is not viable because the Act does not allow private investment in SOEs. Continuing 100% Crown ownership of these companies is incompatible with the Governments fiscal and capital market development, and commercial discipline objectives.

Option 2 – amending the SOE Act to remove Genesis Energy, Mighty River Power, Meridian Energy, and Solid Energy

Amending the SOE Act to remove Genesis Energy, Mighty River Power, Meridian Energy, and Solid Energy from Schedules 1 and 2 is a viable option. Within this option, trade sales of minority stakes in the four SOEs have not been considered because of the Government's capital market development objective and the requirement for widespread and substantial New Zealand ownership. A conceptually equivalent option would be to amend the SOE Act to allow minority private investment in Genesis Energy, Mighty River Power, Meridian Energy, and Solid Energy with a low-control governance model similar to that currently applying to Air New Zealand.

Option 3 – enhanced status quo including equity bonds and holding companies

Issuing equity bonds in the five companies under consideration and/or including the Government's shareholding in a holding company also has the potential to offer improvements over the status quo. Equity bonds are similar to traditional 'vanilla' equity with the exception that equity bonds do not confer voting rights. Holding companies own shares in other companies and, rather than operating the company directly, manages the holdings of the portfolio from a strategic or financial perspective.

Impact Analysis

Tables 1 and 2 below provide an assessment of the impact of each of the options on the Government's objectives and other potential objectives. An assessment of the risks of each option is also provided in Table 2. Air New Zealand has been excluded from the analysis as regulatory change is not required for increased private investment in this company.

Table 1 – impact of options on Government objectives:

	Option 1 - Status quo SOE model	Option 2 – Extend Mixed Ownership Model by removing specified companies from SOE Act	Option 3 - Enhanced status quo (e.g. HoldCo, equity bonds)
Economic efficiency	No material impact	Small to moderate improvements	Small improvements
Fiscal (static) – freeing up capital	No impact	Small to moderate improvements	Some (for equity bonds)
Fiscal (dynamic) – access to private capital sources	No impact	Moderate improvement	Small to moderate improvement
Capital market development	Minimal, with some possibility of subsidiary listings	Moderate impact (Listing 25% or 49.9% would increase market capitalisation by 5% or 10%, respectively)	Minimal impact, with some possibility of listings of subsidiary companies. Equity bonds are likely to be substantially less attractive to investors.
Commercial discipline	No impact.	Moderate improvements	Small improvements
Majority Crown ownership	Consistent, as SOE Act requires 100% Crown ownership.	Consistent, as majority Crown ownership can be maintained	Consistent, as SOE Act requires 100% Crown ownership
Good investment opportunities	No scope to improve opportunities given inability of SOE Act to accommodate private investment	Significant scope for improvement given ability of shareholders to access voting equity	Some scope to improve investment opportunities, but lack of voting rights likely an issue
Protect consumers	No material change	No material change	No material change

Table 2 – other relevant factors:

	Option 1 - Status quo SOE model	Option 2 – Extend Mixed Ownership Model by removing specified companies from SOE Act	Option 3 - Enhanced status quo (e.g. HoldCo, equity bonds)
Economic efficiency	No material impact	Small to moderate improvements	Small improvements
Costs for companies	No change	Preparing companies for private investment likely to involve moderate costs for companies.	Holding company likely to have minimal cost, equity bonds will involve small to moderate costs for companies.

Government accountability	No change. Current performance monitoring undertaken by Crown Ownership Monitoring Unit (COMU) in Treasury. The Government would continue to have the opportunity to engage on company strategy through the Statement of Corporate Intent (SCI). Government appoints all directors.	Reduced level of monitoring by COMU (level likely to be similar to that applied to Air New Zealand). Absence of Statement of Corporate Intent will reduce the ability to engage on company strategy. Government likely to exert less control over director appointments, similar but not necessarily identical to the current Air New Zealand model. Slight reduction in government accountability likely to be more than offset by moderate improvements in commercial discipline and accountability.	Impact will depend on design of holding company structure, but most likely outcome is that: (i) a lower level of performance monitoring will be undertaken by COMU; (ii) current Statement of Corporate Intent process will remain with the holding company acting as the Government's agent; (iii) holding company would act as Government's agent for board appointments. Slight reduction in government accountability likely to be more than offset by small to moderate improvements in commercial discipline and accountability.
Risks	Main risk is opportunity cost of Crown ownership.	Main risks include the perception of an implicit guarantee and perception of limited ability to intervene in difficulty.	Main risk is opportunity cost of Crown ownership. Risk of less than anticipated performance improvements.

Consultation

In preparing its advice on the merits and viability of extending the Mixed Ownership Model, Treasury held discussions with:

- the Chairs and CEOs of relevant companies;
- relevant government agencies: the Ministry of Economic Development, the Ministry of Foreign Affairs and Trade, the Ministry for the Environment, the Ministry of Transport, the Office of Treaty Settlements, the Commerce Commission, and the Electricity Authority;
- market participants, including a number of investment banks; and
- participants in recent government ownership change processes in Australia, including the New South Wales and Queensland Treasuries.

Discussions with these parties generally supported the view that extending the Mixed Ownership Model has merit in achieving the Governments objectives and is viable over a 3-5 year programme.

In preparing this RIS and the associated Cabinet paper, The Treasury has consulted with the Ministries of Foreign Affairs, Transport, and Economic Development, the Office of Treaty Settlements, the Ministry for the Environment, and the Department of Prime Minister and Cabinet. No substantive points of difference emerged in consulting with these agencies on the Cabinet paper and associated RIS.

Conclusion and Recommendation

Taking into account the range or potential impacts and risks, The Treasury recommends that Option 2 of amending the SOE Act to remove Genesis Energy, Mighty River Power, Meridian Energy, and Solid Energy from Schedules 1 and 2 be progressed.

Implementation

Decisions on the exact design, timing, and composition of the extension of the Mixed Ownership Model are subject to further Cabinet decisions following the outcome of detailed scoping study analysis and further work by Treasury's Crown Ownership Monitoring Unit.

Monitoring, Evaluation, and Review

Treasury's Crown Ownership Monitoring Unit will review the outcomes of the extension of the Mixed Ownership Model as part of its ongoing ownership monitoring functions.