Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[3] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[4] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[5] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[6] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[7] 6(a) - to prevent prejudice to the security or defence of New Zealand or the international relations of the government

[8] 9(2)(h) - to maintain legal professional privilege

[9] 6(c) - to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial

[10] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

[11] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, an [8] appearing where information has been withheld in a release document refers to section 9(2)(h).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.
EXTENDING THE MIXED OWNERSHIP MODEL

Purpose

1. This paper seeks Cabinet’s approval to:

   i. extend the type of Mixed Ownership Model that currently applies to Air New Zealand to Genesis Energy, Meridian Energy, Mighty River Power, and Solid Energy, and to further reduce the Crown’s shareholding in Air New Zealand, over a 3-5 year programme beginning in 2012, subject to receiving a mandate in the 2011 general election, market conditions and detailed scoping studies; and

   ii. undertake associated pre-implementation work ahead of the 2011 general election, including undertaking detailed scoping studies and initial steps to design a programme of work for 2012, at an estimated cost of $5.9 million.

Executive Summary

2. Changing the mix of assets on the Crown balance sheet has a critical role to play in funding priority investment and ensuring public debt levels remain prudent and sustainable. The commercial portfolio is the area of the balance sheet where there is the greatest potential to change the mix of assets by extending the sort of Mixed Ownership Model that currently applies to Air New Zealand.


4. Treasury has advised that extending the Mixed Ownership Model:
   - has significant merit because of the potential to reinforce efficiency, fiscal, and capital market development policy goals, providing moderate economic gains;
   - is viable over a 3 – 5 year programme, but is a significant and complex undertaking even by international standards, and there are a wide range of execution and other risks that could have a material impact on how the programme proceeds;
   - will require a high degree of flexibility to be retained in order to deal with the considerable uncertainty and execution risks; and
   - could be undertaken to meet the Government’s five tests.
5. We have considered this advice and now seek Cabinet’s agreement to extend the Mixed Ownership Model to Genesis Energy, Meridian Energy, Mighty River Power, and Solid Energy, and to further reduce the Crown’s shareholding in Air New Zealand, over a 3-5 year programme beginning in 2012 (i.e. after a mandate has been sought in the 2011 general election).

6. Approval is also sought for Treasury to undertake associated pre-implementation work ahead of the 2011 general election, including undertaking detailed scoping studies and initial steps to design a programme of work for 2012. This work would not commit the Government ahead of seeking a mandate in the 2011 general election. Detailed scoping work is estimated to cost approximately $5.9 million. The Treasury has identified $1.9 million of existing funding that could be reprioritised to partially meet these costs, thereby reducing the new operating funding required as part of Budget 2011 to $4 million. This funding is being sought through the 2011 Budget Package Cabinet paper.

Background

7. In December 2010 the Government released its inaugural Investment Statement outlining its investment intentions, including:
   • continuing to look at introducing private sector capital and disciplines where appropriate to help drive the performance of State assets; and
   • more actively reprioritising Crown capital to its highest value use.

8. On 26 January 2011 the Prime Minister announced that the Government wants to look at areas where it can prioritise and reallocate its capital to reduce the rate of debt accumulation. The greatest scope to change the mix of assets lies with the government’s portfolio of commercial assets, and in particular by extending the sort of Mixed Ownership Model under which Air New Zealand currently operates.

9. We wrote to the Secretary of the Treasury on 27 January 2011 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.

10. The State Owned Enterprise (SOE) model involves companies being 100% owned by the Crown and run on a commercial basis. The principal objective of an SOE is to be a successful business. Ministers have considerable involvement in board appointments and company strategy. On the other hand, Air New Zealand currently operates under a Mixed Ownership Model, where the Crown owns a majority of the company but there is a minority of outside equity. Government interactions with the company on appointments and strategy are much lower than for SOEs.
Comment

Government objectives

11. In his 26 January speech, the Prime Minister outlined the Government’s desire to change the mix of assets it owns as an alternative to continued borrowing given the trade-offs involved, and identified three main benefits from extending the Mixed Ownership Model:

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.

12. The Prime Minister also set out five tests in his speech that the 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 we 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.

13. In addition to these objectives and tests, we have the following execution and timing objectives:

ix. low execution risk – successful implementation is achieved. For example, there is good demand for the shares and they perform well after listing; and
x. timing – the programme will be well advanced by 2014, to allow capital to be released over the next few years to finance other capital priorities.

14. Some of these objectives have the potential to pull in different directions, particularly between fiscal and other objectives. It will not be possible for all ten objectives to be maximised simultaneously, and as a result trade-offs between different objectives will need to be balanced to achieve a successful outcome. Maintaining maximum flexibility as long as possible into the process will be critical to ensure that Ministers have adequate policy space to balance competing objectives.

Treasury advice

15. The Treasury has analysed the merits and viability of extending the Mixed Ownership Model. Overall, Treasury has advised that extending the Mixed Ownership Model:

• has significant merit because of the potential to reinforce efficiency, fiscal, capital market development policy goals, providing moderate economic gains;
• is viable over a 3 – 5 year programme, but is a significant and complex undertaking even by international standards, and there are a wide range of
execution and other risks that could have a material impact on how the programme proceeds;

- will require a high degree of flexibility to be retained to deal with the uncertainty and execution risks; and
- could be undertaken to meet the Government’s five tests.

16. We have considered this advice and propose that the Government proceed with the extension of the Mixed Ownership Model. In particular, we are confident that the five tests can be met, as outlined below.

**Test 1: Majority government ownership**

17. Maintaining majority Government ownership is readily achievable by ensuring that no more than 49% of any of the five companies under consideration is offered to the public (i.e. the minimum Government ownership level is 51%). With some companies, dividend reinvestment plans and planned capital expenditure may make it prudent to hold more than the minimum 51% to ensure that the Government’s majority holding is not diluted over time. Maintaining flexibility over the exact percentage of the company that is offered to the public will assist with achieving the Government’s fiscal objectives by matching supply to market demand. It is proposed that the exact percentage above 51% of each company that is offered to the public be examined further through the planned detailed scoping study process and be confirmed only immediately prior to share allocation decisions being taken.

18. Retaining majority Government control will involve trade-offs with the Government’s fiscal objectives given that private investors will not be able to purchase a controlling stake in the five companies under consideration (controlling stakes generally attract a price premium over minority stakes). There are also likely to be trade-offs with the commercial discipline objective relative to a complete sell down of the Government’s shareholding in the five companies under consideration.

19. All things considered, majority government ownership is readily achievable.

**Test 2: Achieving widespread and substantial New Zealand share ownership**

20. Initial public offerings (IPOs) are the preferred method of extending the Mixed Ownership Model given the Government’s desire to achieve widespread and substantial New Zealand ownership across the five companies under consideration. Treasury’s discussions with market participants suggest there is likely to be domestic demand for up to around $2 billion in any 12 month period (across both retail and institutional investors).

21. Experience from previous government initial public offerings (e.g. Contact Energy and Auckland International Airport) suggests that we can achieve widespread and substantial New Zealand ownership across the five companies. There are also a range of options for incentivising New Zealand participation should it become clear that these measures are required (e.g. price discounts, loyalty shares). Incentives to encourage domestic participation typically range from 5 to 10% of total value ($250m to $500m based on a $5 billion programme). However, past experience suggests that significant incentives may not be required and their use should be kept in reserve given the trade-off with the Government’s fiscal objective that their use involves. We propose that the use and form of any participation incentives be examined through the detailed scoping study process.
22. New Zealanders will be at the front of the queue for any offers arising from the extension of the Mixed Ownership Model, but overseas investors have an important part to play in providing pricing tension to support the Government’s fiscal objectives. [2][3][10]

It is also worth noting that maintaining majority Crown ownership removes the possibility of foreign control and associated perception issues. However, we intend to maintain flexibility on the potential use of foreign ownership restrictions and will further examine their desirability and scope as part of the proposed detailed scoping studies process.

23. Crown Financial Institutions such as the New Zealand Superannuation Fund (NZSF), Government Superannuation Fund (GSF), Accident Compensation Corporation (ACC), National Provident Fund (NPF) and the Public Trust will be able to participate in the Mixed Ownership Model and are likely to take up shares to maintain their desired New Zealand equity weightings. KiwiSaver and other institutional fund managers are also likely to take up shares to maintain their desired New Zealand equity and industry weightings.

24. Iwi also have the potential to play a significant role in the achievement of widespread and substantial New Zealand ownership as enduring strategic investors. [2][3][6][11] In addition, some iwi may seek clarity about contemporary Treaty claims to natural resources ahead of final decisions on exact timing of the extension of the Mixed Ownership Model to individual companies.

25. [2][3][6][11] To allow iwi views to be considered, it is proposed that iwi are consulted through the Iwi Leaders Forum and other forums prior to the programme for extending the Mixed Ownership Model being finalised in late 2011.

26. Overall, we consider that widespread and substantial New Zealand share ownership is achievable across the programme under consideration.

Test 3: Good investment opportunities for New Zealanders

27. Providing good investment opportunities for New Zealanders is critical to achieving the Government’s capital market development objectives and reducing the dominance of residential property investment as the primary savings vehicle for New Zealanders.

28. Treasury’s discussions with market participants suggest that, overall, the five companies on offer have the potential to provide good investment opportunities for New Zealanders. Restructuring options for Genesis Energy and Solid Energy could be considered as these could further enhance the attractiveness of these two companies.
29. The high degree of complexity implicit in extending the Mixed Ownership Model and volatility in global equity markets suggest that the exact timing for extending the Mixed Ownership Model to individual companies should be kept flexible.

30. We propose that both restructuring and timing be considered further as part of detailed scoping study analysis that will be carried out in the second half of 2011.

31. To ensure we achieve sharper commercial disciplines, more transparency and greater external oversight for the companies involved, the level of Government control that is exercised needs to be set at a level that allows market disciplines to apply. Market participants have also expressed a view that a governance model involving the Government exercising a high level of control on a day-to-day basis would significantly diminish the attractiveness of the companies to investors, with a likely flow-on impact on the Government’s fiscal objectives. With these points in mind, the two key aspects of control that need to be considered are nominations/appointments of board members and involvement in company strategy. Whilst further work will need to be done, we envisage an ownership model with a level of day-to-day control that is much more akin to the current Air New Zealand model. However, as ongoing majority shareholder, we see it as critical that the Government retains the ability to use its voting power to pass ordinary resolutions to protect its interests in appropriate circumstances. Further work will be undertaken to determine whether additional levers are required.

32. Overall, we are confident that the extension of the Mixed Ownership Model will provide good investment opportunities, including through some consideration of restructuring.

**Test 4: Use of capital freed up by extension of Mixed Ownership Model**

33. Treasury estimates that between $5 and $7 billion of capital could be released by extending the Mixed Ownership Model to Genesis Energy, Meridian Energy, Mighty River Power, and Solid Energy, and by further reducing the Crown’s shareholding in Air New Zealand. The exact proceeds will depend on the price ultimately received, percentage of the company offered to the public, any retail price discounts, company performance, and equity market conditions. Based on the latest commercial valuations available, and assuming no foreign ownership restrictions or price discounts, the following proceeds are likely:

<table>
<thead>
<tr>
<th>Company</th>
<th>Current shareholding</th>
<th>Commercial value</th>
<th>Government retaining 51%</th>
<th>Government retaining 60%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air New Zealand</td>
<td>74.32%</td>
<td>$1.2b(^1)</td>
<td>$0.28b</td>
<td>$0.17b</td>
</tr>
<tr>
<td>Genesis Energy</td>
<td>100%</td>
<td>$1.6b</td>
<td>$0.78b</td>
<td>$0.64b</td>
</tr>
<tr>
<td>Meridian Energy</td>
<td>100%</td>
<td>$6.3b</td>
<td>$3.09b</td>
<td>$2.52b</td>
</tr>
<tr>
<td>Mighty River Power</td>
<td>100%</td>
<td>$3.7b</td>
<td>$1.81b</td>
<td>$1.48b</td>
</tr>
<tr>
<td>Solid Energy</td>
<td>100%</td>
<td>$1.7b</td>
<td>$0.83b</td>
<td>$0.68b</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$14.5b</strong></td>
<td><strong>$6.80b</strong></td>
<td><strong>$5.49b</strong></td>
</tr>
</tbody>
</table>

34. The Government’s December 2010 *Investment Statement* identified a balance sheet that is forecast to increase by approximately $33 billion over the next five years. Fiscal forecasts in the 2011 Budget Policy Statement included capital allocations of $1.4 billion in coming budgets, with key social and economic infrastructure social assets generally being the highest priority. There is scope and need to finance some of this expenditure through capital released from the extension of the Mixed Ownership Model.

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\(^1\) Based on NZX share price of $1.11 on 24 March 2011.
35. In short, the extension of the model has the potential to fund significant new public assets and substantially reduce the pressure on the government to borrow.

**Test 5: Industry specific regulations**

36. Competition between firms is the primary form of protection for consumers in New Zealand. Competition is safeguarded through general competition law in the Commerce Act 1986, which is enforced by the Commerce Commission.

37. The regulatory regime that is most relevant to consumers in the context of the Mixed Ownership Model is the electricity sector. We reviewed this sector thoroughly in 2009 and made the following changes through the Electricity Industry Act 2010 to strengthen competition and improve security of supply:

- disestablishing the Electricity Commission and setting up the Electricity Authority whose statutory objective is to ‘promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers’;
- providing customer compensation and a floor on spot prices during public conservation campaigns;
- providing for “virtual asset swaps” (by way of long-term contracts) between the SOEs and transferring Tekapo A and B power stations from Meridian to Genesis;
- disestablishing the reserve energy scheme and selling the Crown’s Whirinaki power station;
- allowing lines businesses back into electricity retailing;
- providing for a more liquid hedge market; and
- providing for more standardised line tariffs.

38. In addition to its importance for consumer protection, industry specific regulation is also very important for efficiency and effectiveness of markets and market participants. Experience from overseas and New Zealand public share offers suggests that the degree of regulatory certainty is a critical determinant of the attractiveness of individual companies and the overall success of offerings. For these reasons, the Government should seek to provide the highest degree of regulatory certainty that is achievable in the industries where the Mixed Ownership Model is proposed to be extended.

39. We have not identified any significant issues that suggest that the consumer protection test will not be met. The table below sets out the current level of competition in the various markets and the current and future status of regulatory issues.

[2]
### Level of competition/potential regulatory issues

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Degree of certainty/proposed regulatory changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity generation/retail</td>
<td>Competitive market with three state-owned firms and a number of privately owned firms. A ministerial review in 2009 identified various measures to strengthen competition and improve security of supply. While these changes are designed to reduce the potential for future price rises, electricity prices reflect the cost of new generation and are likely to rise over time.</td>
<td>The priority initiatives identified in the ministerial review are either in place or will be implemented by the Electricity Authority during 2011 and 2012.</td>
</tr>
<tr>
<td>Coal/resources</td>
<td>Competitive market. No significant regulatory issues identified.</td>
<td>The coal royalty regime has been in place for a significant period of time. No significant changes proposed at this stage.</td>
</tr>
<tr>
<td>Air services</td>
<td>Highly competitive industry. No significant regulatory issues provided that the Crown maintains majority ownership of Air New Zealand.</td>
<td>No regulatory changes proposed, but a review of policy on the ownership of New Zealand airlines that operate internationally is proposed.</td>
</tr>
<tr>
<td>Capital Markets</td>
<td>New Zealand capital markets compete with overseas markets for investment capital. Review of Securities Act has introduced a range of measures to enhance consumer protection.</td>
<td>No significant regulatory changes are proposed.</td>
</tr>
<tr>
<td>Water</td>
<td>Approach to water allocation differs across regional councils. Land and Water Forum report outlined options but recommended further investigation. No regulatory issues that would prevent the extension of the Mixed Ownership model have been identified.</td>
<td>National Policy Statement on water limits currently under development, which would require councils to set water allocation limits. Decisions have not been made on when any further changes to allocation provisions may occur. Continued access to water for electricity generation may be subject to some regulatory uncertainty.</td>
</tr>
<tr>
<td>Emissions Trading Scheme (ETS)</td>
<td>Emissions Trading Scheme has been progressively introduced since 2008. No regulatory issues that would prevent the extension of the Mixed Ownership model have been identified.</td>
<td>Review of ETS required by legislation currently underway and is due to report back to Ministers by 30 June 2011. Some regulatory uncertainty about future carbon price is likely to persist.</td>
</tr>
</tbody>
</table>

40. In summary, we are confident that current regulatory settings, including changes in train through the Electricity Authority and the Government’s water management work stream, are adequate to protect consumers.
Next Steps

41. If Cabinet agrees to the extension of the Mixed Ownership Model, Treasury will undertake the following pre-implementation work ahead of the 2011 general election:

- establish a Commercial Transactions Group within Treasury to progress the extension of the Mixed Ownership Model;
- issue requests for proposals for, and appoint:
  - a Probity Adviser to ensure that processes associated with the extension of the Mixed Ownership Model are defensible and able to withstand internal and external scrutiny;
  - a Crown Adviser to ensure that the Crown’s interests are protected throughout the extension of the Mixed Ownership Model; and
  - commercial advisers to provide detailed scoping studies for Genesis Energy, Meridian Energy, Mighty River Power, Solid Energy and possibly Air New Zealand.

42. As part of its work to appoint commercial advisers, Treasury will explore options that would provide Ministers with access to independent advisors.

Consultation

43. 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.

44. In the preparation of this paper, Treasury has consulted with the Ministries of Foreign Affairs, Transport, and Economic Development, the Office of Treaty Settlements, and the Ministry for the Environment. The Department of Prime Minister and Cabinet was informed.

Financial Implications

45. Extending the Mixed Ownership Model is likely to result in the freeing up of $5-7 billion of capital funding, depending on the exact structure and timing of the programme (see paragraph 33 above). Releasing capital from the commercial part of the balance sheet could provide a substantial contribution towards high priority new investment in future Budgets, allowing the Government to fund new investment off its balance sheet instead of taking on additional debt. It is therefore proposed that capital released by the extension of the Mixed Ownership Model be incorporated in to Budget processes for the relevant financial years.

46. Undertaking detailed scoping study analysis and appointing Crown and probity advisers ahead of the 2011 election is estimated to cost approximately $5.9 million.
In its Four Year Budget Plan, Treasury identified work on the Crown’s balance sheet as an item of ‘unfunded’ work and proposed the reprioritisation and transfer of $1.9 million from 2010/11 to 2011/12 to progress this work. This reprioritisation reduces the quantum of new funding required to $4 million. Cabinet agreement to the $4 million of new funding and the proposed reprioritisation is being sought through the 2011 Budget Package Cabinet paper. Any additional funding unspent during pre-implementation work will either be returned to the Crown during the 2012 March Baseline Update, or Cabinet approval will be sought to use any under spend to contribute to some of the costs for the implementation phase.

Additional transactional funding will be required once the overall programme structure has been determined following detailed scoping study analysis. Transactional costs could be around $2 treeNode 3 treeNode 6 TreeNode 11 on a $5 billion programme. There is potential for some of these costs to be offset against the capital that is likely to be released.

**Human Rights**

This paper has no human rights implications.

**Legislative Implications**

Legislation will be required to remove Genesis Energy, Meridian Energy, Mighty River Power, and Solid Energy from the State Owned Enterprises Act. Final decisions on the exact form of the Mixed Ownership Model are yet to be taken, but it is likely that these companies will be governed by the Companies Act only (rather than special legislation), as is currently the case with Air New Zealand.

**Regulatory Impact Analysis**

The Regulatory Impact Analysis (RIA) requirements apply to the proposal in this paper and a Regulatory Impact Statement (RIS) has been prepared and is attached as Appendix 1.

The Regulatory Impact Analysis Team (RIAT) has reviewed the RIS prepared by the Treasury and associated supporting material, and considers that, given the nature of the decisions being taken at this stage of the policy process, the information and analysis summarised in the RIS meets the quality assurance criteria.

**Publicity**

Announcements on the proposed extension of the Mixed Ownership Model after the 2011 general election are planned to be made as part of Budget 2011.

Air New Zealand’s listing on NZX also necessitates that any announcements or media comments comply with the Securities Markets Act 1988. For these reasons, it is proposed that the Prime Minister, the Minister of Finance, and the Minster for State Owned Enterprises be delegated authority to determine which Minister(s) are authorised to comment on the extension of the Mixed Ownership Model.
Recommendations

55. We recommend that Cabinet:

**Background**

1. **note** that the *2010 Investment Statement of the Government of New Zealand* stated that the Government’s investment intentions included, among others:
   
   1.1 continuing to look at introducing private sector capital and disciplines where appropriate to help drive the performance of State assets; and

   1.2 more actively reprioritising Crown capital to its highest value use.

2. **note** that Air New Zealand currently operates under a Mixed Ownership Model, where the Crown owns a majority the company but there is a minority of outside equity;

3. **note** that the Minister of Finance and the Minister for State Owned Enterprises wrote to the Secretary of the Treasury on 27 January 2011 requesting advice on the merits and viability of:
   
   3.1 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

   3.2 reducing the Crown’s shareholding in Air New Zealand, again while maintaining a majority stake.

**Treasury’s advice**

4. **note** that Treasury has advised that extending the Mixed Ownership Model:
   
   4.1 has significant merit because of the potential to reinforce efficiency, fiscal, and capital market development policy goals while providing moderate economic gains;

   4.2 is viable over a 3 – 5 year programme, but is a significant and complex undertaking even by international standards, and there are a wide range of execution and other risks that could have a material impact on how the programme proceeds;

   4.3 will require a high degree of flexibility to be retained in order to deal with the considerable uncertainty and execution risks; and

   4.4 could be undertaken to meet the Government’s five tests.

**Decision to proceed with the Mixed Ownership Model**

5. **agree** to extend the Mixed Ownership Model to Genesis Energy, Meridian Energy, Mighty River Power, and Solid Energy, and to further reduce the Crown’s shareholding in Air New Zealand, over a 3-5 year programme beginning in 2012, with the objectives and key policy parameters as outlined below, and subject to the Government receiving a mandate in the 2011 general election, market conditions and detailed scoping studies;

6. **note** that extending the Mixed Ownership Model will require a legislative amendment to remove Genesis Energy, Meridian Energy, Mighty River Power, and Solid Energy from the State Owned Enterprises Act.
Objectives

7. **agree** that the Government has ten objectives for the mixed ownership model:

7.1 *Fiscal (static)* – optimising the value for the Crown and freeing up capital;

7.2 *Fiscal (dynamic)* – allow the companies to obtain growth capital without depending entirely on the Government;

7.3 *Capital market development* – broaden the pool of investments available to New Zealand Savers, and increasing the depth of New Zealand capital markets;

7.4 *New Zealand participation* – place New Zealand investors at the front of the queue and achieve widespread and substantial New Zealand share ownership;

7.5 *Commercial disciplines* – ensure these large and important companies reap the benefits of sharper commercial disciplines, more transparency, and greater external oversight to allow them to make the strongest possible contribution to New Zealand’s economic growth;

7.6 *Majority Crown ownership* – ensure the Government has a controlling stake;

7.7 *Good investment opportunities* – ensure the companies involved present good opportunities for investors;

7.8 *Protect consumers* – ensure that industry specific regulations adequately protect New Zealand consumers;

7.9 *Low execution risk* – successful implementation is achieved (such as good demand for shares, and the shares perform well after listing); and

7.10 *Timing* – the programme will be well advanced by 2014, to allow capital to be released over the next few years to finance other capital priorities.

8. **note** that it is not possible for all ten objectives to be maximised simultaneously, and that objectives will need to be balanced throughout the process.

Key policy parameters

9. **agree** to a general principle of maintaining considerable flexibility throughout the process to provide the Government with sufficient policy space to deal with execution and other risks as they arise;

10. **agree** that 51% is the minimum ownership level for the Crown, but that a higher level may be appropriate for some companies following detailed scoping study analysis to prevent dilution below 51% over time;

11. **agree** that Initial Public Offering (IPO) is the preferred method for extending the Mixed Ownership Model;

12. **agree** that restructuring options be considered for Genesis Energy and Solid Energy in detailed scoping studies;

13. **agree** to maintain maximum flexibility on the use of financial incentives to achieve widespread and substantial New Zealand participation by keeping
them in reserve while their need is investigated as part of company scoping studies;

14. **agree** to consider the use of hard foreign ownership restrictions, such as individual or total ownership caps, or separate domestic shares;

15. **agree** that the exact timing for extending the Mixed Ownership Model to individual companies be determined following detailed scoping study analysis;

16. **agree** that the Government should exert a level of control over the companies under a Mixed Ownership Model that is similar but not necessarily identical to the current approach for Air New Zealand;

17. **agree** that options for iwi participation, managing contemporary/pan iwi claims on natural resources, and potential title issues be considered as a detailed programme for extending the Mixed Ownership Model is developed;

**Publicity**

18. **note** that it is planned that the extension of the Mixed Ownership Model be announced as part of Budget 2011;

19. **note** that Initial Public Offering processes are particularly sensitive to comments or announcements by Government Ministers and that any comments on Air New Zealand will need to comply with the Securities Markets Act 1988;

20. **agree** to delegate authority to determine which Minister(s) are authorised to comment on the extension of the Mixed Ownership Model to the Prime Minister, the Minister of Finance, and the Minister for State Owned Enterprises;

**Next steps in 2011**

21. **agree** that iwi will be consulted through the Iwi Leaders Forum and other forums as appropriate prior to the programme being finalised;

22. **agree** to Treasury contracting for detailed scoping studies for Genesis Energy, Meridian Energy, Mighty River Power, Solid Energy, and Air New Zealand;

23. **agree** to Treasury taking initial steps to design a work programme for 2012;

24. **agree** to Treasury appointing:

24.1 a Probity Adviser to ensure that processes associated with the extension of the Mixed Ownership Model programme are beyond reproach to the maximum extent possible;

24.2 a dedicated Crown adviser for the Mixed Ownership Model programme;

25. **note** that officials would consider the appointment of an independent adviser for shareholding Ministers;

26. **note** that none of the work planned to be undertaken ahead of the 2011 general election commits the Government to proceed ahead of receiving a mandate from the electorate;
Financial implications

27. note that likely proceeds from the extension of the Mixed Ownership Model are in the order of $5-7 billion, depending on the exact structure of the programme;

28. note that releasing capital from the commercial part of the balance sheet could be used to fund high priority new investment off the Government’s balance sheet as an alternative to further borrowing;

29. agree that capital released from the extension of the Mixed Ownership Model be incorporated into the Budget processes for the relevant financial years;

30. note that $5.9 million of funding is required for pre-implementation work of which $4 million will be sought through the 2011 Budget Package Cabinet paper with the remaining $1.9 million being reprioritised from within Treasury’s baseline;

31. note that any additional funding unspent during pre-implementation work will either be returned to the Crown during the 2012 March Baseline Update or Cabinet approval will be sought to use any under spend to contribute to implementation phase costs; and

32. note that additional transactional funding of around \[2][3][6][11] will be required once the overall programme structure has been determined following detailed scoping study analysis, and that there is potential for some of these costs to be offset against capital proceeds.

Hon Bill English
Minister of Finance

Hon Tony Ryall
Minister for State Owned Enterprises

Date: _____ / _____ / _________

Date: _____ / _____ / _________
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.


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

____________________________________  ______ / ______ / ___________
Status Quo


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 Government’s 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:

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

Table 2 – other relevant factors:

<table>
<thead>
<tr>
<th>Economic efficiency</th>
<th>Option 1 - Status quo SOE model</th>
<th>Option 2 – Extend Mixed Ownership Model by removing specified companies from SOE Act</th>
<th>Option 3 - Enhanced status quo (e.g. HoldCo, equity bonds)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No material impact</td>
<td>Small to moderate improvements</td>
<td>Small improvements</td>
<td></td>
</tr>
<tr>
<td>Costs for companies</td>
<td>No change</td>
<td>Preparing companies for private investment likely to involve moderate costs for companies.</td>
<td>Holding company likely to have minimal cost, equity bonds will involve small to moderate costs for companies.</td>
</tr>
<tr>
<td><strong>Government accountability</strong></td>
<td>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.</td>
<td>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.</td>
<td>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.</td>
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<tr>
<td><strong>Risks</strong></td>
<td>Main risk is opportunity cost of Crown ownership.</td>
<td>Main risks include the perception of an implicit guarantee and perception of limited ability to intervene in difficulty.</td>
<td>Main risk is opportunity cost of Crown ownership. Risk of less than anticipated performance improvements.</td>
</tr>
</tbody>
</table>

**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 Government’s 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.