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)(b)(ii) - to avoid unreasonable prejudice to the commercial position of the person who supplied the information or who is the subject of the information

[3] 9(2)(ba)(i) - to protect information that is subject to an obligation of confidence, or that was or could be provided under legal compulsion, where making the information available would be likely to prejudice the supply of similar information and it is in the public interest for that information to continue to be supplied

[4] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

[5] 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[6] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[7] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[8] 9(2)(j) – to enable the Crown to negotiate 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)(j).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.
**Treasury Report:** Extending the Mixed Ownership Model

**Date:** 4 March 2011  
**Report No:** T2011/336

### Action Sought

<table>
<thead>
<tr>
<th>Action Sought</th>
<th>Deadline</th>
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</table>
| **Minister of Finance**  
(Hon Bill English) | **Read** this report ahead of your meeting with Treasury at 8.30pm on 9 March 2011.  
**Refer** a copy of this report to the Prime Minister and the Associate Minister of Finance (Hon Joyce). | Before meeting with Treasury (8.30pm 9 March). |
| **Minister for State Owned Enterprises**  
(Hon Simon Power) | **Read** this report ahead of your meeting with Treasury at 8.30pm on 9 March 2011. | Before meeting with Treasury (8.30pm 9 March). |

### Contact for Telephone Discussion (if required)

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Telephone</th>
<th>1st Contact</th>
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<tbody>
<tr>
<td>[6]</td>
<td></td>
<td>[1]</td>
<td></td>
</tr>
<tr>
<td>Nic Blakeley</td>
<td>Manager, Sector Performance &amp; Balance Sheet, COMU</td>
<td></td>
<td>✓</td>
</tr>
</tbody>
</table>

### Minister of Finance’s Office Actions (if required)

Refer a copy of this report to the Prime Minister and the Associate Minister of Finance (Hon Joyce).

Enclosure: Yes *(Mixed Ownership Model - A3 Diagrams (Treasury:2014787v1))"
Executive Summary

This report responds to your request for advice on the merits and viability of:

- extending the mixed-ownership model to Mighty River Power, Meridian, Genesis and Solid Energy, with the Crown retaining a majority stake; and
- reducing the Crown’s shareholding in Air New Zealand, again while maintaining a majority stake.¹

We have identified the main high-level issues, trade-offs, and decisions that would be required over time.

Our initial analysis is set out in eight A3 attachments to this report and covers what we see as the most important sets of issues for Ministers, plus an overview. The key areas are:

- Objectives and trade-offs;
- Achieving widespread and substantial New Zealand ownership;
- Treaty and iwi related issues;
- Governance arrangements;
- Initial company-by-company analysis;
- Illustrative programme of offerings; and
- Fiscal impact and investment options.

This analysis highlights a number of issues, trade-offs, and decisions for Ministers relating to each area, though the vast majority of these decisions are not required to be taken in the short-term. All of these issues would be the subject of more in-depth analysis over coming months if Ministers decide to proceed.

We see significant merit in extending the mixed-ownership model...

We have previously advised that we think reducing Crown ownership of the commercial portfolio would provide moderate economic gains, and would reinforce efficiency, fiscal, and capital market development policy goals [T2010/2513 refers].

For the five companies, all of these potential benefits would be met:

- the companies include the largest SOEs, thereby maximising potential fiscal benefits (potentially releasing $5-7 billion of capital), and the fiscal environment has if anything deteriorated recently given a weaker economic outlook and additional costs associated with the Canterbury earthquake;
- the proposal to use listing as the primary method of sale would provide a significant boost to domestic capital markets – the size of the companies listed would be unprecedented in New Zealand’s recent history and would boost both depth and liquidity (e.g. market capitalisation could increase by up to 10%); and

• the companies are in sectors crucial to New Zealand’s economic performance, where enhanced commercial disciplines to improve efficiency and drive growth opportunities could be significant.

On the other hand, the tests and constraints set out by the Government that would need to be met before pursuing a mixed-ownership model would reduce potential fiscal and economic gains relative to where government ownership could be reduced further, or where widespread New Zealand participation was less important.

But overall, we consider that extending the mixed ownership model would provide significant net benefits, especially as part of a broader economic agenda. There would be a point, however, where the severity of measures to achieve other objectives tip the balance (for example, heavy ownership restrictions), or where substantial loss of value would lead to net benefits not being realised.

...and we consider the programme would be viable, but highly complex.

We have not identified any obstacles as part of our initial analysis to progressing a programme of offerings commencing in 2012. We think it would be possible to meet all the required tests you have set.

However, a range of issues would make the complexity of the programme substantial. This in turn leads us to recommend caution in committing to any particular timeframe or sequencing of offerings. In particular:

• many of the Government’s objectives pull in different directions (particularly between fiscal and other objectives) and not all can be maximised simultaneously, requiring difficult balancing and trade-offs;

• a number of the relevant regulatory settings have changes in train, such as the electricity reforms and water allocation, that would create uncertainty for investors (though we see no significant further regulatory changes that would need to be made before proceeding);

• a programme of the nature contemplated would be unprecedented in its scale in terms of New Zealand capital raisings, and would require significant resources and Ministerial time to progress; and

• there are a number of potential Treaty/iwi issues that may need to be resolved relating to mode of participation, contemporary/pan-iwi claims on natural resources,

Appointment of advisors and scoping studies could be progressed in 2011.

The chart below sets out key milestones that we anticipate would be involved in preparing for the commencement of a programme of offerings in 2012, if the Government decides to proceed. All timings are illustrative only and will depend, among other things, on decisions taken on the commencement date of any programme. A key decision is whether Ministers would be comfortable with preparatory work progressing during the second half of 2011, and if not, the trade-off being a later start in 2012 or 2013.
In the short term, if the Government wishes to proceed, an announcement could be made as part of Budget 2011. If so, we would recommend a Cabinet process that provides Cabinet decisions by 4 April (or 11 April if absolutely necessary to align with the Budget Cabinet paper). This would suggest either EGI on 23 March or CBC on 28 March. We would see the scope of Cabinet agreement at this stage as relatively limited, to retain flexibility. A discussion at STR on 21 March could also be considered.

Communications

We would advise against any communication related to this report at this point. Any comments by Ministers on the initial analysis and options will result in uncertainty and possible detrimental commercial impacts. Commenting on the initial analysis and options may also give rise to expectations developing regarding future policy directions, putting at risk flexibility in relation to policy options.

Consultation

This report has been informed by our discussions with:

- the Chairs and CEOs of relevant companies;
- relevant government agencies: MED, MfE, the Commerce Commission, the Electricity Authority, MFAT, OTS, and the Ministry of Transport; and
- market participants, [3][8]

We have not shared our own thinking with any market participants, and have only shared our thinking at a high level and where appropriate with government agencies and the relevant companies. We have not shared this report (or any draft) with any of these parties.
Recommended Action

We recommend that you:

a  discuss the contents of this report with Treasury in your meeting at 8.30pm on 9 March 2011; and

b  refer a copy of this report to the Prime Minister and the Associate Minister of Finance (Hon Joyce).

Agree / Disagree

Nic Blakeley
Manager, Sector Performance & Balance Sheet, COMU
for Secretary to the Treasury

Hon Bill English
Minister of Finance

Hon Simon Power
Minister for State Owned Enterprises
Extending the Mixed Ownership Model – Overview of Advice

Key messages:
- Extending the mixed ownership model to Mighty River Power, Meridian Energy, Genesis Energy, and Solid Energy, together with a further sell-down of Air New Zealand, has merits and is viable over a 3–5 year programme.
- Widespread and substantial New Zealand ownership is achievable, but significant participation by foreign investors will be essential to achieve the Government’s overall objectives.
- Extension of the model 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.
- Maintaining maximum flexibility will be critical to dealing with the considerable uncertainty and execution risks.

Overview of potential execution risks:
- Iwi/Treaty issues – Iwi participation would be highly beneficial but a number of issues need to be worked through. Early engagement/consultation with relevant Iwi groups will be important to identifying areas of concern, and considering potential mitigation measures.
- Regulatory settings – discussions with Government agencies have not revealed any issues that are a significant barrier to extending the mixed ownership model. The Electricity Authority considers that their current work programme will provide greater regulatory certainty to electricity generators/retailers, particularly in areas such as transmission and scarcity pricing.

Impact of major trade-offs on overall value:
The Government’s objectives involve a number of trade-offs, of which the value/fiscal objective has the most tension with other objectives. This diagram provides an overview of how the key decisions on the possible extension of the mixed ownership model impact on overall value/fiscal receipts:

- NZ Participation
  - Free NZ shares
  - Retail price discounts
  - Loyalty shares
  - Dual ASX/NZX Listing
  - US Offer Documents
  - No major foreign ownership restrictions
  - Trade sale of cornerstone share
  - Separate domestic shares
  - Ownership cap
  - Primary listing in NZ
  - Domestic marketing campaign

- Iwi/Treaty issues
  - Strong Iwi participation in offerings

- Governance issues
  - High level of Govt control
  - Low level of Govt control

- Company issues
  - Regulatory uncertainty
  - Low rainfall in hydro catchment areas
  - Certainty of board/executive tenure
  - High quality boards
  - Depressed sharemarket conditions

- Market conditions
  - Offshore investor marketing
  - Bullish sharemarket conditions
Objectives and Trade-offs

Being clear about the Government's objectives is critical to designing a successful programme. But not all objectives can be maximised simultaneously: trade-offs will be required. The following list is based on the objectives and tests set out in the PM's 26 January speech (as indicated), with two suggested additional objectives.

<table>
<thead>
<tr>
<th>Objective</th>
<th>Achievable?</th>
<th>Trade-offs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Fiscal (static) [obj 1, test 3]</td>
<td>Yes, but probably not maximised</td>
<td>Value will be reduced, other things equal, by: i) IPO rather than trade sale; ii) restrictions on foreign/institutional investors; iii) discounts for retail investors; and iv) less 'commercial' corporate governance arrangements. Retaining some shareholding (i.e. above 50.1%) for future capital calls would reduce upfront fiscal proceeds. Key question: level of comfort with realising lower value (or proceeds) to achieve other objectives?</td>
</tr>
<tr>
<td>2 Fiscal (dynamic) [obj 4]</td>
<td>Depends on Crown stake and capex plans</td>
<td>If Govt sells down to 50.1% and still wishes to retain 50.1% threshold over time, any further capital raisings will require Govt participation to avoid dilution. Capital structure at float also needs to be adequate to cover future capex plans. Key question: rather go too (say) 55-60% now to allow dilution over time, or 50.1% and have to participate in capital calls?</td>
</tr>
<tr>
<td>3 Capital market development [obj 2]</td>
<td>Yes, but shouldn't overtake</td>
<td>IPO will support capital market development (through depth/liquidity), but some caution is: i) NZX already heavy in energy stocks; ii) potential negative effects on current listed energy stocks as investors swap one for another (e.g. from Contact to Meridian).</td>
</tr>
<tr>
<td>4 NZ participation [test 2]</td>
<td>Yes, but trades off value</td>
<td>Main trade-off is with value: Significant NZ retail participation trades off capital release. Restrictions on foreign/institutional investors will reduce market pricing. Pricing and degree of institutional participation will also determine attractiveness/likelihood of retail investors 'flipping' soon after IPO. Key question: what is the desired outcome/bottom line for NZ participation on day one, and in one years' time?</td>
</tr>
<tr>
<td>5 Commercial disciplines/growth [obj 3]</td>
<td>Depends on ongoing level of control by Ministers</td>
<td>Company management responsibilities remain unchanged, so different comes from changes in involvement of Ministers in Board composition and company strategy. To meet this objective, Govt will need to be seen to step back from level of influence (i.e. distinction between level of ownership and level of control - control depends on the corporate governance arrangements). Key question: level of comfort in reducing level of control/influence over the companies?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Objective</th>
<th>Achievable?</th>
<th>Trade-offs</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 Majority Crown ownership [test 1]</td>
<td>Yes</td>
<td>The companies will still be under Govt 'control', which may not be attractive to some investors (though may be attractive to other investors). This objective has the potential to send a contrary message to the commercial disciplines objective, unless corporate governance arrangements suggest otherwise.</td>
</tr>
<tr>
<td>7 Good investment opportunities [test 4]</td>
<td>Yes, but may take time</td>
<td>Companies are in varying stages of readiness for IPO. Adequate preparation is essential for enhanced scrutiny from listing, but is time consuming. Any company restructuring would take further time. Given NZX is already heavy in energy stocks, there is potential for rebalancing (e.g. investors swap from currently listed stocks such as Contact and Trustpower). Key question: prepared to delay timetable to ensure good company preparation?</td>
</tr>
<tr>
<td>8 Protect consumers [test 5]</td>
<td>Yes</td>
<td>Whatever changes are deemed necessary to achieve this objective must be put in place prior to any IPO. Depending on what these are, it may delay an IPO. Key question: satisfied that current regimes (and changes in train) for electricity/ETS/Emissions are adequate?</td>
</tr>
<tr>
<td>9 Low execution risk</td>
<td>Yes</td>
<td>Considerable thought and analysis needs to be put into determining how these transactions should be undertaken. Preparation of the companies will also be important. The time required to fully scope the transactions, prepare the companies, and execute successfully should not be underestimated.</td>
</tr>
<tr>
<td>10 Timing</td>
<td>Yes</td>
<td>A rushed transaction can result in poor execution and low offer uptake. Key question: prepared to accept movements in the timetable to ensure successful execution?</td>
</tr>
</tbody>
</table>

Key questions for Ministers:
- What does success look like?
- How far are you prepared to trade off some objectives to achieve others?
- Where is the point at which the trade off would be too great to proceed?

Possible scope of Cabinet agreement in April:
- agree to ten main objectives for the mixed ownership model
- note that it is not possible for all objectives to be maximised simultaneously and that objectives will need to be balanced through the process
Achieving widespread and substantial New Zealand ownership

NZ Market Capacity
- Initial market soundings suggest there would be domestic demand for up to $2b in any given 12 month period (across both retail and institutional). Thus it should be feasible for NZ investors to fill the majority of any offering, depending on careful timing and sequencing (e.g. maximum tranche of $1.5b in a 12 month period) and the underlying quality of the company.
- Balancing pricing, allocation, timing, and aftermarket performance will require careful thought. For example, over-allocation to retail can have a detrimental effect by:
  - Reducing the pricing tension that foreign investors provide; and
  - Compromising after-market performance as foreign investors can provide further demand post IPO.
- Treasury recommends maintaining as much flexibility as possible on the use and form of incentives, and the % holding of each company offered to the market to allow the programme to adapt to changing market conditions.

Options for encouraging New Zealand participation
A number of options are available to support the achievement widespread and substantial NZ participation. Some may be desirable in any market conditions (e.g. priority allocation), while others should only be used if market conditions make it clear that additional support is required (e.g. significant retail discounts):

Conduct of IPO:
- Priority allocation for New Zealanders - As far as possible, prioritise allocation of shares to NZ retail investors. Pros: Easy to do. Cons: Can only be done up to a point if fiscal receipts and aftermarket are not to be put at risk.
- Marketing - overseas experience suggests that an effective marketing campaign is a key element in achieving significant domestic participation. Pros: can have a big effect on retail participation. Cons: marketing cost.
- Instalment receipts - shares offered to retail investors in instalments. Pros: makes more shares available to investors who do not have sufficient cash. Cons: Higher transactions costs, may have complex tax implications for investors.
- Issuance of warrant - see separate Wri issues page.
- Kiwisaver diversion - at the election of savers, part of the Kiwisaver tax credit could be paid in the form of shares into a special Kiwisaver fund. Savers would end up with two Kiwisaver accounts. If they later change their minds on owning SOE shares, they would close their second account with the value transferred to their main account.
- Pros: could substantially increase the number of NZ investors with semi-direct ownership of SOE shares; a pool of demand that might not otherwise participate; these investors would be able to take part in profits in after-market and are therefore likely to be long-term holders. Cons: would require careful communications exercise; it would create some complexity for IRD; could lead to a need to scale back other NZ retail investors; could reduce market liquidity.

Financial incentives:
- Retail discount - set NZ retail investors' price at a discount to the price for institutions. Pros: will boost domestic participation. Cons: May not have much effect if investors immediately sell to cash in the discount, and there would be a significant fiscal cost.
- Loyalty shares - offer bonus 'loyalty' shares to NZ retail investors who hold shares for at least 12 months. Pros: Equivalent to offering a discount. Would discourage immediate on-sale. Cons: reduces liquidity in the share market. Fiscal cost.
- Free domestic shares - giving shares to all adult residents, or citizens, or taxpayers. Pros: achieves widest possible ownership. Cons: large fiscal cost, administratively expensive, does not meet govt's fiscal objectives.

Restrictions on foreign ownership:
Various restrictions on foreign ownership are available. The following list provides options in order of severity (low to high). The more severe the restrictions, the greater the trade-off with the Government's fiscal objectives:
- Residency requirements - Company constitution to provide that majority of directors must be NZ residents. Pros: Board more likely to be working in NZ's interests. Cons: not necessary to achieve objectives.
- NZ Listing - Company constitution could provide that the primary listing must be in New Zealand. Pros: may achieve greater NZ participation. Cons: may not have much effect, difficult to remove, removing the possibility of cornerstone shareholders will reduce price tension and have fiscal costs.
- Separate domestic shares - offer A and B shares, with A shares reserved for NZ domiciled investors. Pros: Effective in achieving participation objectives. We have experience of that with Air NZ prior to 2001. Cons: Loss of value to Crown will be more visible if domestic shares sell at a lower price. Domestic shares likely to trade at a lower price in the aftermarket, which could be seen to conflict with one of the Government's tests (that companies would have to present good opportunities for investors). Reduced liquidity in each market.

Possible scope of Cabinet agreement in April:
- Agree to maintain flexibility on the use of mechanisms to achieve widespread and substantial NZ participation and to investigate options as part of the detailed programme and company scoping studies.
- Agree in principle not to use hard ownership restrictions such as ownership caps, separate domestic shares, or restrictions on participation by sovereign wealth funds.

Initial Public Offering (IPO) Case Studies

Contact Energy (April 1999)
- Total proceeds: $2.3 billion from 227,000 initial shareholders.
- 40% sold to cornerstone shareholder (Edison Mission, $1,200 m, $5.00 per share)
- 60% sold by way of initial public offering (IPO), $1,100m, $3.10 per share. Of this, the allocation was 30% foreign investors, 24% NZ/Australian institutions, 46% Retail investors.
- All tranches were heavily oversubscribed (partly because of discount to price paid by cornerstone).
- Price was set in a bidding process ('Book build') by foreign and NZ institutions.
- Retail investors were allocated shares at the same price.
- Govt had some flexibility in determining allocation between the three groups and between individual classes within groups. But was constrained by concern that sale would be seen as a failure (share price drops in the aftermarket) if (i) too much was allocated to retail investors; or (ii) not enough was allocated to foreign investors.

Auckland International Airport (1998)
- Total Proceeds: $480m from 66,000 initial shareholders.
- Retail investor demand could not be met.

Queensland Rail National (Queensland, 2010)
- Total Proceeds: $4.6b from sale of a 66% stake to 80,000 investors.
- Of this stake, 13.2% was purchased by Australian/NZ institutions ($2.55 per share), 52.8% by foreign institutions ($2.55 per share), and 34% by retail investors ($2.45 per share).
- Sale proceeded by structural separation of QR National freight services (which were the subject of the IPO) from Queensland Rail passenger services.

Other issues that need to be considered
- Dual listing - should there be dual listing on both the New Zealand and Australian stock exchanges? Pros: this could increase the reach of the shares and increase their price. Cons: Could be seen to be encouraging foreign ownership.
- Sovereign wealth funds - should sovereign wealth funds be allowed to participate in the IPO? Pros: would assist with pricing. Cons: Could be seen as encouraging foreign ownership.
- US offer documents - should shares be offered in the US? Pros: dramatically widens the market and assists with pricing. Cons: Significant additional cost to prepare offer documents to meet US regulations and could be seen as encouraging foreign ownership.
<table>
<thead>
<tr>
<th>Company Valuation</th>
<th>Regulatory issues</th>
<th>Legislative issues</th>
<th>Governance issues</th>
<th>Structural issues</th>
<th>Long term performance outlook</th>
<th>Market readiness</th>
<th>Market attractiveness</th>
<th>Mode of sale</th>
<th>Overall view</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mighty River Power</td>
<td>$3.7b (independent valuation)</td>
<td>- Some uncertainty on impacts of Electricity Industry Act and transmission/scarcity pricing</td>
<td>Requires change to SOE Act</td>
<td>None</td>
<td></td>
<td></td>
<td></td>
<td>IPO</td>
<td>2[2][8][7][8]</td>
</tr>
<tr>
<td>Meridian</td>
<td>$6.3b (independent valuation)</td>
<td>- Some uncertainty on impacts of Electricity Industry Act and transmission/scarcity pricing</td>
<td>Requires change to SOE Act</td>
<td>None</td>
<td></td>
<td></td>
<td></td>
<td>IPO</td>
<td>2[2][8][7][8]</td>
</tr>
<tr>
<td>Air New Zealand</td>
<td>$1.6b (current mkt capitalisation)</td>
<td>- No significant regulatory issues</td>
<td>Requires change to SOE Act</td>
<td>None</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Solid Energy</td>
<td>$1.7b (independent valuation)</td>
<td>- Some uncertainty around future of ETS, including Carbon sequestration and carbon allocations</td>
<td>Requires change to SOE Act</td>
<td>None</td>
<td></td>
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</tr>
<tr>
<td>Genesis</td>
<td>$1.6b (independent valuation)</td>
<td>- Some uncertainty on impacts of Electricity Industry Act and transmission/scarcity pricing</td>
<td>Requires change to SOE Act</td>
<td>None</td>
<td></td>
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**Key decisions for Ministers:**
- Can methods of sale other than IPO be considered as parts of the programme?
- Can restructuring of some companies be considered prior to any offering?

**Possible scope of Cabinet agreement in April:**
- Agree in-principle that the mixed ownership model should be extended to all of these companies over 3-5 years, but that restructuring options be considered for Solid Energy and Genesis as part of the process of preparing detailed scoping studies.
Potential Programme for Extending Mixed Ownership Model

Practical Considerations for Programme Structure:

- **Mode of Sale** - the Government's desire for 'widespread and substantial' New Zealand ownership means Initial Public Offerings (IPOs) as the most suitable vehicle for extending the mixed ownership model, although some smaller parts of the programme could better suit alternative methods.
- **IPO Size** - ability of the New Zealand equities market to absorb large listings after a prolonged period without new offerings is uncertain - discussions with Investment Banks suggest that offerings of more than $1b are significant. This suggests keeping offerings in any 12 month period below $3b (e.g. two offerings in a 12 mth period of up to $1.5b each).
- **'Market readiness' of individual companies** - Getting companies ready for external investors will require a significant resource commitment for both the companies concerned and Treasury.
- **IPO Success** - Momentum is important in a programme that covers multiple companies over multiple years - ensuring that the first offerings are market ready and attractive to investors will enhance the chances of success, and provide positive momentum for subsequent offerings.
- **Sequencing** - there is a need to spread the range of company offerings across the programme period given; (i) the overall size of the programme, and (ii) the size of some of the individual companies. The fact that three of the companies under consideration concentrated in the electricity generation sector may also be an issue given Contact Energy and Trustpower are already listed on NZX.
- **Offer timing** -

Illustrative Programme Structure:
The following is an outline of what an illustrative programme for extending the Mixed Ownership Model could look like. Company values and timing are subject to: (i) the views of expert advisers through formal scoping studies as these could change significantly depending on market conditions and the status of individual companies; (ii) residual IWI/Treaty issues being satisfactorily resolved; and (iii) the new Government forming quickly following the 2011 election. We have taken an optimistic view of these in developing this illustrative structure based on discussions with Investment Banks, however we note that the final structure could be markedly different depending on market conditions and the outcome of detailed scoping studies.

Key decisions for Ministers:

- Does this illustrative programme meet the Government's objectives?

Possible scope of Cabinet agreement in April:

- agree to extend the Mixed Ownership Model to the designated companies over a 3 to 5 year period with exact timing and sequencing of companies subject to detailed scoping study analysis,
- agree that 50.1% is a minimum ownership level of the Government, but it may be appropriate to hold a higher stake in some companies to prevent dilution below 50.1%, and
- agree that IPO is the preferred method for extending the Mixed Ownership Model, but options will be investigated for:
  - Private placement/cornerstone for Air NZ, Solid Energy and Genesis Energy, and
  - Restructuring of Genesis and Solid Energy prior to IPO.
Governance arrangements

Key issues and tradeoffs

- **Introducing other shareholders** – ownership and control are clearly related, but to some extent can be considered independently. Introducing other shareholders to a company fundamentally changes the Governance arrangements for a company:
  - **Board appointments** – involvement in appointments, dismissals and company planning are key elements of control available to Ministers under current SOE arrangements;
  - **Voting rights** – Movements away from 100% ownership will have implications for the level of control Ministers will have. For example, the Government will no longer be able to single-handedly approve or reject special resolutions that require a 75% majority (e.g. a change to the company constitution);
  - **Business planning** – the Government will not have the same level of input into company planning as it does through the Statement of Corporate Intent process under the SOE Act;
  - **Minority shareholder rights** – a shareholder who feels that the actions of the Government (as majority shareholder) has been prejudicial to the interests can apply to the court for an order requiring the company to purchase their shares or pay compensation; and
  - **Related party transactions** – the Government will be unable to vote in transactions where it is a related party. This means that minority shareholders have significant influence.

- **Control trade-offs** – Governance arrangements involving a high level of control by Ministers have high trade-off costs:
  - **Impact on markets and fiscal receipts** – capital markets are unlikely to see a company that remains highly controlled by the Government as attractive, resulting in reduced capital market development and fiscal receipts;
  - **Impact on commercial discipline** – high levels of Government control reduce the scope for market/independent board appointments and limit the scope for ‘market discipline’ to improve Governance, monitoring, and overall performance; and
  - **Risk transfer/implied Crown guarantee** – a high degree of Crown control is likely to heighten perceptions of an implicit Crown guarantee

- **Board quality** – board quality will have a significant impact on the attractiveness of individual companies to potential investors.

- **Director and executive remuneration** – remuneration levels are likely to increase substantially under the mixed ownership model.

Mechanisms to achieve desired level of control

- **Control dimensions** – there are three dimensions that contribute to the overall level of control:
  - **Board appointments** – three key decisions:
    i. how many directors does the Crown nominate?
    ii. whether the Crown retains a veto right for directors it doesn't nominate?
    iii. whether the appointment convention is codified in company constitutions?
  - **Business/strategy planning** – non-SOE companies do not have a formal channel for owner input into business planning.
  - **Voting rights** – how will the Crown exercise its voting rights on standard and special resolutions?

- **Holding structure** – shares could be held directly by Ministers or through a holding company.

- **Implementation mechanisms** – there are a range of options for achieving the desired control structure, such as legislation (hybrid SOE model), the company constitution, or publicly communicated convention. 'Kwi Share' provisions could be used to augment shareholder rights.

- **Voting rights** – these can also be exercised in a number of ways – direct votes, Chair proxy, abstention.

Indicative Governance Options

Governance arrangements can be configured in a number of different ways. The following diagram sets out some indicative options as a starting point for discussion. Higher levels of control will have high trade-off costs in relation to capital market disciplines and fiscal receipts. Treasury's preliminary advice is that lower levels of control are more consistent with achieving the Government's fiscal, capital market, and commercial discipline objectives.

[Diagram showing various governance options with increasing Crown control]

- **Increasing Crown control**

- **Government objectives (fiscal, capital markets, commercial discipline)**

- **Board appointments**
  - 1) How many directors does the Crown nominate?
  - 2) Other aspects
    - Whether the Crown retains a veto right in respect of directors it doesn't appoint directly?
    - Whether the appointment convention is codified in the constitution or not?

- **Business/strategy planning**

- **Voting Rights on company resolutions**

- **Increasing Crown control**

Key decisions for Ministers:

- What levels of control over board composition and company planning do Ministers wish to maintain?
- What is the prime purpose of maintaining a minimum of 50.1% to maintain ownership or exercise control?

Possible scope of Cabinet agreement in April:

- agree that the Government should exert a low level of control over the companies under a mixed ownership model, similar but not necessarily identical to the current arrangements for Air NZ.
Treaty/iwi issues associated with the mixed ownership model

Iwi have the potential to play a significant role in the achievement of widespread and substantial New Zealand ownership as long-term and stable investors. At the same time, iwi will have multiple interests in the mixed ownership context that will need to be considered. We have identified four main interests:

1. Iwi as investors:
   - A number of larger iwi have indicated their interest in purchasing shares (such as Waikato-Tainui Ngai Tahu).
   - But there is likely to be some concern amongst smaller iwi that they will 'miss out' due to lack of financial capacity (since further back in settlement process).
   - In any event, consultation and focussed engagement with iwi Leaders Forum will be important.

2. Iwi as historical Treaty claimants:
   - Key question – how will Crown respond to claims over natural resources including water?
   - Risk of contemporary claims on natural resources (including water).

3. Iwi as contemporary Treaty claimants:
   - Key Question – can title issues be resolved early?

4. Iwi as stakeholders in title/memorial issues:
   - May require resolution of competing Government objectives.
   - Options in this area will be investigated as part of more detailed analysis over coming months.

Illustrative options: Iwi as investors

Key decisions for Ministers:
- What is the best approach for consulting/engaging with iwi?

Possible scope of Cabinet agreement in April:
- Agree that iwi will be consulted on and provided with appropriate opportunities to engage in later stages of policy development, including through engagement with the iwi leaders forum, where appropriate, and agree that options for iwi participation, options for managing contemporary/past-iwi claims on natural resources, and potential title issues will be investigated further as part of more detailed analysis.
Fiscal impacts of the mixed ownership model

Total Fiscal Impact
- **Operating Balance** - the impact on the Total Crown Operating Balance is the gain on sale, the SOE profit foregone (made up of dividends and retained profits), the costs of making a sale, and the positive impact of reduced interest costs. This is shown in the Illustration on the right.
- **Debt** - the net impact on debt is the combination of the sale proceeds and the items above, after excluding any non-cash items.
- **Overall impact** - the main impact of the mixed ownership model will be on the balance sheet, with a much smaller positive impact on the operating balance. In this example, the positive impact on the operating balance arises because the sale value is likely to be greater than the book value, and means there would be no net call against the operating allowance. It is possible there could be a small negative impact under different assumptions.

Incorporating decisions into the fiscal forecasts and Budget documents
- **Public Finance Act (PFA) requirements** - the PFA requires that the fiscal impacts of all Government decisions and other circumstances are included in the Economic and Fiscal Update, ideally in the forecast financial statements. If the fiscal implications of a decision cannot be quantified for particular years with reasonable certainty, the Act requires that the fiscal implications are instead disclosed in the statement of specific fiscal risks.
- **Three options** - we have identified three approaches to the treatment of the mixed ownership model in the Budget Economic and Fiscal Update. The application of these options will depend on the decisions that Cabinet makes between now and when the 2011 Budget is finalised.

Option 1: fully reflect all of the financial flows into the forecast financial statements. To do this there would need to be a Cabinet decision to proceed with the partial floats, and sufficient information to make assumptions with reasonable certainty about the timing and size of the fiscal implications.

Option 2: exclude all of the financial flows from the forecast financial statements. Include a positive specific fiscal risk against the debt forecasts relating to the possible partial floats. This would apply if either no Cabinet decision about partial floats had been made or if there was significant uncertainty quantifying the impacts.

Option 3: exclude all of the financial flows as in option 2, but incorporate a lower debt track into the forecasts by setting the capital allowance to zero for Budgets 2012 to 2014. This would require Cabinet agreement that the government would not borrow any money for new capital spending. Any capital spending would need to be met from other sources of funding, such as the partial floats.

Use of sale proceeds
- **Incorporate into budget process** - as funds are received, they could be used to offset planned capital expenditure (i.e. assist with a 'net zero capital allowance'). Pros: consistent with the Government's fiscal strategy and the investment statement approach of prioritising across the Crown's balance sheet. Cons: no major cons have been identified.
- **Specific investments** - various use of funds have been raised such as €0.5bn. Pros: clear link from source of funds to end use. Cons: avoids the normal budget prioritisation process with commensurate spending quality risks.

We recommend incorporating sale proceeds into the Budget process.

Possible scope of Cabinet agreement in April:
agree that mixed ownership model proceeds should be incorporated into the Budget process.