

Short History of Post-Privatisation in New Zealand

John Wilson, December 2010

This paper is intended to provide an outline history of the experience of privatisation in a series of New Zealand companies, and to provide an assessment of that experience. The companies are:

- **Ports of Auckland:** one of the country's 2 largest ports, partially privatised by one of its regional government owners in 1988, and then brought back fully into regional government ownership in 2005.
- **Bank of New Zealand (BNZ).** One of New Zealand's largest banks. The BNZ has a long history of moving in and out of government ownership. Most recently the government sold its shareholding in the BNZ in 1992 to National Australia Bank.
- **Air New Zealand.** New Zealand's historically dominant domestic and international airline. The government sold it in 1988 to a consortium. Following a financial collapse in 2001 the government injected new capital and became the dominant shareholder.
- **Auckland International Airport (AIA).** New Zealand's most important airport. AIA was originally established as a joint venture between government and Auckland local authorities. The government sold its majority shareholding in AIA by public float in 1998.
- **Telecom.** New Zealand's incumbent telephone company. Telecom grew up as part of the Post Office. It was sold to a consortium led by two US telephone companies in 1990; with an agreement the consortium would offer shares to the public. Telecom remains a listed company.
- **Tranz Rail.** New Zealand's only significant rail operator. The government sold it to a consortium in 1993. In response to the implications of Tranz Rail's declining financial viability, the government progressively bought back Tranz Rail's assets between 2002 and 2008.
- **Trustpower.** Originally a local authority owned electricity utility in the Tauranga area, Trustpower took in private capital, and in 1998 bought a set of hydro stations from Electricity Corporation of New Zealand (ECNZ) the then dominant electricity SOE. Trustpower is now New Zealand's 5th largest electricity generator and retailer. Trustpower is a listed company.
- **Contact Energy.** One of New Zealand's 4 largest electricity generator/retailers. Split out from ECNZ in 1996, and sold by the government as a float with a cornerstone shareholder in 1998. Contact remains a listed company.

- **Forestry Corporation of New Zealand.** Owner of major plantation forest interests in the central North Island, including the Kaingaroa forest and the Waipa mill. Sold to a consortium in 1996. The consortium went into receivership and the assets were on-sold.

Methodology

The information and judgements in this report are based on a number of sources, largely in the public arena: recollections by the author and some other Treasury officials who were involved in either the original asset sales or in subsequent interactions with the companies; publicly available histories of individual companies where those are available; New Zealand government Budget documents for the privatisation period; a number of books which touch on these issues, most notably “The Rise and Fall of Brierley Investments” and “A Centennial History of Fletcher Building”; and newspaper articles from the last two decades which canvas these issues.

The selection of companies was intended to illustrate the issues that have arisen from privatisation. The list of companies is not comprehensive, nor is it necessarily a sufficiently robustly drawn sample to draw strong aggregate conclusions about privatisation in New Zealand. The strongest general conclusions about the merits of private rather than government ownership can be drawn from global studies with much bigger samples. The intention in this case is to illustrate some of the specific issues that have arisen in New Zealand privatisations.

Objectives of Privatisation

Globally privatisation has had a number of objectives:

- Putting businesses under the full pressures of private capital markets, and thus making them more efficient.
- Reducing the exposure of the government balance sheet to risky debt-financed assets.
- Removing the capacity of the businesses to seek government aid in bad times, thus both promoting better business management (to avoid that risk) and reducing risks to government fiscal outcomes.
- Promoting the development of local capital markets, and/or encouraging a broad ownership of shares in the community.
- Using the sale proceeds for higher priorities, typically to reduce government debt.

These objectives are generally compatible, although a strong emphasis on one particular objective is likely to lead to a particular approach to sale. In New Zealand's case the prioritisation of these objectives moved somewhat through time, and it is probably fairest to judge individual privatisations by the objectives of the time.

More specifically, a survey of New Zealand Budget speeches through the late 80s and the 90s reveals the following.

Privatisation first appears in the "Public Debt" section of the 1987 Budget. The text says there are only 3 ways to reduce government debt: raising taxes, cutting government spending or selling assets. It rejects tax increases because they would discourage investment and job-creation, and rejects large scale spending cuts because only core Health, Education and Welfare could provide the funding needed. It then proceeds to announce the intended sale of 3 companies including Air New Zealand.

The 1988 Budget developed a more comprehensive policy, based both on the desire to reduce government debt and the expectation that moving businesses into the private sector would improve their efficiency and raise economic growth, because "the mix of politics and commerce has proved to be a recipe for failure" and because the "return from SOEs is still expected to be well below the market average" and "retaining ownership would entail a risk that a large proportion of New Zealand's assets would under perform".

From 1996 on, from the first MMP coalition government, there was an emphasis on "strategic assets" that would be protected from sale, and where sale did occur, on ensuring that New Zealanders who wanted to buy shares could do so, typically through a float. By this stage, reflecting a more sustainable fiscal and government debt position, the issue of retiring public debt had moved somewhat to the background.

Typically, in an asset sale, the best price is obtained by selling a controlling shareholding to a single entity that can control the destiny of the business (a trade sale). A float generally gets a lower price. The sale method is also constrained by financial market capacity. Some companies are not amenable to float, and even for those that are, the capacity of the New Zealand private and institutional market to absorb new issues is limited. In terms of trade sales, again the potential group of buyers is limited. Often there is no large New Zealand company in the same industry, so the range of buyers in a trade sale comprises foreigners with interests in that industry, and New Zealand companies with broader investment interests. The annex describes the background to some of these local investors who have been involved in more than one privatisation.

The outcomes for the individual companies dealt with here vary a great deal. Some have prospered and greatly rewarded their shareholders; others have gone into financial distress and some of those have required government finance again. It is

probably unfair to see both of these ends of the spectrum as indicative of failed privatisation. In any group of companies over two decades, some will prosper and some will fail. That is in the nature of a competitive economy.

I now turn to the history of the nine individual companies.

Ports of Auckland

Ports of Auckland (POA) has grown with the emergence of Auckland as New Zealand's dominant city. Ports of Auckland is the country's biggest import port and vies with Port of Tauranga to be the largest port overall. The history of the modern business begins with the creation by statute in 1871 of the Auckland Harbour Board, with a mix of commercial and public policy roles, governed by a directly elected board.

From the 1970s containerisation began to change the nature of POA's business: the amount and nature of investment required and the nature and size of the workforce. This has combined with pressure from both end customers and increasingly global shipping companies to speed up turnaround and to reduce costs. In 1988 Parliament passed the Port Companies Act, which established the commercial operations of the Harbour Boards as companies, and vested their shares in Regional Authorities. The current mixed ownership of New Zealand ports has its origin in some Regional Authorities selling their shares. In the case of POA, the shares were allotted 80% to the Auckland Regional Council, and 20% to the Waikato Regional Council. Waikato Regional Council proceeded to sell its shares into a float, at \$1.60 a share and Ports of Auckland was listed. There were some significant efficiency gains in the subsequent period. For example between 1988 and 1993 staff numbers fell from 1393 to 504, and average turnaround times fell from 38.4 to 15.7 hours. In 2004 POA bought a 19.9% holding in Northland Port Corporation from the Northland Regional Council. That company holds Northland Port land and holds a 50% shareholding in the Northland Port operating company.

POA's market listing lasted until 2005, when Auckland Regional Holdings, which had by then inherited the Auckland 80% of the shares, made a successful on-market bid for the shares it did not own, at \$8.00 a share, and took POA back fully under Auckland Regional Holdings control. The Auckland Regional Holdings takeover bid for Ports of Auckland appears to have been motivated mostly by a desire to simplify some land transfers between the Port Company and the Auckland Regional Council. In 2007 the land at the Western reclamation, (to the west of Viaduct Harbour) was transferred from Ports of Auckland to the Auckland Regional Council. There was some discussion at the time of the buyback of an alternative approach, which would have vested the port land in a council entity, and left the port operations in a listed entity, but it got no political traction.

There have been at least 2 failed attempts at some sort of commercial collaboration between Ports of Auckland and Port of Tauranga. In 2007 Ports of Auckland rejected a proposal from Port of Tauranga for a merger. POA agreed there were business benefits in the proposed merger, but argued the proposed shareholding structure in the Tauranga proposal was not in the interests of Auckland more broadly. It appears the POA's owners were not interested in the proposition. Then in 2009 Port of Tauranga rejected a POA plan to merge the container businesses of both ports. Following a somewhat disappointing 2009 financial year (POA is dependent on the import trade), and a review of POA's capital structure, ARH invested \$40 million in POA at the end of 2009 to strengthen its balance sheet. POA is now owned by Auckland Council Investments, an Auckland council controlled investment company, which also controls the Auckland Council's continuing 22.4% shareholding in Auckland International Airport (see later).

Discussion

Ports of Auckland provides a case of a company that was partially privatised, and then brought back into public ownership by its majority owner. Private ownership was never more than 20% of the company. Evidence of both productivity increases and the share price increase between the original 1988 listing and the ARH takeover in 2005 suggest that POA was a commercial success in this period. The problems that were apparent in the Crown's partial privatisation of the BNZ (see later) have not surfaced. Two possible reasons for that are that the private owners were dispersed, and that they would not have expected a local government owner to have a huge capacity to provide new capital. But more importantly POA, as a listed entity, did not get into financial difficulties.

To some extent port companies are local monopolies. Beyond that the suggested mergers between POA and Port of Tauranga would likely have raised some competition concerns; but to date the regulatory regime does not appear to have been tested. In any case these issues are likely to arise if the port companies behave commercially, irrespective of their ownership. Experience to date suggests that local government ownership of Ports of Auckland is likely to inhibit any fundamental merger with Port of Tauranga.

The period in partial private ownership does not appear to have led to any broader adverse changes in POA corporate behaviour or outcomes. As noted above the ARH takeover appears to have been at least partially motivated by a desire to simplify land transfers on the Auckland waterfront between POA and ARH. Also as noted above it would have been possible to do that by separating the ownership of land from the port operation. Interestingly, POA has shares in Northland Port Corporation, where a land/port operation separation has taken place.

POA was a material addition to the NZX from 1988 to 2005. There are other listed port companies, but only Port of Tauranga is both large and has a significant proportion of shares on issue to the public.

POA appears to have been successful as a partially privatised business. While it would probably be unfair to draw a strong conclusion from the 2009 capital injection, it does seem at least to have demonstrated that any view that POA is some kind of simple cash cow is not correct. A study of relative costs and efficiency at Auckland and Tauranga ports through recent decades would be interesting.

Lessons

POA, though highly successful through the listing period, is not a straightforward cash cow.

Partial privatisation can be successful in a New Zealand context.

Bank of New Zealand

Bank of New Zealand (BNZ) is one of New Zealand's largest trading banks. It has a long history of moving in and out of government ownership. The BNZ was founded in Auckland under private ownership in the 1860s. In 1894 the government provided BNZ with a guarantee in response to a financial crisis. The government then became a shareholder in 1904. In 1945 the Labour government nationalised the BNZ by buying out all the private shareholders.

From 1984 the financial markets were substantially and quite quickly liberalised. This new environment required a somewhat different set of skills from the banks. The 1987 share market crash and subsequent broader fall in asset prices added to the banks' challenges. In both Australia and New Zealand there were banking crises in the late 1980s. In New Zealand the most public crisis was in the BNZ. The BNZ had been an aggressive seeker of new business in this period. As examples, in 1986 BNZ took a shareholding in European Pacific Investments, a joint venture designed to take advantage of the Cook Islands as a tax haven. By 1987 it is claimed the BNZ had secured over half the NZ corporate debt market. The BNZ moved aggressively to build up a loan book in Australia. Ron Brierley, at that time executive chair of Brierley Investments (see annex) was appointed to the board in 1985 and became chair in 1987.

The first move back to private ownership came in 1987, when the BNZ sought additional capital. The Labour government agreed it could do that by way of a share issue. New shares were issued at \$1.75 each, providing the new shareholders with 15% of the BNZ's capital.

In early 1988 the government announced its intention to sell its BNZ shares. The sale was abandoned late in 1988, after Brierley Investments had apparently been identified as the preferred bidder, at \$1.45 a share. (Ron Brierley stood down from the Board in this period). It appears that Ministers were uncomfortable with the price relative to the recent sale of Postbank to the ANZ bank, and were uncomfortable with giving Brierleys control of the BNZ.

In 1989 it became apparent that the BNZ would need more capital, and a rights issue of 7 new shares (at 70c) for every 10 existing shares held was announced. The government passed its rights to new shares to Capital Markets (see Annex). After the rights issue the Crown had 51.6% of the shares, Capital Markets had 30.5% and the general public 17.9%. The share price rose to \$1.25 in the belief the capital adequacy problem had been addressed.

However, in November 1990 the incoming National government was confronted with a new crisis at the BNZ, this time deriving from its lending in Australia. This time the issue was addressed by separating the bad loans into a separate company. The government provided \$620 million of the resulting recapitalisation, and Capital Markets provided \$100 million. The BNZ share price fell to 43c.

In 1992, once the Bank had been stabilised, the government sold its shareholding in the BNZ to National Australia Bank (NAB) for 80c a share (conditional on agreement from other shareholders, which was secured). Since then the BNZ has operated under its own name but as a wholly owned subsidiary of NAB.

Discussion

The BNZ's recent history has 3 phases: a period of government ownership; a period of mixed government/private ownership, and a period of control by NAB.

Clearly the initial response of Australian and New Zealand banks to the late 1980s financial liberalisation and the 1987 share market crash was poor. The BNZ's response to these events appears to have been, with hindsight, particularly ill judged. It would appear that this unrealistically aggressive response started in the final period under government ownership. It is clear however that the period of mixed public/private ownership did not sufficiently address these issues. It would appear, with hindsight, that the Crown's processes for looking after its interests as a shareholder in the partial privatisation period were inadequate.

The BNZ's failings did come back to the Crown as a major fiscal cost. The Crown bore a good deal more than the share of those costs that it would have borne as a regular shareholder. However it is a little difficult to disentangle government as shareholder from government as protector of the financial system in that analysis. As we have seen recently, governments generally do recapitalise major banks where they believe failure would threaten the stability of the financial system.

In summary then, the period of mixed ownership of the BNZ was not a success.

The subsequent sale to NAB was successful in removing specific BNZ financial risk from the government. Australasian banks performed rather well during the recent financial crisis (albeit with a government guarantee of their borrowing).

As a wholly owned subsidiary of NAB, the value of the BNZ is harder to establish, and I have not attempted to assess how current value compares with the sale price. The BNZ, subsequent to sale to NAB, does not appear to have created any specific issues for governments, although in parallel with its major competitors it has done things which have either irritated its customers and thus provided a launching pad for Kiwibank (e.g. closure of branches) or have raised some material economic policy questions (shift of parts of operation to Australia). These changes appear to have arisen from competitive pressure rather than from private ownership per se.

Underlying some of this is a question as to whether a major stand-alone NZ bank would be able to compete with the Australian banks, given both their economies of scale, and their capacity to provide service on both sides of the Tasman in an increasingly integrated economy. The fact that NAB was the successful bidder for BNZ, and that ANZ was the successful bidder for the National Bank when it was sold by its UK owner, suggests that the banks believe the Trans-Tasman bank model is the value maximising approach.

The BNZ experience has probably been negative for capital markets. The BNZ was in its history sometimes listed. There is now no major listed financial institution in New Zealand. But beyond that the BNZ was part of a set of experiences that soured New Zealanders on equity investment.

Lessons

Partial privatisation can be unsuccessful in New Zealand. In the BNZ case it is not clear to what extent that was due to (1) the nature of the BNZ's business in the late 1980s; (2) the objectives and operating style of the largest private owner or (3) the Crown's failure to set up proper mechanisms to secure its interests in the company.

It is almost impossible for the Crown to escape liability for failure of systemically significant financial institutions, irrespective of ownership.

Air New Zealand

Air New Zealand has its origin in two airlines: TEAL which was established in 1940 to provide some international services, with joint ownership by Qantas, BOAC (the ancestor of British Airways), the New Zealand government, and the privately owned Union Airways; and National Airways, established in 1947 by nationalising all existing domestic air services in New Zealand. By 1961 the NZ government had bought out all the other TEAL shareholders. The two airlines were merged under the Air New Zealand brand in 1978. Air New Zealand maintained a monopoly of the domestic network, and of international landing rights granted to New Zealand. From the mid-1980s that monopoly was being broken up, and in 1986 airlines with up to 50% foreign ownership were allowed to operate domestic services. The 1987 Budget announced an intention to privatise Air New Zealand. The original intention was a strategic sale to an airline, with the possibility of a sell down onto the share market. At the end of 1987 the Australian government confirmed that airlines with more than 15% foreign ownership would not be allowed to operate on Australian domestic routes. By late 1988 negotiations with Qantas, as the potential strategic buyer of Air New Zealand were called off and a new sale process opened. This process was to provide that 65% of the shares must remain in New Zealand hands and 30% was to be made available to the public and Air New Zealand staff. There would be a Crown-held kiwi share to protect NZ ownership. (It should be noted that international air rights granted to New Zealand may only be taken up by New Zealand owned airlines, so a private owner has strong incentives to retain NZ ownership). At this time the Australian airline Ansett was allowed to purchase a New Zealand domestic airline.

In December 1988 the government announced the sale of Air New Zealand to a consortium of Brierley Investments –see annex- (65%), Qantas (19.9%), Japan Air Lines (7.5%) and American Airlines (7.5%). Brierley was required to sell some of its shares into a float, and in 1989 30% of Air New Zealand was sold to share market investors, and the company was listed. In 1991 Air New Zealand and Qantas established an agreement, which included a code-share that covered 80% of Trans-Tasman flights, and Air New Zealand raised new capital with a 2 for 1 rights issue. In 1992 the Australian and New Zealand governments announced an agreement that included Tasman competition and access to the Australian market for NZ Airlines from November 1994. Presumably in preparation for this, the Air New Zealand–Qantas agreement was revised, to reduce the number of code-shares and each airline increased its stand alone Tasman capacity. However, in late 1994, the Australian government unilaterally withdrew its 1992 agreement to air liberalisation. Air New Zealand started looking at a new strategy for operating in Australia.

In late 1996, Air New Zealand purchased 50% of Ansett (the second Australian domestic airline). The Qantas/Air New Zealand agreement was terminated in early 1997 and Qantas sold its 19.9% shareholding in March.

In early 2000, Air New Zealand purchased the remaining 50% of Ansett, after a tussle with Singapore Airlines. (Ansett's New Zealand domestic operation had been withheld from the Air New Zealand transactions, and was sold to a group of NZ investors who operated it as a Qantas franchise). Singapore Airlines now bought 8% of Air New Zealand, with approval to increase its shareholding to 25%. Singapore Airlines, having failed to secure a shareholding in Ansett on its own account, was attracted by the capacity of a combined Air New Zealand/Ansett to feed into its own routes. In late 2000 Air NZ raised more capital through a 1:3 rights issue.

From late 2000 the Ansett investment ran into serious problems. The Ansett 767 fleet was grounded over safety issues in December 2000 and again in April 2001. In April 2001, as a signal of what was to come, the Qantas New Zealand franchise went into receivership. In May/June 2001 Qantas proposed to purchase a controlling shareholding in Air New Zealand from Brierleys and Singapore Airlines. However the Air New Zealand Board rejected this approach and decided to seek new capital through Singapore Airlines. It therefore sought approval to raise the foreign investor limits established by the kiwi share. While this approval was being sought, the Ansett situation continued to worsen. Singapore Airlines withdrew its agreement to recapitalise at the agreed share price. Air New Zealand tried and failed to sell Ansett to Qantas, and in September 2001 Ansett was put into administration, closed down and the investment written off.

The Ansett write down left a huge void in Air New Zealand's balance sheet. International landing rights required that the airline be NZ-controlled. That meant that a large part of any new capital had to be NZ-sourced. The sum required was beyond the short-term capacity of NZ equity markets. The government was therefore faced with a choice of recapitalising Air NZ itself, or letting the airline collapse. It chose recapitalisation, and put \$885 million of new equity into it.

In 2002 Air New Zealand and Qantas proposed a strategic alliance, which was rejected by the ACCC and the Commerce Commission in 2003. Singapore Airlines sold its Air New Zealand shares in 2004. Air New Zealand remains listed. The Crown currently holds 74% of the shares. Since the recapitalisation the commercial performance of Air New Zealand has been good. A possible alliance with Virgin Blue, the current 2nd Australian domestic airline, is at present before regulatory authorities.

Discussion

There have essentially been 3 strategies for Air New Zealand pursued at different times in the modern era: collaboration with Qantas to achieve economies of scale (most recently rejected by the regulatory authorities); the Ansett/Singapore model, to create two competing Australasian airlines (which collapsed because of the failure of Ansett), and Air New Zealand as a stand-alone New Zealand based airline (sometimes thought not a viable strategy but recently working effectively).

In assessing the privatisation outcome, a key challenge is assessing in what way Air NZ's behaviour would have differed had it continued as an SOE. Most particularly how would it have responded to the pressure to expand into Australia, and the ability to purchase Ansett?

Clearly from this distance the Ansett purchase was a strategic failure. The question of what would have happened if Singapore Airlines, with its bigger balance sheet, had purchased the second 50% of Ansett is also interesting.

An Air New Zealand SOE that stayed out of Ansett might have proved a reasonable investment for the Crown. But the record of airlines as investments is poor, and the airline was capital-hungry even before the Ansett purchase. Air NZ had two rights issues in the full privatisation period.

The Crown has ended up having to recapitalise the company. The constraints on foreign equity in an airline increase the likelihood that the Crown will feel obliged to resolve capital issues flowing from a New Zealand based international airline's commercial failure. But the Crown has not (yet) lost money on the Air NZ transactions. It was private shareholders rather than the Crown that bore the value loss from the financial crisis in Air NZ. The Crown still owns the shares it purchased in the recapitalisation.

There have been some moves of maintenance and cabin crews off shore in the privatisation period (both under full privatisation and under the current Crown-dominant ownership). These are responses to commercial pressures.

The impact on NZ's equity markets is a bit mixed. The original shareholders lost much (but not all) of their investment, which does not encourage growth in equity investment. But since recapitalisation the company has performed well. The Ansett debacle damaged the relationship between Air New Zealand and Singapore Airlines. Given the linkages of Singapore Airlines into Singapore business that was not a good outcome.

Lessons

It was private investors, rather than the government, who lost money as a result of Air New Zealand's financial failure.

The Ansett purchase was a major strategic failure. It does not disprove the general principle that private ownership is more commercially adept than government ownership. But it reminds us it is a general principle rather than an iron law.

A New Zealand government is likely to find itself the only potential source of new capital in the event of financial failure of a New Zealand-based international airline.

The current ownership model (dominant Crown ownership of a listed company, with negligible Crown influence other than in the Chair appointment), has been successful to date.

This company has twice been badly impacted by Australian regulatory interventions.

Auckland International Airport

Auckland International Airport (AIA) was built at Mangere in the 1960s. It was a joint venture between central government and the Auckland local authorities. In 1988 it was corporatized, with shares held by central government (the largest single shareholder) and individual Auckland local authorities. Some of the smaller local authorities sold down their shares, and the Crown took the opportunity to increase its shareholding to a majority.

The government announced its intention to sell its shareholding by float in May 1998, and the float took place in July 1998. The shares were sold at \$1.80. AIA became the 5th listed airport in the world. Initially reliance was placed on the Commerce Act provisions about abuse of a dominant position (“light handed regulation”)

In 2002 the Commerce Commission recommended price control for services provided to airlines by AIA. Ministers rejected that recommendation and put in place an information disclosure regime instead.

AIA planned and started construction on a 2nd runway to relieve peak hour congestion by moving slower turboprop aircraft off the main runway, but has subsequently deferred that. AIA has invested extensively in the property it owns surrounding the airport. AIA carried out a 4 for 1 share split.

In 2007/8 both Dubai Aerospace and the Canadian Pension Plan Investment Board expressed interest in buying a major share of AIA. In the end the Canadians made a bid for 40% of the shares at \$3.60 (i.e. \$14.40 pre-split). This provoked the government to introduce a new regulation requiring assessment of “whether the overseas investment will, or is likely to, assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land.” In the end the bid was rejected but that rejection did not rely on the new regulation the government had just gazetted.

Auckland Airport has taken a shareholdings in two Queensland airports and in Queenstown airport. The new Auckland Council retains a 22.4% shareholding in AIA. At the time of writing AIA shares sold most recently for \$2.12 (i.e. \$8.48 pre-split)

Discussion

AIA has rewarded those who took shares in the 1998 float well. As noted above by 1998 spreading share ownership had become one of the objectives of privatisation. It is possible that a trade sale of the Crown shareholding to a single buyer would have achieved a higher price, but such a buyer would likely have been foreign. It is difficult to assess how much of the share price gain should be attributed to management performance.

There have been some questions about the regulatory regime for airports. The airlines are often litigious, but it is at least possible that with hindsight the 1998 sale was overly optimistic about the efficacy of light handed regulation. It should be noted that airline charges represent less than half of AIA's income.

AIA has become one of the major and respected companies on the NZX, and it retains a wide shareholding. The 2008 rejection of the Canadian bid was probably damaging to New Zealand's capital markets reputation, mainly because the rules were changed in the middle of a major transaction.

Lessons

AIA has been a successful company that has rewarded its shareholders well.

The regulatory approach at privatisation was possibly a bit optimistic.

Foreign ownership issues were resolved in a somewhat untidy manner. Unless New Zealanders' appetite for equity investments increases, these problems will recur elsewhere. As a successful, widely held company, AIA is a useful platform in that increase.

Telecom

The business that became Telecom originated as part of the Post Office. It was responsible for the line telephone system, and had a statutory monopoly. From the 1980s the emergence of mobile telephone technology began to change the industry. In 1987 Telecom was separated from the Post Office and became an SOE.

In 1990 the government announced that it intended to sell Telecom, in a sale process that would limit a single foreign consortium to 49.9% shareholding, provide a residual level of government influence through a "kiwi share" and allow for the sale of \$500 million in shares to the public.

In June 1990 the government announced that Telecom had been sold to Bell Atlantic and Ameritech (two of the regional telephone companies that had been created as a result of a regulatory break-up in the US). Under the terms of the sale the buyers agreed to sell 5% each to Fay Richwhite (see annex) and Freightways (Alan Gibbs'

investment vehicle) over 3 years, and to offer shares to the public within the 3 year period to reduce its shareholding to 49.9%. As with other asset sales where the privatised company might be in a dominant market position, reliance was placed on Commerce Act provisions to deter abuse of a monopoly position, and there was no telecommunications-specific regulation. (“light-handed regulation”).

In 1991 Clear Communications established a competing national toll service. In July 1991 30.9% of Telecom was sold to the public by share float at \$1.82 a share.

In 1993 Bell South (another US regional telco) set up a 2nd mobile network (subsequently sold to Vodafone). Bell Atlantic and Ameritech sold down a further 4.6% of their shares each.

In 1995 an interconnect agreement with Clear Communications was established. Telecom established First Media to build a fibre optic network in Auckland and Wellington. (This project was subsequently abandoned). By this stage the emergence of the internet was creating a major new change in the environment for Telecom

In 1998 Bell Atlantic and Ameritech sold the remainder of their shares mainly to institutions. In 1999/2000 Telecom progressively bought AAPT, an Australian telecoms company. That investment has not been successful and much of it has subsequently been written off.

In 2000-2001, following a review of telecoms regulation, the government started to move away from the “light-handed regulation” approach and appointed the first Telecoms Commissioner.

From this period pressure for higher speed and more competitive internet services grew. In 2006 the government required unbundling of the local telecom loop. Telecom voluntarily separated itself into wholesale and retail operations.

In 2008 Telecom split into 3 units: Chorus (network operator); wholesale; and retail. Having reached around \$9 in the late 1990s, at the time of writing Telecom shares were selling for \$2.19. The linkage between Telecom’s corporate structure and Telecom’s role (if any) in the government funded broadband network remains an open issue.

Discussion

Telecom’s post-privatisation performance divides, on the face of it, into two periods. For the first five years or so the value of the company rose quickly, as reflected in its share price, and although that led to some critics arguing that it had been sold too cheaply, the public also appreciated both Telecom’s improved service compared to the memory of the Post Office, and the new competition from Bell South and Clear.

Subsequently, as Telecom's share price has fallen back to near the original float level, criticism of the original sale price has dissipated. The decline in Telecom's share price appears to have several reasons: Firstly the commercial environment has got much tougher for incumbent telcos over recent years. For example their traditional services are a declining proportion of peoples' telecoms purchases, and they are under pressure to invest extensively in fibre-optic networks that they do not expect will be commercially attractive. The share prices of incumbent telcos globally have followed similar patterns to Telecom over recent years. Secondly the regulatory environment in New Zealand has become a good deal less friendly to Telecom over recent years. Thirdly Telecom's investment in AAPT has been a failure.

With hindsight, at the time of the Telecom sale there may have been rather too much optimism about how effective the "light-handed" regime would be in dealing with an incumbent telephone company, and perhaps an underestimation of the power of the incumbent. Beyond that, at the time telephone lines were probably seen as a declining technology, with mobile as the technology of the future. Those establishing the regime did not imagine the importance of the internet and the pressure for high-speed broadband networks.

Telecom was for some time after privatisation the largest company on the NZX. (It has recently been overtaken by Fletcher Building). An investor who bought Telecom shares at float and held them to date would have received an adequate but unspectacular return mainly through dividends.

It is difficult to assess how Telecom as a continuing SOE would have performed by comparison. Presumably if it had behaved differently it would have been more amenable to the kinds of investments in fibre-optic that Telecom has not seen as commercially attractive. An SOE's approach to investments like AAPT is not clear. An SOE is most likely to have been less of a challenge on the policy/regulatory front, and by extension produced less of a return to its shareholders.

Lessons

The growth of the internet has hugely changed the telecoms industry, and the requirements of the regulatory system, since privatisation.

The returns to Telecom shareholders who have held their shares since the 1991 float have been relatively modest. Those who quit their shares in the late 1990s did well.

If Telecom as an SOE had been more flexible on regulatory issues it would likely have produced a lower return to its shareholders.

Tranz Rail

The first railway in New Zealand from Christchurch to Lyttelton opened in 1863. Early railways were built either by provincial governments, or by private investors (financed through land grants). By the late 19th century the central government had taken over all the rail lines. Until the spread of buses and trucks after WW1 rail was the only way of transporting heavy loads or large numbers of people efficiently by land. From the 1930s rail freight was protected by limits on the distance trucks could carry goods, and passenger trains were protected because the Railways owned the long-distance buses. The rail network reached its maximum extent in 1953. The growth of the private car, and ultimately of cheap domestic air travel, meant that aside from the urban passenger services, by the late 20th century rail in New Zealand became in commercial substance a freight operator. Railways established the existing Wellington-Picton ferry service in 1962.

From the 1970s a number of major changes began to impact on transport operators. Containerisation changed the way freight was handled; just-in-time stocking and the growth of IT changed customer expectations; and both roads and trucks improved quickly. From 1983 removal of the restrictions on how far goods could be trucked began. As a government department the railways was a perennial money loser.

Rail was made into a SOE in 1986. There was a considerable level of cost-reduction in the SOE period, including dramatic reductions in railways staffing, and a substantial debt write-down. Rail was then restructured in 1990, in an arrangement that separated the rail operations and track (NZ Rail Ltd) from the land (the continuing Railways Corporation). NZ Rail paid a nominal rental for the land. It was expected on that basis that NZ Rail would be commercially viable, at least in the medium term, and would be a candidate for sale.

The government announced the prospective sale of NZ Rail in 1992, and completed the sale in 1993. The purchaser was a consortium comprising Wisconsin Central Rail (a US regional rail operator); Berkshire Partners (a US investment fund); and Fay Richwhite (see annex). The purchase price was \$328 million.

In 1994 Tranz Rail sold its interest in Clear Communications (see Telecom section) which it had acquired pre privatisation by contribution of some Tranz Rail fibre links, for \$72 million. This was used to help finance a capital repayment to shareholders of \$100 million in 1995. (Since the original purchase price had been significantly debt-financed, the capital withdrawal meant that the private shareholders remaining original equity contribution was now small) In 1996 capital was raised by issuing new shares at \$6.19. By 1997 the share price had peaked at \$9. In 1998 Fay Richwhite sold down some of its shareholding. Around this time Tranz Rail's capital investment began to decline. In 2001 Wisconsin Central was taken over by the privatised Canadian National Railway, which appears to have had a more aggressive approach to its investments. By this point Tranz Rail was once again running into financial

trouble. The costs that had been taken out of it were not sufficient to match continuing declines in competing freight costs. Fay Richwhite and Canadian National both sold out. In an effort to provide a foundation for improved Auckland commuter rail services the government bought the Auckland track assets, which provided some temporary financial relief for Tranz Rail.

The Auckland and Wellington commuter rail systems had been included in the privatisation. Like other commuter rail systems both require substantial operating subsidies, which are provided through regional government entities. The expectation had been that the continuing service would be contracted through Tranz Rail. Through the latter part of the privatisation period, the regional governments became progressively more dissatisfied with Tranz Rail's unwillingness or inability to fund new commuter rail capital investment, and increasingly invested themselves (with substantial government financial support) in commuter rail assets.

The next year the government provided further modest support to Tranz Rail by purchasing the Wellington Railway station. Tranz Rail's financial problems were now creating visible shortfalls in its capital asset replacement programme, and leading to pressure from major users and other stakeholders on government to intervene. Tranz Rail's share price dropped to a low of 30c.

In response to this crisis, Ministers made an offer to take back the track and to take partial control of Tranz Rail. At the same time Toll Holdings (a major Australian transport group) made a bid for 100% of Tranz Rail at \$1.10. In the end the shareholders, presumably preferring the option of selling all their shares and moving on, opted for the Toll offer. The Crown agreed with Toll to take back the track for a nominal \$1, but with a commitment to some track refurbishment at the Crown's expense. Beyond that Toll agreed to pay the full capital and operating cost of the track.

The long-term decline in the economics of New Zealand rail freight soon reasserted itself; however, and Toll concluded it was unable to pay the full cost of the track. Frustrated with the inability to establish a sensible long-term commercial arrangement with Toll, the Crown bought back the rail and ferry business in 2008 for \$665 million. Kiwirail, the Crown operator, now operates with a substantial subsidy.

Discussion

The recent experience for rail divides into 3 periods: a period from formation of rail as an SOE to the late 90s when there was some optimism about the commercial future of rail; a period from then until 2003, when Tranz Rail's financial problems became progressively more acute, and finally a period from 2003 to date when the government progressively increased the subsidy to rail. Overlaying all of this is the long-term decline in the commercial viability of rail freight. When rail was privatised

the expectation was that as structured the freight operation could be commercially viable at least in the short term. It now loses at least \$100 million a year.

There have been a number of attempts to make rail viable either by investment (North Island main trunk electrification in the 80s, track refurbishment after the track purchase in 2003) or by organisational reform (corporatisation and privatisation). The underlying decline has proved stronger than each of these. Put another way, 2 different but very aggressive commercial operators. (Fay Richwhite and Toll) have tried to make money out of New Zealand rail freight and concluded that it is not possible.

Search of the documents around the original privatisation reveals two views of the objective: a view that privatisation would make rail more efficient and thus viable. In the end whatever efficiencies were secured by private ownership they were not enough to make rail freight commercially viable. There was an alternative view at the time that rail was in long-term commercial decline, and that putting it into the private sector would make it less likely that rail could secure government financial contributions to keep it alive. The commercial analysis in this second view proved to be correct during the privatisation period, but the view of how the private sector and government would interact over the decline of rail was not correct.

In the end the decline in investment in the later Tranz Rail period was a commercial reaction to first of all the fact that investment in rail was not a good commercial use of funds, and subsequently to the fact that Tranz Rail was running out of cash. The shareholder withdrawal of equity in 1995 was also no doubt commercially rational to the then Tranz Rail shareholders, but damaged the public perception of private owners as reliable stewards of utilities. In the end the public was not looking for such a hard-nosed commercial approach to rail investment. It would appear the public is prepared to subsidise rail freight if that is necessary to keep it operating.

In terms of the Auckland and Wellington commuter rail systems, with hindsight the view that Tranz Rail would invest in long-lived assets on the basis of medium term contracts was optimistic. And the reluctance of regional councils to commit to long-term contracts is understandable. Tranz Rail's financial troubles only exacerbated this problem. With hindsight it probably would have been more sensible to withhold the commuter rail assets from the asset sale, and simply to have contracted out the operation. (The current Auckland commuter rail model). Although the economics of commuter and freight rail are quite different, there is a political process link, in that voters are most likely to draw their conclusions about how well rail is run from the commuter rail system, and lobby their representatives accordingly.

Nonetheless, privatisation meant that for 10 years from 1993 to 2003 the Crown did not have to fund the rail freight system. That is quite likely the only such decade since rail came under central government control in the 19th century.

Post-privatisation the Tranz Rail share price peaked at prices that would have valued the company significantly above the \$328 million sale price. The value put on it at the time of the 2003 Toll bid was lower than the sale price. As an integrated commercial asset rail is probably worthless now, though elements of it (for example the ferries; the West Coast coal route) would still have value in a break-up. The price paid by the government in 2008 reflected essentially a non-commercial transaction.

Lessons

The rail system has reverted to Crown ownership and Crown funding.

A view that rail freight could be commercially viable proved optimistic.

Private rail companies will not readily invest in long-term commuter rail infrastructure on the basis of short-term funding contracts. The expectation that a Tranz Rail owned commuter rail system would work was therefore optimistic.

Ultimately the rail system reverted to government ownership and public funding because although Tranz Rail and Toll faced hard budget constraints, the public, including significant parts of the business community, did not find the consequences of the hard budget constraint acceptable.

Trustpower

Trustpower originated from the Tauranga Electric Power Board, which was founded in 1923. From an early date the business was a mix of electricity generation, lines and retailing. In 1994, following legislation corporatizing such local electricity companies, Trustpower was formed. Infracore (see annex) and US electricity utility Alliant purchased shares in Trustpower. Some shares were listed and a shareholding also remained with a consumer trust whose beneficiaries are Tauranga electricity consumers. Infracore's initial 20% investment was purchased at 93.5c a share.

In 1997/98 the state-owned Electricity Corporation of New Zealand sold 5 small hydro stations, and Trustpower purchased 4 of them (Matahina, Cobb, Coleridge and Highbank). In 1999 local electricity companies were required to split their lines business from their generator/retailer businesses. Trustpower chose to be a generator/retailer. In 2003 Trustpower bought back shares. Infracore did not participate in the buy-back, and so increased its shareholding to 33.5%. In 2006 Infracore purchased Alliant Energy's Trustpower shares for \$6.20 a share and secured majority control.

Today Trustpower is NZ's 5th largest electricity generator/retailer. It remains listed, with Infracore holding just over 50% and the Tauranga Energy Consumer Trust just over 30%. At the time of writing Trustpower shares had most recently traded at \$7.46.

Discussion

Trustpower has been highly successful for its shareholders since its 1994 listing. It is effectively controlled by Infratil. In assessing the outcome of privatisation it would be necessary to compare Trustpower as it stands with what it would have been under continued local authority or trust ownership. Trustpower appears to be the only one of the former local electricity companies to have become a successful generator/retailer. This may partly reflect a high level of generation in the Tauranga Electricity Board's historic assets; but at least some of the credit for this outcome should go to Infratil and private shareholders. (Interestingly, Port of Tauranga is probably the most successful port and is a highly regarded listed company also. It has a broadly similar history).

Concerns about electricity industry outcomes focus more usually on regulatory issues, rather than on whether the electricity companies respond effectively to the commercial environment they face. In other words questions about whether competing generators, or a single generator, are better fitted to search out lowest cost new generation options, co-ordinate the system, deal with dry year risk, and do all this with a sensible electricity pricing system are not addressed here.

Lessons

Trustpower is a successful company that has rewarded its shareholders well.

It is one of a number of successful partially privatised former local authority businesses.

Contact Energy

New Zealand's state-owned electricity system grew up in the Electricity Department, which developed hydro, geothermal and some thermal stations. The Electricity department was turned into an SOE in 1987.

In 1996, in an attempt to get some competition at the generation level in electricity (e.g. competing thinking about the best source for new generation) Contact Energy was separated out from ECNZ as a separate SOE. Contact's assets comprised the Clutha river hydro stations, geothermal stations, and some thermal stations. (ECNZ was subsequently split into Meridian, Genesis and Mighty River Power).

In 1998 Contact was sold. A 50% cornerstone holding was sold to Edison Mission Energy (a US electricity utility) for \$5 a share and the remainder of the shares sold to institutions and the public in a float at \$3.10 a share.

In 2001 Edison Mission Energy made a takeover offer for full control of Contact at \$4.14 a share. The offer was conditional on achieving 90% acceptances, and it failed.

In 2004, following financial problems elsewhere in its business Edison Mission sold its shares in Contact to Origin Energy of Australia. In 2006 Origin proposed a merger with Contact that also failed to get shareholder approval.

Contact remains listed, with Origin as its controlling shareholder. At the time of writing Contact shares had last traded at \$6.07.

Discussion

Contact has been a successful business since privatisation. A precise comparison of the efficiencies that the 5 main generators have achieved since they were all separated would be interesting.

With hindsight the average price achieved appears reasonable. Small shareholders in Contact have done well. Contact has provided a large robust company for the NZX.

As noted in the Trustpower section, the main concerns about electricity outcomes have been about the regulatory environment rather than whether the commercial players responded effectively to commercial incentives. Those issues are not addressed here.

Beyond that the main concern about Contact has been some governance issues. In both the 2001 and 2006 takeover bids the independent directors (who had originally been appointed by the Crown as SOE directors) voted in favour of bids that were subsequently rejected by shareholders, thus raising questions about how effectively they represented shareholders' interests.

Lessons

Contact is a successful business with a wide shareholder base.

Issues of concern are usually about the regulatory framework rather than the performance of the company.

Forestry Corporation of New Zealand

Plantation pine forests developed in New Zealand from the 1930s. By the 1970s there were 4 major forest owners in New Zealand (Fletcher Challenge, Carter Holt, New Zealand Forest Products-which was absorbed into Carter Holt in the late 1980s; and the Forest Service-a government department which was responsible for both conserving indigenous forest and for production forests) There were interlinkages between these operators: for example the Forest Service leased land to New Zealand Forest Products, and sold logs to Fletcher Challenge.

The Forest Service was restructured (the conservation role was passed to DOC, and the production forest turned into an SOE) in the late 80s, with a view to sale of plantation forests. In 1989 following serious concerns from Maori about the prospective sale of forest land, the Crown Forests Assets Act was passed. The Act separated the land from the forest cutting rights. The cutting rights were to be sold, and the land would stay in Crown ownership until Treaty claims in the region were resolved, and would be leased to forest companies.

There was a set of forest sales through the country in 1989, leaving the substantial state-owned forest resources in the Central North Island: Forestry Corporation of New Zealand (FCNZ). The assets included both the Kaingaroa forest and the Waipa timber mill near Rotorua.

A sale process for FCNZ was announced in 1996. The objectives were to move commercial assets from the Crown to the private sector, and to encourage development of the forestry industry. In August 1996 FCNZ was sold to the Central North Island Forests consortium of Fletcher Challenge (see annex) 37.5%; Citifor (a Chinese company) 37.5%; Brierleys (see annex) 25%.

In 1998 the Asian financial crisis led to a sharp reduction in log prices, and particularly in the price of douglas fir logs. The buyers had predicated their purchase price round an accelerated harvest of douglas fir. Brierleys exited the consortium.

In 1999 Fletcher Challenge Forests was recapitalised, with \$427 million of new shares. But the consortium's problems continued, and in 2001 it was placed into receivership. Fletcher Challenge wrote down over \$500 million of its investment, as part of a total forests write down of \$1 billion that was a factor in driving the dismemberment of Fletcher Challenge.

In 2003 the forests were sold to the Harvard University endowment fund for around half of the 1996 sale price. At the same time the Waipa mill was sold to a local company.

In 2006 the New Zealand Superannuation Fund bought a share of the forests. The pricing appears to have been consistent with the price initially paid by the Harvard Fund.

Discussion

The FCNZ sale was a success, but not for reasons that were expected at the time. It shifted the write-down of forest assets as a result of the 1998 Asian crisis from the Crown to Fletcher Challenge and its consortium partners. Clearly in this case the price received for the asset was, with hindsight, excellent.

Despite hopes at the time about investment in further forest processing, privatisation has had no obvious transforming effect on the industry, which remains heavily dominated by the bulk log trade, and which, in the face of soaring dairy prices, has been in substantial territorial retreat in the Central North Island.

The FCNZ purchase and subsequent write down was one of a number of factors leading to the break up and dismemberment of Fletcher Challenge, once New Zealand's largest listed company. (Other factors included continued poor returns from paper mills).

Lessons

With hindsight the price received for FCNZ was good.

The sale transferred the forest value losses flowing from the 1998 Asian financial crisis from the Crown to the Fletcher Challenge led consortium.

Conclusion

The privatised companies have followed very different paths, and the level of commercial success they have achieved has varied greatly. That should not surprise us. That is how an economy made up of competing private businesses functions. This section attempts to draw together some lessons from across the experience of these nine companies.

Sale price: Contrary to what might well be the public view, it does not appear from looking at these assets now that the Crown received consistently poor prices for its sales. There are some where shareholders who have held their shares have done very well (Auckland Airport, those who bought into Contact at float), and some where at least those who held onto their shares did badly (Forestry Corporation, Air New Zealand). In some cases shareholders who sold out after the initial round of post-privatisation cost-cutting have done well even out of companies that subsequently performed rather poorly. (Telecom, Tranz Rail). Interestingly the early sellers seem to be a similar set of shareholders.

Regulation: With hindsight the reliance on “light-handed regulation” was rather optimistic in terms particularly of dealing with the power of an incumbent telephone company, and the pressure to create a broadband network.

Spillovers and linkages: Generally there does not seem to have been much loss from linkages with the rest of the public sector as a result of privatisation. Ports of Auckland land is perhaps one exception. The one area of major concern is the electricity industry. The split of ECNZ into 4 competing generator retailers did not require privatisation, but the two decisions are linked. Whether the 4 generating company structural model is the best for New Zealand remains the subject of some debate.

Hollowing Out: There has been some transfer of skilled functions out of NZ (notably in BNZ and Air NZ) but this appears to be more a result of competitive pressure than of private ownership per se.

Equity markets: As noted in the individual sections, some of the companies were listed on the NZX but no longer are (BNZ, Ports of Auckland, and Tranz Rail). And not everything that has happened in this story has contributed to the reputation of NZ equity investment. But it is worth noting that the 5 of the companies under discussion that remain listed on the NZX (Auckland Airport, Air New Zealand, Contact, Telecom, Trustpower) make up over a third of the market capitalisation of the NZX50.

The reputation of privatisation: The public perception of privatisation in New Zealand is negative. It would require proper opinion sampling to understand what the public sees as the major negative features. Obviously it is an issue that draws ideologically

based support and opposition, but it would appear that middle New Zealand is not happy about the privatisation experience. The concerns will include:

(1) The assets were sold cheaply (as noted above, this might have appeared true in the late 90s but does not appear to be generally the case from the viewpoint of 2010.)

(2) A small group of people made a lot of money. (This is clearly true for example of those who made early exits out of Telecom and Tranz Rail, but there are also significant groups who lost a lot of money in Forestry Corporation and Air New Zealand. It does not help that some of those seen to have made a lot of money are also linked to the 3rd issue)

(3) Privatised companies are perceived to have under-invested in necessary infrastructure. (This is not true across all these companies. But the Tranz Rail and Telecom (broadband) cases have created this perception, however commercially rational the companies approach might have been.)

Did the privatisations achieve their objectives?

As noted at the start of this paper, privatisation has a number of objectives. This section attempts to assess whether the privatisations described above in fact achieved those objectives. The objectives set out at the start are addressed below:

Putting businesses under the full pressures of private capital markets, and thus making them more efficient.

Those businesses that were only partly privatised (Ports of Auckland, Trustpower) obviously had some constraint on the extent to which the private capital market pressures operated on them at any point. Those that came back fully (Ports of Auckland, Tranz Rail) or partly (Air New Zealand) under public ownership did not long face those full capital market pressures. And there would be scope for some questions about whether ownership by the Harvard Endowment Fund and the NZ Superannuation Fund (Forestry corporation assets) constitutes full capital markets pressure. Beyond those constraints the companies have faced capital markets pressures. There is some evidence of greater efficiency, but a more detailed study of their performance would be needed to confirm that.

Reducing the exposure of the government balance sheet to risky debt-financed assets

Government avoided the balance sheet impact of the collapse of both Forestry Corporation and Air New Zealand.

Removing the capacity of the businesses to seek government aid in bad times, thus both promoting better business management (to avoid that risk) and reducing risks to government fiscal outcomes.

Of the four of these companies that got into financial trouble post privatisation, the Crown avoided any loss from the late 90s write down of FCNZ assets, and from the Ansett related value loss at Air New Zealand. But it could not avoid recapitalising Air New Zealand or the BNZ, or buying back the rail assets. The implicit liability to recapitalise Air New Zealand arose from the international regulatory requirement that an airline holding New Zealand landing rights had to be substantially New Zealand owned, coupled with the limited capacity of NZ equity markets. Air New Zealand may be an unusual case. The implicit liability to recapitalise the BNZ arose at least in part because the BNZ was deemed systemically significant. The buyback of rail happened because the public did not accept the implications of a hard commercial budget constraint for rail.

Promoting the development of local capital markets, and/or encouraging a broad ownership of shares in the community.

As noted above, the 5 of the companies under discussion that remain listed on the NZX (Auckland Airport, Air New Zealand, Contact, Telecom, Trustpower) make up over a third of the market capitalisation of the NZX50. So the contribution to local equity markets, notwithstanding the delisting of Tranz Rail, Ports of Auckland and BNZ, has been substantial.

Using the sale proceeds for higher priorities, typically to reduce government debt.

Two of these companies (Ports of Auckland and Trustpower) were privatised out of local government. Of the others, the sale proceeds from all of them were used to repay government debt. The privatisation programme of the 1980s and 1990s is one of the factors behind New Zealand entering the recent financial turmoil with a relatively modest level of government debt.

Annex

This annex provides some background on four of the New Zealand based businesses that invested in more than one privatisation.

Brierley Investments

Brierley Investments was founded in the 1960s by Ron Brierley. It grew up as the first major business in New Zealand focused on corporate restructuring. That is to say that its approach was to buy companies where some major restructuring could release value, carry out that restructuring and then sell its interests. In 1960s and 1970s New Zealand this approach and so also Brierleys itself was seen as rather aggressive, but by the 1980s it had been accepted into the corporate mainstream and had a large and very loyal shareholder base.

Brierleys had a tangential role in the BNZ saga. They were key to the Air New Zealand privatisation, where Brierley interests would have been centrally involved in the Ansett purchase, and they were for a time involved with Forestry Corporation. Brierleys most likely lost money on their privatisation investments in total.

By the late 1990s the gloss had come off the Brierley operation. Ron Brierley was eased out and set up Guinness Peat, a similarly conceived investment company that remains listed today. Brierley Investments passed into the hands of Asian investors. It remains in existence under the name of Guoco Leisure, and has a secondary listing on the NZX, but it now has no material investments in New Zealand.

Fletcher Challenge

Fletcher Challenge (FCL) grew into a conglomerate with wide investment interests through a series of mergers in the 1970s and 80s. The businesses that formed it were the Fletcher businesses in construction and forestry, the Tasman pulp and paper business and the Challenge/Wright Stephenson businesses in retail and rural servicing. Prior to the listing of Telecom in 1991, Fletcher Challenge was the largest NZ listed business.

Fletcher Challenge proceeded to acquire interests in forests, pulp and paper and construction globally. In the late 1980s FCL bought Petrocorp from the NZ government, thus establishing interests in the energy sector. FCL also bought the Rural Bank from the government.

The 1990s proved a very difficult decade for FCL. The pulp and paper assets were consistent underperformers. In 1993 FCL sold a large group of property and rural assets, and separated its forests interests into a separate share. In 1996 it separated out the remainder of its businesses into Building, Energy, and Paper shares. So the FCL that bought into FCNZ in 1996 was already under serious pressure.

In 2000 the FCL Board concluded that the conglomerate structure was value destroying, and proceeded to break the company up and sell several parts of it. Fletcher Energy was sold to Shell; Fletcher Paper was sold to Norske Skog; Fletcher Forests remained as a listed entity but sold down its forests interests (It remains listed today as Tenon); Fletcher Building was retained as a listed company. With the decline in the value of Telecom in the last decade, and a strong performance from Fletcher Building, the latter has become NZ's largest listed company.

Fay Richwhite

Fay Richwhite was a New Zealand based investment bank, owned by Michael Fay and David Richwhite, which grew its business on the basis of the economic changes brought about by the economic liberalisations of the 1980s and early 1990s. Capital Markets was a linked listed company. Fay Richwhite sold its investment banking interests to Capital Markets in 1990, and then bought the company back for a fraction of the sale price 5 years later.

Fay Richwhite/ Capital Markets appear in the privatisation story 3 times.

When the BNZ sought new capital through a rights issue in 1989, the Crown passed its rights to Capital Markets, which subsequently became a 30% shareholder in the BNZ. Capital Markets and the BNZ were both shareholders in European Pacific, the company that was the vehicle for the Cook Islands based tax avoidance arrangements that became the basis for the "Wine box" enquiry. Capital Markets investment in the BNZ itself, given the subsequent financial crisis and the fact Capital Markets put another \$100 million into the restructuring, would not have been especially profitable.

The investments in Telecom and Tranz Rail however were very profitable for Fay Richwhite. This was at least partly because of astutely timed exits. In the Tranz Rail case the timing of Fay Richwhite's exit was the basis of a Securities Commission case about insider trading (Midavia Investments). The case was settled with a substantial payment but without admission of liability.

In sum then, Fay Richwhite's involvement with privatisation was extremely lucrative for them.

After the "Wine box" enquiry, Michael Fay and David Richwhite moved their business interests overseas.

Infratil

Infratil is a listed investment company established by Lloyd Morrison in the early 1990s. It was established to invest in infrastructure.

Infratil's investment in Trustpower is outlined above. Infratil also bought the Crown's shares in Wellington airport, and bought bus systems in Wellington and Auckland, which had originally been local authority owned. To date the Trustpower and Wellington airport investments have been successful for Infratil.

Infratil has bought some infrastructure and utilities overseas. It has recently bought Shell's New Zealand distribution assets. Infratil remains an NZX listed company.