The Treasury

Mixed Ownership Model for Crown Commercial Entities: Shares Plus Proposal Information Release

21 December 2012

Release Document

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

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Not relevant.

Where information has been withheld a reference to the applicable section of the Official Information Act has been made, as listed above.

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

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Wai 2358: Preliminary Analysis of "Shares-Plus"

Date:	29 August 2012	Report No:	T2012/2137

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Note** this report and discuss with Ministers and officials to inform the drafting of a Cabinet paper for Mon 3 Sept.	4pm, Wed 29 Aug
Associate Minister of Finance (Hon Steven Joyce)	**Note** this report and discuss with Ministers and officials to inform the drafting of a Cabinet paper for Mon 3 Sept..	4pm, Wed 29 Aug
Minister for State Owned Enterprises (Hon Tony Ryall)	**Note** this report and discuss with Ministers and officials to inform the drafting of a Cabinet paper for Mon 3 Sept..	4pm, Wed 29 Aug
Attorney-General (Hon Christopher Finlayson)	**Note** this report and discuss with Ministers and officials to inform the drafting of a Cabinet paper for Mon 3 Sept..	4pm, Wed 29 Aug
Minister for the Environment (Hon Amy Adams)	**Note** this report and discuss with Ministers and officials to inform the drafting of a Cabinet paper for Mon 3 Sept..	4pm, Wed 29 Aug

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Chris White	Manager, Commercial Transactions Group, The Treasury	[Withheld under s9(2)(a)]	✓
Jeremy Salmond	Treasury Solicitor and Manager, Legal Group, The Treasury		✓
Kirsten Price	Senior Solicitor, Commercial Transactions Group, The Treasury		

Actions for the Minister's Office Staff (if required)

None.

Enclosure: **No**

Treasury Report: Wai 2358: Preliminary Analysis of "Shares-Plus"

Executive Summary

This report provides our preliminary analysis of the “shares-plus” proposal put forward by the Waitangi Tribunal. It assesses:

- Whether “shares plus” can be implemented, legally, practically and in terms of the government’s policy objectives, in the way the Tribunal envisages, and
- Whether other forms of redress can substitute for “shares plus”.

[Withheld under s9(2)(h)]

Recommended Action

We recommend that you:

a **note** this report, and

b **discuss** with Ministers and officials to inform the drafting of the relevant cabinet paper.

Chris White
Manager, Commercial Transactions Group
The Treasury

Jeremy Salmond
Treasury Solicitor
The Treasury

Hon Bill English
Minister of Finance

Hon Steven Joyce
Associate Minister of Finance

Hon Tony Ryall
Minister for State Owned Enterprises

Hon Christopher Finlayson
Attorney-General

Hon Amy Adams
Minister for the Environment

Background

1. In addressing the stage one issues for its inquiry into the *National Freshwater and Geothermal Claim*, the Tribunal accepted the Crown's assurances that post any sale of the power-generating SOEs the Crown:

> *...is open to discussing the possibility of Māori proprietary rights (short of full ownership), that it will not be 'chilled' by the possibility of overseas investors' claims, and that the MOM policy will not prevent it from providing appropriate rights recognition once the rights have been clarified.*
>
> *...*
>
> *But there is one area in which the Crown will not be able to provide appropriate rights recognition or redress after the partial privatisation, and that is in the area we have termed 'shares-plus': the provision of shares or special classes of shares which, in conjunction with amended company constitutions and shareholders' agreements, could provide Māori with a meaningful form of commercial rights recognition.*[1]

2. In reaching this view, the Tribunal recognised the claimants' concession that shares on their own would not suffice "as even proxy recognition" of their rights in waterways within their rohe:[2]

> *A shareholding, however, in conjunction with a real and meaningful stake in the company, appeared to the claimants to be a much closer approximation to recognising Māori rights.*[3]

3. The Crown's position in the Tribunal, accepted in part by the Tribunal and claimants, was that shares are an unsuitable form of redress/rights recognition for many reasons and that there is no single remedy for recognising Māori rights and interests in water. The preferred focus should instead be on developing models for the control and management of water that reflect Māori interests. This would be the appropriate route by which Māori might gain a direct economic interest in, and benefit from, the use of water to generate electricity (for which the government has processes in train).

4. However, the Tribunal has adopted the view that in the absence of certainty that "any other commercial rights recognition will actually come to pass" and that the opportunity for a "shares-plus" remedy, which could create a more meaningful connection for claimants to the underlying resource in which they have a residual proprietary interest, is only available pre-sale, the Crown must delay the sale while an 'accommodation' is reached with Māori.[4] On that basis, the Tribunal has said the Crown would be in breach of Treaty principles if it were to proceed to sale without first preserving this remedy and consulting with Māori (T2012/2124).

5. While the Tribunal is not prescribing any particular form of redress – it considers that a matter to be resolved by the Treaty partners by negotiation – it is recommending that because this one form of redress would be eliminated if the Crown was to go ahead with the Mighty River Power Initial Public Offering (MRP IPO) planned for 2012, the Crown has a Treaty obligation to consult with Māori on this (and by implication other

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1 Waitangi Tribunal, *Interim Report on the National Freshwater and Geothermal Resources Claim,* (Wai 2358, Wellington, 2012) page 197.
2 See, for example, the extract from Claimant counsel (Felix Geiringer) cited at ibid fn 1, pages 132 and 154.
3 Ibid fn 1, page 132.
4 Ibid fn 1, Transmittal Letter.

options) before proceeding. According to the Tribunal, to do otherwise would be a Treaty breach.

'Shares-plus'

The Tribunal's articulation

6. The Tribunal did not specify exactly what 'shares-plus' is, it said 'matters of detail for the framework of rights recognition' would be addressed in stage two, but it did say "shares plus" would be characterised by a shareholding in a MOM company coupled with enhanced rights of control over the company. These enhanced rights could be achieved through any or all of:[5]

    - A shareholders agreement/s between the Crown and Māori (the Crown as sole shareholder could vest some of the existing MOM shares in Māori to enable this):
        - Operational company matters would be addressed by way of shareholders' agreements between the Crown and Māori before any other shares in the MOM are alienated.
    - Revised company constitutions.
    - A special class of shares for Māori possibly with special rights.

Development of analysis

7. Given that the Tribunal has only illustrated rather than specified what the enhanced rights might look like, the first step in the analysis has been to envisage what the possible suite of enhanced rights might be. The following team has developed and analysed what shares-plus might look like (and which is set out in the table below):

    - Treasury officials (to advise on policy options and analysis)
    - Bell Gully (to provide legal advice on commercial law)
    - Deutsche Bank (to advise on capital markets and commercial value matters), and
    - Crown Law and David Goddard QC (to provide commercial and strategic legal advice as well as Treaty compliance advice).

8. We have focused on the possibility of shares with special rights attached because it is clear that it would not be feasible to have a freestanding shareholders' agreement along the lines contemplated by the Tribunal to which all shareholders in a listed company are parties, regardless of when it is entered into. Even if the Crown and Māori were to enter into a shareholders' agreement before an IPO, the many new shareholders post-IPO would not be bound by such an agreement except to the extent that it was reflected in the company's constitution.

9. We also note that a shareholders' agreement between the Crown and holders of shares vested in Māori by way of redress, to which other shareholders are not parties, is equally feasible before or after a sale. The Tribunal did not explore this possibility in any depth, but it is important because it provides an alternative method of achieving many (though not all) of the outcomes that might be achieved through a "shares plus" approach. The ways in which this mechanism could substitute for "shares plus" is discussed below.

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5 Ibid fn 1, page 158.

10. While it would be possible to issue shares in the proposed MOM companies with enhanced rights, the terms of those shares would almost certainly need to be agreed, and the shares issued, pre-IPO. Special shares could provide the holders with the following broad types of rights:

    - enhanced financial entitlements
    - enhanced votes on matters normally decided by shareholders
    - the power to appoint one or more directors, and/or
    - decision-making powers or veto powers on management and strategic issues that would otherwise be decided by the company's board.

11. As the table below sets out, there are relatively simple contractual and company law mechanisms for replicating all but the last of these after a sale. The last category – management/strategic decision-making rights – could not be replicated after a sale. But as outlined in the table below, this possibility gives rise to legal difficulties even if implemented pre-IPO (in particular, there is a strong argument that such rights would have to be exercised in the best interests of the company, not for the benefit of Māori interests) and there are more effective and more comprehensive methods for providing Māori with a meaningful voice in relation to the resource which is the subject of their claims through regulatory channels or Treaty settlements.

12. In relation to assessing the commercial feasibility/impacts, we have taken the view that the provision of economic, voting or control preferences to a specific group of shareholders, potentially through a separate class of shares, will have a negative impact on value, and in some circumstances make the prospect of being a minority shareholder in MRP undesirable for public market investors. The valuation impact would be most pronounced where it creates a significant level of uncertainty as to the future operational and financial performance. This uncertainty could be created, for example, by the Crown agreeing pre-IPO to take direction on how to vote its shareholding or seek to impose restrictions on the company at the request of a certain interest group, where that interest group's drivers could be inconsistent with minority shareholders' drivers. In this situation, there will be a very material negative impact on value, to such an extent that an IPO would not be viable. In contrast, where the preference provided to a certain class of shareholders can be defined narrowly (e.g. dividend preference), this can be valued by IPO investors and taken into consideration when bidding for shares. It should be noted however that this form of preference may impact MRP from a capital employment and capital structure perspective given the higher dividend payout required – that is, the Crown could need to inject capital to strengthen the balance sheet.

13. Because the question of whether a Treaty obligation (s45Q) should extend to the company as well as the Crown was covered extensively in the February consultation and the government made an informed decision that it should not: providing decision making rights to Māori shareholders to empower them to give effect to Treaty outcomes through the company can be argued to be essentially the same issue and therefore one that does not need to be revisited.

Consultation

14. The Ministry for the Environment has been consulted. The Department of Prime Minister and Cabinet has been informed.

Rights	Test 1 - Substitutability	Test 2 – Feasibility pre-listing			Test 3 – Feasibility post-listing	
Nature of the enhanced right	**Relevance as form of Treaty redress – can the right be provided in another way?**	**Can the right be granted under company or other law or regulations?**	**Can the right be implemented in a practical terms?**	**What is the impact on the government's policy objectives (fiscal, efficiency, market development)**	**Can the right be granted under company or other law or regulations?**	**Can the right be implemented in a practical terms?**
Preferential financial return: • Higher levels of dividend. • Greater certainty of payment. • Preferred ranking for dividend rights. • Enhanced capital distribution rights on liquidation. • Preferred capital distribution rights on liquidation.	**Yes** • These rights are of financial value only. They can be readily substituted. • The level of return can be increased by increasing Māori's shareholding (up to 10%). • The Crown can fund any return over and above "normal" with a derivative instrument. • Special shares to enhance financial returns suffer from the lack of a direct link to the resources claimed (as compared, for example, to a royalty).	**Yes, subject to 10% cap (absent a law change)** • Separate classes of shares with preferential returns are possible under company law and NZX listing rules. • Under the new Part 5A of the PFA, the Crown is required to hold at least 51% of all classes of securities. No other investor may have a relevant interest in >10% of each class. • If Māori hold ≤10%, the Crown will have to hold the balance, i.e. ≥90%. • If Māori wish to hold more than 10%, no party could hold a relevant interest >10% meaning shareholding blocks would have to be held by unrelated parties and no agreements could exist between those parties regarding the exercise of voting rights attached to their respective shares. • A law change could address these constraints.	**Potentially** • Special shares would need to be issued ahead of listing. • The special shares would not be tradable given they relate to an underlying right held only by particular shareholders. Or, if they were tradable, the enhanced rights would need to fall away when they are sold. Sale would require the approval of the Crown if that sale would have the effect of diluting the Crown below 51% ownership, as the Crown would then be required to purchase shares to stay above 51%. Insider trading rules may, however, impact on the Crown's ability to purchase shares.	**Some, or significant compromise** • Preferential shares for one class of shareholders would reduce the value of the ordinary minority shares being sold at IPO. By how much depends on the nature of the preferential return required (may be manageable, but will be a focus for investors). • Special shares could not be issued ahead of listing on the government's timetable to float MRP in 2012 (not manageable). • Depending on the level of preferential returns, the company might need to ration capital, which would impact company performance, growth prospects, dividend policy, capital structure and potentially electricity market performance: these implications will all go to the value achieved by the Crown. • Special shares may also hinder the company's ability to raise additional capital in the future.	**Not practically achievable** • Absent an NZX waiver, the issue of special shares would need approval of shareholders by ordinary resolution. Potentially, the Crown may not be able to vote. • The constitution could be amended post-listing to provide for the issue of special shares but the Crown, as the holder of only 51% of the company, could not ensure that the resolution was passed (requires 75%) and under the Listing Rules. NZX may, in any event, require non-Crown shareholders to approve the issue of special shares.	**Unlikely** • May be very hard for directors to determine the consideration to be provided for the shares and certify that the issue of the special shares is fair and reasonable to the company and all existing shareholders.

Rights	Test 1 - Substitutability	Test 2 – Feasibility pre-listing			Test 3 – Feasibility post-listing	
Nature of the enhanced right	**Relevance as form of Treaty redress – can the right be provided in another way?**	**Can the right be granted under company or other law or regulations?**	**Can the right be implemented in a practical terms?**	**What is the impact on the government's policy objectives (fiscal, efficiency, market development)**	**Can the right be granted under company or other law or regulations?**	**Can the right be implemented in a practical terms?**
Enhanced voting rights – over issues normally controlled by shareholders: • Appointment of directors. • Major transactions. • Some share issues/repurchases. • Changes to the constitution. • Related party transactions.	**Yes** • The level of voting rights can be increased by increasing Māori's shareholding (up to 10%, absent a law change). • Within some limits, the Crown can enter into an agreement with Māori on how it will exercise its 51% voting rights on certain matters, e.g. to procure the appointment of a director nominated by Māori interests. • The link provided to the resource via MRP as only one user of the resource would be very indirect. It would not provide a distinctive Maori voice on management matters. This could be better achieved in other ways, e.g. enhanced regulatory involvement.	**Yes, subject to 10% cap (absent a law change), and within limits** • Separate classes of shares with enhanced voting rights are possible. • The same issues arise under the 51% floor and 10% cap as for preferential financial returns. • Benefit may be limited as, for example, any director appointed to represent Māori would need to act in the best interests of the company – not of their appointer, or of designated interests or to protect relevant resources. In addition, the director may be unable to share company confidential information with wider stakeholder group, so unable to consult with represented interests on many strategic matters relating to use of resources. • Alternatively, Māori could be granted the right under the constitution to appoint a set number of directors to the board, provided their appointees are acceptable to the Crown and the board (acting reasonably).	**Potentially** • Special shares would need to be issued ahead of listing. • There are examples in the region of corporations collapsing separate classes of shares for reasons including valuation, investor confidence and access to capital. • The cost of separate classes of shares can be significant if not managed effectively. • The special shares would not be tradable given they relate to an underlying right held only by particular shareholders. Or, if they were tradable, the enhanced rights would need to fall away when they are sold. Sale would require the approval of the Crown if that sale would have the effect of diluting the Crown below a 51% ownership, as the Crown would then be required to purchase shares to stay above 51%. Insider trading rules may, however, impact the ability of the Crown to purchase shares.	**Some, significant, or fatal compromise** • There is evidence that representative boards perform less well than independent boards. • Any indication that the Crown intended to take a non-commercial approach to the ongoing management of its shareholding would impact adversely on company value and the consequent fiscal and macroeconomic benefits from reducing Crown debt using sale proceeds. • Providing open ended or poorly defined commitments to take instruction on how to vote the Crown's 51% shareholding would not be feasible as it would have significant negative equity markets consequences. Incoming minority shareholders at IPO would interpret this as diminishing their voting rights and would be concerned as to the quality of potential board appointments to drive value.	**Not practically achievable** • Absent an NZX waiver, the issue of special shares would need approval of shareholders by ordinary resolution. Potentially, the Crown may not be able to vote on such resolution. • Technically, the constitution could be amended post-listing to provide for the issue of special shares but the Crown, as the holder of only 51% of the company, could not ensure that such a resolution was passed (requires 75%) and under the Listing Rules NZX may, in any event, require non-Crown shareholders to approve the issue of special shares.	**Unlikely** • May be very hard for directors to determine the consideration to be provided for the shares and certify that the issue of the special shares is fair and reasonable to the company and all existing shareholders.

Rights	Test 1 - Substitutability	Test 2 – Feasibility pre-listing			Test 3 – Feasibility post-listing	
Nature of the enhanced right	**Relevance as form of Treaty redress – can the right be provided in another way?**	**Can the right be granted under company or other law or regulations?**	**Can the right be implemented in a practical terms?**	**What is the impact on the government's policy objectives (fiscal, efficiency, market development)**	**Can the right be granted under company or other law or regulations?**	**Can the right be implemented in a practical terms?**
Voting/decision rights on strategic or management decisions (not normally controlled by shareholders): • Approval or veto rights over certain decisions. • Rights to active participation in decision making on how the companies are to be operated. • Illustrative examples could include prohibition on sales of specific assets, management of water flows, targeting particular employment outcomes.	**Yes** • Direct Māori voice/control in relation to water resources can be achieved through reform of the regulatory system and/or individual Treaty settlements. This is a significantly more direct and meaningful connection with the resource than voice/control in relation to business decisions of one user (or a handful of users) of the resource, constrained by company law obligations. • As MRP is only one user of the resource this mechanism provides only a very indirect influence. Enhanced involvement in regulatory regimes is a superior approach to provide a distinctive Maori voice on management matters.	**Partially, at best** • Special shares or company constitutions could confer special approval/veto rights on certain shareholders, for example on decisions relating to water or geothermal management or resources (similar to Kiwishare). • Any shareholder that exercises or controls the exercise of a power that would otherwise be exercised by the board becomes a deemed director (s126(1)(b)(iii) and (2)) and would therefore be bound by the obligation to act in the best interests of the company rather than in the interest of the shareholder or specific persons. However, there is uncertainty as to whether this requirement applies to decisions about the company's share structure or to veto rights where the board has made a decision but shareholder approval is also required.	**Potentially** • Companies would be designated "non-standard" and listing rule and NZX waivers would be required. • Securing approval to commercial proposals by the holder of the rights will prove difficult in reasonable commercial timeframes if lengthy consultation processes with stakeholders are required, impacting MRP performance. In addition, there are legal constraints on the release of price-sensitive information by the company to shareholders and other persons. • Management will not be able to operate effectively, which can undermine the quality of personnel attracted to senior positions and adversely impact on value.	**Not manageable** • Even if this was possible, it could have a significant negative effect on the value of the companies and hence proceeds, and on the companies' operational and financial performance, growth prospects and the electricity market as well as adverse economic outcomes. • It is very likely that the IPO of MRP would not be able to proceed if a specific party had the ability to influence management and potentially drive the company to uneconomic outcomes. New investors would anticipate the worst possible outcome and price accordingly, which would destroy the value the Crown could realise. • To the extent that the companies make non-commercial decisions, this may advantage competitors including those with full private ownership.	**Not practically achievable** • Absent an NZX waiver, the issue of special shares would need approval of shareholders by ordinary resolution. Potentially, the Crown may not be able to vote on such resolution. • Technically, the constitution could be amended post-listing to provide for the issue of special shares or to confer these rights direct but the Crown, as the holder of only 51% of the company, could not ensure that such a resolution was passed (requires 75%) and under the Listing Rules NZX may, in any event, require non-Crown shareholders to approve the issue of special shares.	**N/A**