

The Treasury

Solid Energy Information Release

March 2013

Release Document

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- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people
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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Draft 2009 Business Planning Expectations' Letter for State-owned Enterprises (SOEs)

To	Minister for State Owned Enterprises	Priority	Routine
cc	Minister of Finance Associate Minister of Finance (Hon Steven Joyce)		
Date	4 December 2008	Deadline	8 December 2008

Purpose

This report presents for your consideration, a draft 2009 business planning expectations' letter from shareholding Ministers.

Background

It has been standard practice for shareholding Ministers to send a letter in advance of the business planning round, which sets out the proposed timeline together with generic and SOE-specific expectations.

The attached draft letter is addressed to New Zealand Post Ltd, to illustrate what a complete expectations' letter to a specific SOE might look like. We are in the process of completing similarly-tailored letters to the Chairs of all SOEs with a June balance date¹:

- Airways Corporation of New Zealand Ltd
- Animal Control Products Ltd²
- Genesis Power Ltd
- Kordia Group Ltd
- Landcorp Farming Ltd
- Learning Media Ltd²
- Meridian Energy Ltd
- Meteorological Service of New Zealand Ltd
- Mighty River Power Ltd
- New Zealand Post Ltd
- Quotable Value Ltd
- Solid Energy New Zealand Ltd
- Transpower New Zealand Ltd.

¹ With the exception of New Zealand Railways Corporation (as it has already been sent an expectations' letter, following its acquisition of KiwiRail from the Crown), ECNZ Residual Ltd and Timberlands West Coast Ltd.

² Note that you are not the responsible Minister for this SOE; therefore you will not sign the letter to this company. However, it will contain the same generic expectations.

Issues

The draft 2009 business planning expectations' letter outlines:

- the proposed 2009 business planning timetable, culminating in each SOE's Statement of Corporate Intent (SCI)
- performance expectations for the SOE portfolio, with a focus on improving performance and productivity
- heightened expectations concerning performance targets and reporting
- the importance of a comprehensive, challenging and informative SCI
- SOE-specific expectations.

We propose replicating the generic expectations in all SOE letters, while acknowledging that shareholding Ministers may wish to convey a different set of messages. Therefore, we welcome an opportunity to discuss the draft letter with you. A similar letter will also be sent to the other entities monitored by CCMAU that the Crown has an ownership interest in, e.g. Airports, Public Trust etc.

Please note that we do not propose communicating a general expectation that all SOEs hold public annual meetings, given the costs involved (versus the perceived benefits), but rather suggest limiting this expectation to the seven largest SOEs (excluding the New Zealand Railways Corporation): Meridian, Mighty River Power, Genesis, Transpower, New Zealand Post, Landcorp and Solid Energy.

Consultation

The Treasury has been consulted in the preparation of the attached draft letter, and agrees with its content.

Recommendations

We recommend that you:

- a) **note** that it has been standard practice for shareholding Ministers to send an expectations' letter to SOEs, prior to the start of the business planning round
- b) **note** that a draft expectations' letter (addressed to NZ Post, for illustrative purposes) for the 2009 business planning round is attached for discussion purposes
- c) **consult** with the Minister of Finance prior to meeting with officials to discuss the draft expectations' letter.



Chris Jones
Manager - Energy, Land &
Environment; CCMAU

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Hon Simon Power
Minister for State Owned Enterprises

Rt Hon James B Bolger, ONZ
Chair
New Zealand Post Ltd
Private Bag 39990
WELLINGTON 5045

Dear Mr Bolger

2009 Business Planning Round

I am writing on behalf of shareholding Ministers to set out our expectations for the 2009 business planning round and, in particular, to highlight the areas that we expect all SOE boards to focus on this year.

The letter outlines Ministers' expectations for all SOEs, then highlights specific expectations for New Zealand Post.

Timetable for 2009

The process and timetable is very similar to previous years, as outlined in Annex 1.

A key feature of this year's timetable is to build in early and regular engagement with officials during the planning process. As initiated last year, our expectation is that officials will meet with you to discuss the content of the strategic issues letter, before it is submitted (in late February). Where possible, I would also like to meet with boards before the strategic issues letter is finalised.

We also expect officials to meet with you on a regular basis as planning documents are developed, to facilitate an ongoing dialogue and provide an opportunity for the shareholder to better understand the key risks and opportunities facing the company.

SOE portfolio performance

For 2007/08, the SOE portfolio achieved a return on shareholders' equity of just 4.8%¹. This result is well below the risk-free rate of return at 6.4%², and as such is inadequate for the portfolio as a whole. While this obviously disguises considerable variation across the portfolio, we will pay close attention to the rates of return anticipated in upcoming 2009/12 Business Plans and SCIs, and expect to see a significant improvement.

The value of the Crown's investment in SOEs is approximately \$24 billion. SOEs are therefore a significant part of the NZ economy. This means it is important that they operate as successful businesses and shareholding Ministers expect SOEs to clearly demonstrate achievement of financial and non-financial performance.

Generally, our expectation is that performance targets will at least exceed those set in previous years' SCIs. We would therefore expect this to be reflected in an increase in the directors' estimate of the value of the Crown's investment in each SOE and for the business plan to clearly demonstrate how this will be achieved.

Increasing productivity

The National-led government places a high priority on increasing productivity and economic growth. As SOEs and other Crown entities are a significant component of the New Zealand economy and employ a significant number of people, it is important that they play their part in enhancing productivity.

Whilst the specific means of achieving this objective is a matter for boards to determine, shareholding Ministers will be looking for evidence that key productivity measures are improving over time.

Performance reporting

Recent Auditor-General reports³ have called into question the quality of performance targets and reporting by SOEs and other Crown-owned companies. Given the important role of performance reporting in ensuring the accountability of boards, this is a specific area of focus for this year's business planning round.

Rather than list the Auditor-General's findings (the reports are available at www.oag.govt.nz), we would like to outline the following expectations:

- performance targets must be high quality (refer to Annex 2 for a definition)
- performance targets – financial and non-financial – should be specified out three years in the SCI (consistent with section 14(2)(e) of the SOE Act)
- ideally, financial and non-financial performance targets should be summarised in one table within the SCI

¹ Excluding ONTRACK, or 2.4% including ONTRACK

² Long-term government bond rates are used as a proxy for the risk-free rate - rate as at June 2008

³ The Auditor-General's Observations on the Quality of Performance Reporting (June 2008) and Statements of Corporate Intent: Legislative Compliance and Performance Reporting (June 2007), Office of the Auditor-General, available from www.oag.govt.nz

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- performance targets (financial and non-financial) should demonstrate improved performance over the three year planning period
 - non-financial targets should not only be reflective of company objectives, but also stakeholder interests
 - ideally, SOEs should subject their non-financial performance to independent audit (as they do their financial performance)
 - SOEs should not only report actual performance against targets in their respective annual reports, but provide an explanation for material variances.

While you may find some of these expectations challenging to meet in the short term, we are looking for a material improvement in the quality and consistency of performance reporting during the 2009 business planning round, and invite you to work with officials to achieve this outcome.

SCI

The SCI, as the key accountability document for SOEs, must be: comprehensive, challenging, informative and written for a non-technical audience, as well as meet the statutory requirements of section 14 of the State-Owned Enterprises Act 1986.

It is important that an SCI clearly states an SOE's objectives and scope of business, sets challenging and relevant performance targets (both financial and non-financial), and provides a credible estimate of the commercial value of the Crown's investment in the company.

An SCI should demonstrate a clear link between each company-specific objective (including CSR objectives) and associated measureable targets, so that the reader can readily evaluate performance. I expect the same logic to be applied to annual reports, to enable the reader to assess performance against plan without undue effort.

Specific expectations for NZ Post

In addition to the expectations listed above for all SOEs, the following identifies specific expectations for NZ Post. These expectations will form the central core of CCMAU's engagement with NZ Post throughout the year.

Strategic issues:

- NZ Post should look for continued growth, where profitable opportunities to do so exist without incurring undue risk
- NZ Post should seek a balance between growth of Kiwibank and growth of other core business areas in the NZ Post Group
- NZ Post should maintain its Standard and Poor's rating at AA-.

Expectations for 2009/10:

- produce a positive EVA
 - in 2007/08, NZ Post produced a return on equity of 17.6%. NZ Post should aim for a similarly commendable return in 2009/10, whilst also ensuring high
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service performance

- performance targets generally should exceed those set in the 2008/09 SCI
- we would like the Board to consider NZ Post's dividend policy, in light of the company's available growth/acquisition opportunities, and the importance of maintaining a healthy credit rating. In 2008, NZ Post's dividend was \$23.5 million and, unless there is a compelling reason, a dividend equal to or greater than this figure would be appropriate in 2009/10
- improve service performance in 2009/10 (as measured by Testpo and other measures)
- consideration be given to holding a public annual meeting, in order to improve board accountability
- given that NZ Post has an experienced management team, full and flexible succession plans should cover all senior positions in the group.

Next steps

We propose that NZ Post actively engages with officials following receipt of this letter. Specifically, we expect NZ Post to start a dialogue with officials in February, about the key strategic issues that will be presented in the 2009/12 Business Plan.

Please contact Paul Goodhead of CCMAU (phone ☎) in the first instance to discuss any issues that have been raised in this letter.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of shareholding Ministers

cc: John Allen, CEO, NZ Post Ltd

Annex 1 – Timetable

Mid-to-late February 2009	Early engagement This year we encourage an early engagement with officials to clarify expectations and discuss strategic issues prior to the company submitting its strategic issues letter. I would also like an opportunity to meet with boards at this time.
28 February 2009	Strategic issues letter to shareholding Ministers An early outline of key issues facing NZ Post and/or major changes to strategic focus over the planning horizon (and beyond if informative). This may include a high level assessment of the key risks and opportunities impacting on NZ Post's future profitability and value, and options available for mitigating any adverse impacts.
Ongoing	Dialogue with officials We expect that following the key strategic issues letter a series of meetings with officials will be held to discuss these issues, which will assist you in producing your draft SCI and Business Plan.
1 May 2009	Draft SCI and Business Plan to shareholding Ministers Officials will then engage with NZ Post, prior to the SCI being finalised, to discuss and clarify projected performance and other issues as appropriate to enable shareholding Ministers to make an informed response to NZ Post's draft plans.
30 June 2009	Final SCI for tabling The final SCI is to be provided to shareholding Ministers for tabling in the House of Representatives, as required by the SOE Act 1986. We anticipate fewer extensions to the deadline than in past years. Extension requests will only be considered if the reasons are compelling.

Annex 2 – Performance Indicators

High quality performance indicators (financial and non-financial) must⁴:

- be meaningful to the SOE's business and the SOE Act
- be specific and measureable without ambiguity
- be timely and capable of being audited, where appropriate
- be within the SOE's responsibility or power to control
- be consistent with and influence, as appropriate, the SOE's purpose and principles of operation or business
- respect commercial sensitivity, where appropriate
- encourage and reflect best practice
- where appropriate, ensure employee participation in, and ownership of, these indicators.

⁴ Sourced from Owner's Expectations Manual for State-Owned Enterprises (29 October 2007), available from www.ccmau.govt.nz



Office of Hon Simon Power

MP for Rangitikei

Minister of Justice

Minister for State Owned Enterprises

Minister of Commerce

Minister Responsible for the Law Commission

Associate Minister of Finance

Deputy Leader of the House

16 DEC 2008

John Palmer
Chair
Solid Energy New Zealand Ltd
PO Box 1303
CHRISTCHURCH 8140

Dear Mr Palmer

2009 Business Planning Round

I am writing on behalf of shareholding Ministers to set out our expectations for the 2009 business planning round and, in particular, to highlight the areas that we expect all SOE boards to focus on this year.

The letter outlines Ministers' expectations for all SOEs, then highlights specific expectations for Solid Energy New Zealand Ltd (Solid Energy).

Timetable for 2009

The process and timetable is very similar to previous years, as outlined in Annex 1.

A key feature of this year's timetable is to build in early and regular engagement with officials during the planning process. As initiated last year, our expectation is that officials will meet with you to discuss the content of the strategic issues letter, before it is submitted (in late February). Where possible, I would also like to meet with boards before the strategic issues letter is finalised.

We also expect officials to meet with you on a regular basis as planning documents are developed, to facilitate an ongoing dialogue and provide an opportunity for the shareholder to better understand the key risks and opportunities facing the company.

SOE portfolio performance

For 2007/08, the SOE portfolio achieved a return on shareholders' equity of just 4.8%¹. This result is well below the risk-free rate of return of 6.4%², and as such is clearly inadequate for the portfolio as a whole. While this obviously disguises considerable variation across the portfolio, we are generally dissatisfied with the recent financial performance of SOEs.

The value of the Crown's investment in SOEs is approximately \$24 billion. SOEs are therefore a significant part of the New Zealand economy. This means it is particularly important that they operate as successful businesses, in accordance with section 4 of the SOE Act 1986.

Given the recent poor return from SOEs and their significant scale, the National-led government places a high priority on lifting their performance. Therefore, shareholding Ministers will pay particularly close attention to the forecast returns of each SOE in the upcoming 2009/12 Business Plans and SCIs, and expect to see a marked improvement in both forecast and actual performance.

Generally, our expectation is that performance targets will exceed or at least match those set in previous years' SCIs. We would therefore expect this to be reflected in an increase in the directors' estimate of the value of the Crown's investment in each SOE and for the business plan to clearly demonstrate how this will be achieved.

Increasing productivity

The National-led government places a high priority on increasing productivity and economic growth. As SOEs and other Crown entities are a significant component of the New Zealand economy and employ a significant number of people, it is important that they play their part in enhancing productivity.

Whilst the specific means of achieving this objective is a matter for boards to determine, shareholding Ministers will be looking for evidence that key productivity measures are improving over time.

Performance reporting

Recent Auditor-General reports³ have called into question the quality of performance targets and reporting by SOEs and other Crown-owned companies. Given the important role of performance reporting in ensuring the accountability of boards, this is a specific area of focus for this year's business planning round.

Rather than list the Auditor-General's findings (the reports are available at www.oag.govt.nz), we would like to outline the following expectations:

- performance targets must be of high quality (refer to Annex 2 for a definition)

¹ Excluding ONTRACK, or 2.4% including ONTRACK

² Long-term government bond rates are used as a proxy for the risk-free rate - rate as at June 2008

³ The Auditor-General's *Observations on the Quality of Performance Reporting* (June 2008) and *Statements of Corporate Intent: Legislative Compliance and Performance Reporting* (June 2007), Office of the Auditor-General, available from www.oag.govt.nz

- performance targets – financial and non-financial – should be specified out three years in the SCI (consistent with section 14(2)(e) of the SOE Act)
- ideally, financial and non-financial performance targets should be summarised in one table within the SCI
- performance targets (financial and non-financial) should demonstrate improved performance over the three year planning period
- non-financial targets should not only be reflective of company objectives, but also stakeholder interests
- ideally, SOEs should subject their non-financial performance to independent audit (as they do their financial performance)
- SOEs should not only report actual performance against targets in their respective annual reports, but provide an explanation for material variances.

While you may find some of these expectations challenging to meet in the short term, we are looking for a material improvement in the quality and consistency of performance reporting during the 2009 business planning round, and invite you to work with officials to achieve this outcome.

SCI

The SCI, as the key accountability document for SOEs, must be: comprehensive, challenging, informative and written for a non-technical audience, as well as meet the statutory requirements of section 14 of the State-Owned Enterprises Act 1986.

It is important that an SCI clearly states an SOE's objectives and scope of business, sets challenging and relevant performance targets (both financial and non-financial), and provides a credible estimate of the commercial value of the Crown's investment in the company.

An SCI should demonstrate a clear link between each company-specific objective (including CSR objectives) and associated measureable targets, so that the reader can readily evaluate performance. We expect the same logic to be applied to annual reports, to enable the reader to assess performance against plan without undue effort.

Specific expectations for Solid Energy

In addition to the expectations listed above for all SOEs, the following identifies specific expectations for Solid Energy. These expectations will form the central core of CCMAU's engagement with Solid Energy throughout the year.

Strategic issues:

- continue to develop and nurture key stakeholder relationships, including your relationship with shareholding Ministers
- maintain appropriate commercial discipline on Solid Energy's new energy and renewable energy businesses, to protect and enhance shareholder value
- continue to refine Solid Energy's carbon management strategy, to mitigate the risks of an introduced carbon price, and where possible maximise any

opportunities.

Expectations for 2009/10:

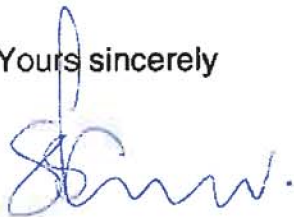
- improve the transparency of Solid Energy's environmental targets, in particular the objective of achieving a net positive effect on the New Zealand environment
- achieve a significant improvement in Solid Energy's health and safety record
- regular engagement with the Chair and CEO to discuss company performance and proposed investments, as agreed with previous shareholding Ministers
- following the success of Solid Energy's first public annual meeting, we look forward to the company hosting another one in 2009.

Next steps

We propose that Solid Energy actively engages with officials following receipt of this letter. Specifically, we expect Solid Energy to start a dialogue with officials in February, about the key strategic issues that will be presented in the 2009/12 Business Plan.

Please contact Chris Hewson of CCMAU (phone ☎) in the first instance to discuss any issues that have been raised in this letter.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'S. Power', with a stylized flourish at the end.

Hon Simon Power
Minister for State Owned Enterprises
on behalf of shareholding Ministers

cc: Dr Don Elder, CEO, Solid Energy Ltd

Annex 1 – Timetable

Mid-to-late February 2009	<p>Early engagement</p> <p>This year we encourage an early engagement with officials to clarify expectations and discuss strategic issues prior to the company submitting its strategic issues letter. I would also like an opportunity to meet with boards at this time.</p>
28 February 2009	<p>Strategic issues letter to shareholding Ministers</p> <p>An early outline of key issues facing Solid Energy and/or major changes to strategic focus over the planning horizon (and beyond if informative).</p> <p>This may include a high level assessment of the key risks and opportunities impacting on Solid Energy's future profitability and value, and options available for mitigating any adverse impacts.</p>
Ongoing	<p>Dialogue with officials</p> <p>We expect that following the key strategic issues letter a series of meetings with officials will be held to discuss these issues, which will assist you in producing your draft SCI and Business Plan.</p>
1 May 2009	<p>Draft SCI and Business Plan to shareholding Ministers</p> <p>Officials will then engage with Solid Energy, prior to the SCI being finalised, to discuss and clarify projected performance and other issues as appropriate to enable shareholding Ministers to make an informed response to Solid Energy's draft plans.</p>
30 June 2009	<p>Final SCI for tabling</p> <p>The final SCI is to be provided to shareholding Ministers for tabling in the House of Representatives, as required by the SOE Act 1986.</p> <p>We anticipate fewer extensions to the deadline than in past years. Extension requests will only be considered if the reasons are compelling.</p>

Annex 2 – Performance Indicators

High quality performance indicators (financial and non-financial) must⁴:

- be meaningful to the SOE's business and the SOE Act
- be specific and measureable without ambiguity
- be timely and capable of being audited, where appropriate
- be within the SOE's responsibility or power to control
- be consistent with and influence, as appropriate, the SOE's purpose and principles of operation or business
- respect commercial sensitivity, where appropriate
- encourage and reflect best practice
- where appropriate, ensure employee participation in, and ownership of, these indicators.

⁴ Sourced from Owner's Expectations Manual for State-Owned Enterprises (29 October 2007), available from www.ccmau.govt.nz