

# **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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CROWN OWNERSHIP  
MONITORING UNIT

## **Treasury Report: 2010 Business Planning Round: Outlook letters**

<b>Date:</b>	15 December 2009	<b>Report No:</b>	T2009/2731
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### **Action Sought**

	<b>Action Sought</b>	<b>Deadline</b>
Minister of Finance (Hon Bill English)	<b>Agree</b> to the recommendations.	5.00 pm Monday 21 December 2009
Associate Minister of Finance (Hon Steven Joyce)	<b>Note</b>	5.00 pm Monday 21 December 2009
Minister for State Owned Enterprises (Hon Simon Power)	<b>Agree</b> to the recommendations and <b>Sign</b> the attached letters, except for Learning Media Limited and Animal Control Products Limited.	5.00 pm Monday 21 December 2009
Minister of Education (Hon Anne Tolley)	<b>Agree</b> to the recommendations and <b>Sign</b> the letter for Learning Media Limited.	5.00 pm Monday 21 December 2009
Minister of Agriculture (Hon David Carter)	<b>Agree</b> to the recommendations and <b>Sign</b> the Letter for Animal Control Products Limited.	5.00 pm Monday 21 December 2009

### **Contact for Telephone Discussion (if required)**

<b>Name</b>	<b>Position</b>	<b>Telephone</b>	<b>1st Contact</b>
James Cunningham	Manager, Sector Monitoring	[1]	✓
Andrew Blazey	Manager, Sector Monitoring	[1]	

### **Office Actions (if required)**

None.
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**Enclosure:** Yes

## Treasury Report: 2010 Business Planning Round: Outlook letters

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### Purpose of Report

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1. This report sets out the proposed focus for the 2010/11 business planning process for state owned enterprises (SOE). Attached are letters for your signature to the Chair of each SOE to convey shareholders' expectations and to commence the business planning process.

### Background

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2. In December 2008, Chairs were advised that the Government considered its investment in SOEs was under-performing and that it intended implementing measures to improve the portfolio's financial performance. Specific measures included to:
  - a. discuss expectations concerning dividend policy and dividend payments;
  - b. expect boards to increase financial disclosure, to match that of their private sector companies (notwithstanding the specific requirements of the SOE Act);
  - c. expect SOE boards to exert industry best practice governance over subsidiaries, and increase the transparency of subsidiaries' performance to shareholders;
  - d. expect boards to conduct credible annual commercial valuations of the company (in accordance with section 14(3) of the SOE Act), and be able to justify those valuations and reconcile changes from year to year;
  - e. hold an annual general meeting (AGM) and in certain cases an annual public meeting;
  - f. publicly disclose officials' analysis of SOE performance, including valuations of specific SOEs; and
  - g. set financial performance targets for SOEs, and hold boards accountable for achieving these.
3. Although progress was achieved by a number of boards increasing their dividend payments, holding annual general meetings and preparing commercial valuations, not all shareholder expectations were met. There is significant variation in financial performance across the SOE portfolio, varying from very poor (eg. KiwiRail) to very good (e.g. MetService). The challenge is to improve the overall financial performance of the portfolio.
4. The progress achieved in 2009/10 provides a basis for continuing to seek better financial performance, transparency and accountability across the portfolio of SOEs by:
  - a. pursuing expectations that were not met;
  - b. identifying best practice examples within the portfolio; and
  - c. giving attention to issues which are a priority for shareholding ministers.

## 2010/11 Business Planning Round

5. The following table summarises the key expectations from the 2009/10 planning round and identifies the proposed focus for the 2010/11 round.

Expectation	2009/10 Planning Round	Proposed focus for 2010/11
1. Dividend policies	65% of operating cash flow	Continue  Giving focus to companies which did not meet expectations last year.
2. Capital structure	BBB(flat) credit rating	Continue
3. Commercial valuation	Discounted Cash Flow (DCF) valuations included in SCI with disclosure of methodology and key variables.	Continue
4. Performance targets	Meaningful investment and performance targets	Continue  Giving emphasis to Boards setting and owning their targets for headline performance metrics, in particular return on equity (ROE).
5. Transparency and accountability	AGMs  Public meetings  Continuous disclosure regime	Continue  Continue  Implement from 1 Jan 2010. Review in June 2010, with a view to applying to all SOEs.

6. Based on the above table, the three expectations to receive emphasis are:
- a *dividend policies and payments*: Economic conditions have changed relative to 12 months ago and boards should be in a position to review their dividend policies and their balance sheet in relation to dividend payments;
  - b *commercial valuations*: Accurate valuations help determine the value of the SOE to the Government and help calculate changes to Crown net worth. Attention to valuations also contributes to better accountability for performance. A discounted cash flow (DCF) valuation is the methodology expected in the SCIs, and SOEs may also include alternative methodologies if they choose; and
  - c *performance targets set by the board*: Targets set and 'owned' by the board reflect the board's expectation of performance. Targets might not necessarily be met every year, but represent the board's vision for satisfactory performance for key headline measures such as ROE and earnings. Our attention to this expectation reflects a general lack of ambition in the targets set by boards in the 2009 SCI process.
7. The attached expectations letter identify the above expectations where they continue from the 2009 planning process and give emphasis to the above three issues. The letters also contain additional references to the circumstances relating to the performance of each SOE. In some cases we would expect the SOE to demonstrate where an expectation should be varied to suit its business requirements. The onus is

on the SOE to initiate such discussions and the letters therefore adopt a generalised approach so as to not introduce concessions or variations that may not be necessary.

## Important dates

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8. The 2010/11 business planning process will be initiated by sending the attached letters to the chairs of each SOE board. Important dates for the planning process include:

<i>Due date</i>	<i>Key action</i>
December/January	Ministers send business planning letters to SOE boards
28 February	Boards send strategic issues letters to Ministers
1 May	Boards submit draft SCIs and business plans
16 June	Ministers send feedback on draft SCIs
1 July	Boards deliver final SCI to shareholding Ministers

9. You will recall that a number of SOEs were granted extensions for delivering their SCIs to you. The extensions brought some gains, but also created a distraction from the SOEs' usual business. We propose that the 2010/11 business planning round maintain the usual completion date of 1 July and be varied only if an SOE has failed to make progress on the expectations or requires time to take account of changes from such things as the Electricity Industry Bill.
10. Ministers will have opportunities to meet representatives from individual SOEs during the planning process to receive updates on business plans and to underscore the central expectation that SOEs perform in line with a well governed commercial enterprise. Although it may not be necessary for ministers to meet representatives from all of the SOEs, it will be appropriate for some, such as Kordia, KiwiRail, Landcorp, NZ Post and Genesis.
11. Officials also plan to meet SOEs to present details of the performance expectations. Ministers can expect to receive updates from officials following the due dates of 28 February and 1 May, or as interactions with the SOEs require.
12. The 2010/11 expectations are consistent with the priorities the Minister for State Owned Enterprises has advised to the Prime Minister.

## Recommended Action

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We recommend that you:

- a **agree** that for the 2010/11 business planning round shareholding ministers set performance expectations of state owned enterprises to:
  - i. build on the expectations established in the 2009/10 planning round;
  - ii. place emphasis on increasing dividends, calculating credible commercial valuations, and for boards to set performance targets for key headline measurements;

*Agree/disagree.*
- b **agree** to maintain the expectation that SOEs hold an annual general meeting with shareholders or their proxies and that large SOES hold an annual public meeting; and  

*Agree/disagree.*
- c **agree** that the responsible minister for each SOE sign the attached letters to the SOE within his or her responsibility.  

*Agree/disagree.*

Andrew Blazey  
**Manager, Sector Monitoring  
for Secretary to the Treasury**

Hon Simon Power  
**Minister for State  
Owned Enterprises**

Bill English  
**Minister of Finance**

Steven Joyce  
**Associate Minister of  
Finance**

David Carter  
**Minister of Agriculture**

Anne Tolley  
**Minister of Education**





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## 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

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

Dear Mr Palmer

### 2010 BUSINESS PLANNING ROUND

I am writing on behalf of shareholding Ministers to set out our expectations for the 2010 business planning round. Our intention is to build on the expectations set out in communications during the 2009 business planning round.

#### Continuous improvement in performance

As you will be aware, the Government expects SOEs to operate on a commercial basis. As a result, Ministers are looking for significant performance improvements across the Crown's portfolio.

The expectations contained in last year's outlook letter remain in place, specifically the emphasis on improving financial performance, productivity, and shareholder value. We also remain focused on improving transparency, at both the company level (such as annual public meetings) and at the portfolio level (such as the continuous disclosure regime).

#### Specific expectations

The following are additional expectations shareholding Ministers have of Solid Energy:

- During last year's business planning round, Solid Energy responded to shareholding Ministers request for SOEs to review their capital structure, consider taking on more debt and returning any excess equity to the Crown. While acknowledging the projects where Solid Energy has forecast to make significant capital investments and the current volatility of the international coal markets, our expectation remains that the Board will continually assess its capital structure, keeping in mind our expectation of a BBB flat credit rating and improving dividend flows to the Crown.
- In 2009, we were pleased with the changes Solid Energy made to its commercial valuation model and Statement of Corporate Intent (SCI) key performance indicators. We consider these measures, and the continuation of annual public meetings, to be key factors in increasing the level of public performance disclosures and accountability. The financial targets should be appropriate for the business environment and reflect the Board's vision for satisfactory performance.
- Solid Energy has made significant steps toward improving the company's health and safety performance. We look forward to the new strategies being continued throughout

## **Timetable**

The timetable for the planning process is the same as last year, final SCIs are to be received by 1 July 2010. Further detail will be communicated to you by officials from the Crown Ownership Monitoring Unit (COMU). As in the previous year, our expectation is that there will be regular engagement with officials throughout the planning process. Please contact Chris Hewson of COMU in the first instance to discuss any issues that have been raised in this letter.

Shareholding Ministers look forward to receiving the strategic issues letter from you by 28 February 2010.

Yours sincerely

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

cc: Dr Don Elder, CEO, Solid Energy New Zealand Ltd.