

# **The Treasury**

## **Mixed Ownership Model for Crown Commercial Entities: Treasury Advice Information Release**

**4 September 2012**

### **Release Document**

**[www.comu.govt.nz/publications/information-releases/mixed-ownership-model](http://www.comu.govt.nz/publications/information-releases/mixed-ownership-model)**

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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.

## **Treasury Report: Mixed Ownership Model - Regulatory Stocktake**

<b>Date:</b>	1 September 2011	<b>Report No:</b>	T2011/1938
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### **Action Sought**

	<b>Action Sought</b>	<b>Deadline</b>
Minister of Finance (Hon Bill English)	Note	None
Associate Minister of Finance (Hon Simon Power)	Note	None
Minister for State Owned Enterprises (Hon Tony Ryall)	Note	None

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

<b>Name</b>	<b>Position</b>	<b>Telephone</b>	<b>1st Contact</b>
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Andrew Blazey	Manager, Commercial Transactions Group		

### **Minister of Finance's Office Actions (if required)**

None.
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**Enclosure: No**

## **Treasury Report: Mixed Ownership Model - Regulatory Stocktake**

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### **Executive Summary**

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This report provides an initial scan of regulatory matters that we consider may have implications for the Mixed Ownership Model (MOM) programme. It canvasses issues relating to electricity market regulation, the emissions trading scheme, water policy, and Crown minerals policy. We have also indicated that there will be a process of checking the implications of a range of commercial legislation and identifying any necessary actions to ensure a smooth implementation of the MOM programme.

The purpose of our regulatory scan is mainly to identify where the timing of any review programme may have implications for the optimal timing of the MOM programme offerings. We do not consider that the MOM programme should have any implications for decisions made within any of the review programmes. Decisions made within those programmes should be based on ordinary policy principles completely independent of the fact that the Government may change its ownership level in some SOEs.

Of the policy programmes covered, we consider that the water policy process has the potential to impose ongoing uncertainty on the MOM programme. Options such as charging for water obviously have asset value implications for the SOE generators. Iwi interests are another source of uncertainty. We intend to report to you separately within the next few weeks on the impact of water issues on the MOM programme.

The Electricity Authority's current review of the HVDC pricing methodology is scheduled to result in a final decision on a new pricing methodology around the middle of 2012. Changes to the methodology have value implications for South Island generators, most notably Meridian and to a much lesser extent Genesis, indicating that it would be preferable to know the regulatory decision prior to any potential IPO of those companies. Scoping study information will clarify whether uncertainty around the HVDC methodology only affects the choice of which SOE should be the first IPO or whether it has implications for the timing of the programme more generally.

### **Recommended Action**

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We recommend that you **note** the contents of this report.

Andrew Blazey  
**Manager, Commercial Transactions Group**

Hon Bill English  
**Minister of Finance**

Hon Tony Ryall  
**Minister for State Owned Enterprises**

## Treasury Report: Mixed Ownership Model - Regulatory Stocktake

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### Purpose of Report

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1. We have undertaken a scan of regulatory matters that may have an impact on the Mixed Ownership Model (MOM) programme. This report provides you with an overview of the regulatory matters that we consider will need to be monitored.

### Key Regulatory Topics

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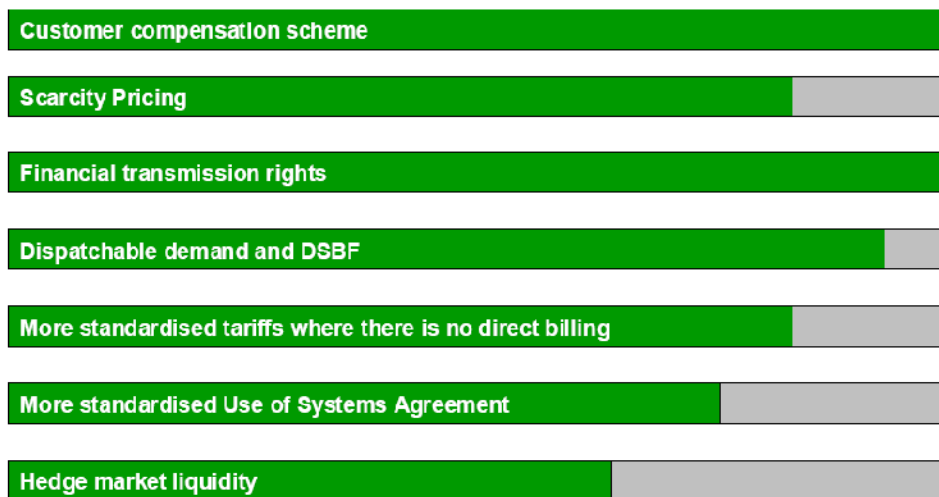
2. We have identified regulatory topics under the general headings of industry specific regulatory matters and commercial regulation, as follows.

Regulation	Comment
<b>Industry</b>	
Electricity market	Code amendments on standardised lines tariff structures, transmission hedging mechanism, developing demand-side participation in the wholesale market and floor on spot prices during conservation campaigns, HVDC pricing review.
Emissions Trading Scheme	ETS Review.
Water	Fresh start for fresh water reforms, National Policy Statements for fresh water and renewable electricity generation.
Crown Minerals	Review of Crown Minerals Act 1991 and associated minerals programme.
<b>Commercial</b>	
Identification and assessment of implications for MOM programme from commercial governing legislation. Examples include: <ul style="list-style-type: none"><li>• Overseas Investment Act</li><li>• NZX Listing Rules</li><li>• Securities Law</li><li>• Commerce Act</li><li>• State Owned Enterprise Act, and</li><li>• Official Information Act.</li></ul>	

3. The purpose of our regulatory scan is to identify where the timing of any review programme may have implications for the optimal timing of the MOM programme offerings and to identify any particular regulatory features that may need to be accounted for in the MOM programme. We do not consider that the MOM programme should have any implications for decisions made within any of the review programmes identified above. Decisions made within those programmes should be based on ordinary policy principles completely independent of the fact that the Government may change its ownership level in some SOEs.

### Electricity Market

4. The Electricity Authority (EA) has been progressing a number of electricity market rules amendments primarily flowing out of the Government's review of electricity market performance. We have met with the EA and received a briefing on their progress. The EA provided us with the following graphic demonstrating that the majority of code amendments are completed or nearing completion. We do not consider there to be any significant implications for the MOM programme from the timing of these code amendments.



5. There are two other material items, however, that are currently being considered. These are the potential change to the HVDC pricing methodology and appeals of the EA's recent undesirable trading situation (UTS) decision.
6. At present the costs of the HVDC link connecting the North and South Islands are charged solely to South Island generators. Some parties argue that this has the effect of discouraging South Island investment even when that investment is superior to the North Island based alternatives. Therefore, the methodology is being reviewed to see if a more economically efficient model could be implemented. The EA's technical advisory committee has recently released a discussion document that favours moving to postage stamp pricing where HVDC costs would be recovered from all electricity consumers, possibly with a transition period.
7. [4] [3]

The EA has indicated that its view will be available by the end of 2011 and the final decision should be made by the middle of 2012. The decision would, however, be subject to judicial review meaning that there could be ongoing uncertainty for an extended period. We will make sure that the scoping studies include appropriate consideration of the potential impacts of a change to the HVDC pricing methodology for each of the SOE generators. This information will clarify whether uncertainty around the HVDC methodology only affects the choice of which SOE should be the first IPO or whether it has implications for the timing of the programme more generally.

8. The EA also briefed us on the appeal of its UTS decision. Genesis, Contact, Todd Energy, and Bay of Plenty Energy have appealed the EA's decision claiming that there has been an error of law. Meridian and Mighty River Power have joined the appeal in support of the EA's decision. [4]

## **Emissions Trading Scheme**

9. A review of the ETS is required by legislation to be completed by the end of 2011. The review is to consider the operation and effectiveness of the ETS and how the ETS should evolve beyond 2012 including the continued use of partial obligations and potential adjustments to the scheduled timing of sector entry into the scheme.
10. At the time the ETS was developed we reported to government on the windfall gains that would arise for SOE generators as a result of the ETS. The ETS has the effect of increasing wholesale electricity prices. Renewable generators make windfall gains as they receive this higher price but do not experience any increase in fuel costs. Thermal generators do face increased fuel costs and are also worse off to the extent that their thermal plants are displaced in the merit order by less emissions intensive generators and dispatched less often. In net terms the benefits to SOE generators outweighed the negative impacts. Changes to ETS design that affect the projected carbon price will have an impact on SOE value with lower carbon prices tending to reduce total SOE value.
11. An independent review panel has reported to the Minister for Climate Change Issues recommending an extension of the partial carbon obligation for emitters beyond its current expiry date of 31 December 2012. This has the effect of lowering the effective carbon price faced by ETS participants below what they expected to face. Instead of \$25 per tonne prices would be forecast as \$16.50 in 2013 and \$20.80 in 2014. Cabinet decisions are scheduled for February 2012, to be followed by legislative change if necessary. Obviously, it would be preferable if any legislative changes were completed prior to any potential IPOs. We will ensure that the scoping studies sufficiently consider the impacts of adjustments to ETS design.

## **Water Policy**

12. The Government is seeking to improve economic outcomes associated with freshwater while putting in place systems that will safeguard environmental outcomes. This involves the setting and implementation of water quality and quantity limits and the efficient allocation of resources within those limits. Both changes to the nature of rights to water, and uncertainties about future policies have the potential to affect the future expenses of generators and the value that may be gained through the partial sale of the relevant assets.

13. Policy areas that could have an effect on the value of SOE assets are set out below.

Policy Area	[3]	Decision Timing
Charging for water		Nov 2012
Water Quantity Limits		Limits now in place, changes to limits are infrequent
Trading of Water		Nov 2012
Governance		Mar 2012
Water Quality Limits		Must be by 2030

<sup>1</sup> This would be akin to the free allocation of emission units provided to emissions intensive industry under the Emissions Trading Scheme.

### ***Iwi-Related Uncertainties***

14. In addition to uncertainties associated with the policies that are identified above, there are uncertainties associated with iwi's relationship to freshwater. Iwi have commonly asserted a special relationship with freshwater, and have been consistent in suggesting that it is important to clarify their rights and interests in freshwater prior to the widespread use of water pricing instruments (such as charging or trading).
15. It is not clear how iwi-related issues would affect future income streams of generators.  
[4]

Timing for decisions on iwi-related matters pertaining to freshwater is unclear.

### ***Implications for the MOM Programme***

16. Issues such as water quality and quantity limits are ongoing issues that the generators already have to deal with as part of their ordinary operations and, as such, should have limited implications for the MOM programme.  
[4]

### **Crown Minerals**

17. The Crown Minerals Act 1991 (CMA) and its associated minerals programmes and regulations are being reviewed. The purpose of the review is to modernise the regulatory regime for petroleum and minerals development. A paper discussing the proposed scope and timeline for the review was considered by the Cabinet Business Committee on 29 August 2011.
18. Policy changes seek to simplify and streamline the regime where appropriate. Legislative design changes will make greater use of clear criteria for important aspects of the permitting regime that are currently the subject of wide ministerial discretion. It is not proposed to review current royalty rates for petroleum or minerals, though the efficiency of current collection and audit functions will be examined.
19. The current timeline for the review (subject to agreement by Cabinet) is:
  - release of a discussion paper for public consultation in December 2011
  - Cabinet report-back on submissions and drafting approval for a Bill in April 2012
  - introduction of a Bill in July 2012, and
  - enactment targeted for February/March 2013.
20. Proposed changes are expected to reduce business compliance costs once the Bill is enacted. Processes under the new regime will better reflect the distinction between the large number of small-scale permit holders and the small number of very large operations which are responsible for the majority of production and royalty income. The review is not expected to affect companies' existing rights as set out in their permits/licences under the CMA or its predecessor legislation.



21. Our thinking at this stage is that the timing of decisions noted above should be satisfactory with respect to the potential IPO of Solid Energy [3]

## Commercial Regulation

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22. We will be undertaking a scan of some more general commercial legislative requirements, and receiving legal advice where appropriate, to see whether any actions are required under that legislation prior to floating SOEs or whether the SOEs have any unique features that may require particular actions to be taken. Examples of potential issues include:
- treatment of floated companies under the Overseas Investment Act and the ability to be granted exemptions under that Act
  - the ability of the Crown and related parties to be given exemptions for disclosures under the Securities Market Act
  - the treatment of disclosures for related party transactions under the NZX Listing Rules
  - the disclosures that may be required by the Crown in the offer document of any initial IPO, given the knowledge it will have gained about all the MOM companies as a result of the scoping studies
  - consideration of the potential implications of the Securities Law review, and
  - consideration of the treatment of the floated companies under acts such as the Official Information Act.
23. There will be a range of legislative adjustments that will be required at the point that any IPO goes ahead. Examples would include removing the company from the State Owned Enterprise Act, although some transitional provisions (for example, in relation to the formalisation of the transfer of land to the SOEs) may continue to apply. There also may be specific auditing and reporting requirements that the Government may wish to consider further. We intend to report to you on legislative options during September.