The Treasury

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

4 September 2012

Release Document

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

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[3] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Comparison of powers of shareholding Ministers in the SOE and mixed ownership model regimes

Date:	8 March 2012	Report No:	T2012/386

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	For information	None
Minister for State Owned Enterprises (Hon Tony Ryall)	For information	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
John Beaglehole	Commercial Transactions Group	[1]	✓
Chris White	Commercial Transactions Manager		

Minister of Finance's Office Actions (if required)

None.

Enclosure: **Yes**

Treasury Report: Comparison of powers of shareholding Ministers in the SOE and mixed ownership model regimes

We enclose for your information a schedule comparing the powers of shareholding Ministers under the State Owned Enterprises Act 1986 with those contained in the Mixed Ownership Model regime. This is a preliminary piece of work, and we will develop it further, to provide advice on how the Crown should act as a shareholder in the mixed ownership model companies. We are also preparing a further report on the ability of Ministers as shareholders to control sales of sensitive assets; we envisage having that to you shortly.

Recommended Action

We recommend that you **note** the attached schedule.

Agree/disagree.

Chris White
Manager, Commercial Transactions

Hon Bill English
Minister of Finance

Differences between the key provisions in the State-Owned Enterprises Act and the Mixed Ownership Model Bill

SOE Act and experience	MOM Bill	Commentary
s.4 sets out that the principal objective of every State enterprise shall be to operate as a successful business and, to this end, to be (a) as profitable and efficient as comparable businesses that are not owned by the Crown; and (b) a good employer; and (c) an organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so. There have been several legal cases considering the meaning of this section of the Act. We have drawn the following conclusions from these: • What can amount to operating "as a successful business" has to be determined in the context of the three requirements of s 4(1) , and there is nothing to suggest that they should not be treated as being of the same weight; • When considering whether an SOE is an organisation that exhibits a sense of social responsibility, courts will most likely assess this over a period of time and not in relation to a particular act or transaction in the course of the SOE's business; and • Courts will be reluctant to second guess subjective decisions of SOEs which involve a "balancing act" between the requirements of s 4(1).	Contains no such provision; neither does the Companies Act. (a) is implicit in being a listed company.	In sum: corporate social responsibility (**CSR**) provisions are not part of the Companies Act framework, and a survey of listed companies' constitutions did not provide examples of CSR requirements included in their constitutions. Even so, a number of NZ corporations have corporate social responsibility programmes (Contact Energy's sponsorship of Triathlon New Zealand, Telecom New Zealand's Telecom Foundation, and Fonterra's 'Milk for Kiwis' programme). Not including a CSR provision in the Act or the constitutions will not prevent the MOMs from developing or continuing their existing work. Corporate social responsibility is typically defined as the voluntary integration of social and environmental concerns into a business' operations, and interactions with stakeholders. Organisations choose to pursue CSR because it can be good for business through building stakeholder trust in an organisation's ability to balance vested interests and the public good, sometimes termed an organisation's 'licence to operate'. We would argue that all businesses are incentivised to do this as a matter of course. The December Cabinet paper on MOM noted that Cabinet had the option of including section 4 of the SOE Act (as well as other discretionary provisions) but did not recommend including it. If Ministers were to consider the inclusion of CSR obligations or enhancements the options appear to be: • Replicating section 4 in Part 5A of the PFA. The Government could consider retaining the whole of section 4, not just subsection 1c to ensure a balance of objectives. This would mirror the thinking of the drafters of the SOE Act. • Including a CSR provision in the companies' constitutions , which directors will have a duty to comply with. An initial scan of the constitutions of Air NZ and other major listed companies indicates there is no precedent for this. This could create difficulties for directors in the execution of their duties, and uncertainty for investors. These issues may require further investigation and analysis.
s. 7 provides for the Crown and an SOE to enter into an agreement for the non-commercial provision of goods or services by an SOE, with the Crown paying all or part of the associated costs. The Act is ambiguous on the extent to which the Crown can compel the SOE to absorb some of the costs of the provision.	The Bill contains no similar provision.	No power is required as the Government can contract with the companies on an arm's-length, commercial basis, with the Crown paying the full costs. As far as we are aware, this provision has only been used once, for Kiwirail's public policy rail initiatives (for which there is an appropriation of $3.720M). We are not aware of any occasion where the SOE has absorbed part of the costs of the service. Making the MOM companies absorb some of the costs of non-commercial goods or services, as is theoretically possible under section 7, is not appropriate given they will have minority shareholders.
s. 8 provides that before entering into any collective agreement under the Employment Relations Act 2000, every State enterprise to which this subsection applies must consult with the State Services Commissioner over the conditions of employment to be included in the collective agreement	The Bill contains no similar provision.	In our view this section is not appropriate for a listed company operating in a competitive environment.
s. 11 provides that the shareholding Ministers cannot sell or otherwise dispose of shares in SOEs	The Bill prevents the Crown from holding less than 51% of the voting rights in each of the companies, and will restrict non-Crown shareholders from holding more than 10% of the voting rights in each of the companies.	The Crown will not be able to hold less than 51% of the shares in each MOM company, except by an amendment to the legislation. While the Crown will own the majority of shares in each company, there is a change in control implicit in moving from 100% shareholding to being a majority shareholder. First, the Crown will no longer have complete control over the companies' constitutions, as a special resolution (75%) is needed for changes. Second, the companies' directors will need to bear in mind the views and interests of other shareholders, as opposed to the interests of a single shareholder
s. 12 provides for the issue of state enterprise equity bonds, following authorisation of the House.	The Bill contains no provision for equity bonds.	Equity bonds have never been issued to our knowledge. SOEs, like MOMs, are free to use a wide variety of non-voting instruments to raise capital, including instruments that have equity characteristics, and SOEs have done so. There is no clear boundary between non-voting shares at one extreme, and debt at the other. The Government's real concern is to ensure that issue of securities with equity characteristics are not used to undermine the Crown's 51% voting rights, which is prevented by the MOM Bill.
Section 13 enables Ministers to give directions in respect of the amount of dividend, and to include or omit from	There is no power of direction. Ministers have the normal shareholder	The ability to give directions to an SOE makes sense in an environment where the company is wholly owned by the Crown. Note, however, that the power to give directions is limited, and we do not believe that

statements of corporate intent provisions of a kind referred to in s. 14(2)(a) to (h). s. 14(2) sets out the information that must be included in an SOE's statement of corporate intent: (a) The objectives of the group; (b) The nature and scope of the activities to be undertaken; (c) the ratio of consolidated shareholders' funds to total assets, and definitions of those terms; (d) The accounting policies; (e) The performance targets and other measures by which the performance of the group may be judged in relation to its objectives; (f) A statement of the principles adopted in determining the annual dividend together with an estimate of the amount or proportion of annual tax paid earnings (from both capital and revenue sources) that is intended to be distributed to the Crown; (g) The kind of information to be provided to the shareholding Ministers by the State enterprise during the course of those financial years, including the information to be included in each half-yearly report; and (h) The procedures to be followed before any member of the group subscribes for purchases, or otherwise acquires shares in any company or other organisation.	rights which include: • Sell and buy shares (subject to the limits set out in the Bill); • Vote on appointment of directors, major transactions (transactions in excess of half the value of the company) and other powers conferred on shareholders by the Companies Act or the companies' constitutions. • Vote on changes to the constitution; • Decide whether to take up any issue of new shares; • Possibly approve the appointment of the chairman of the Board (this is yet to be decided).	any direction as to dividends has ever been given. In particular, Ministers cannot give directions in respect of individual transactions. Also, in practice directions have been rarely given, because: • A direction may be difficult to reconcile with the principal objective of an SOE which is to operate as a successful business, which includes being as profitable and efficient as comparable businesses that are not owned by the Crown. • A direction could expose Ministers to the risk of being deemed to be directors of the company, and expose them to directors' liabilities. • A direction could put directors into a difficult position if they do not agree with the direction. Under the MOM legislation, these powers are: • Unnecessary, because of the stronger performance incentives that arise as a result of share prices being quoted on the stock exchange; and • Inconsistent with the MOM model, because they enable ministers to intervene in MOM activities for non-commercial reasons, which could harm the value of the company. Non-commercial objectives are better pursued through other means, such as the Government's regulatory powers.
s. 18 allows shareholding Ministers to seek effectively any information in respect of a SOE and its subsidiaries (except for information on individuals)	The Bill contains no similar provision. The Companies Act allows shareholders to request information, but companies do not have to provide it.	The Crown can obtain further information through agreement with the MOM companies, as it does currently for Air NZ. The Treasury can also require the MOM companies to provide it with information necessary to prepare the Government's annual financial statements.
Subject to the OIA and OA.	No longer subject to the OIA and OA.	The main purpose of the OIA and OA is to make official information more available and hold accountable state entities that can impact on the public through their administrative functions. In particular, it enables the public to understand why certain decisions or policies have been made. This enables the public, either directly or through the Ombudsman, to challenge decision-makers where appropriate. This important because the state and most of its agencies have the characteristics of a "monopolist", i.e. customers do not have anywhere else to go. This includes a number of SOEs that have monopoly characteristics. However, the MOMs operate in a competitive environment. This enables customers or investors who have had no success in using their contractual rights, to switch to a different provider. It also provides the MOMs with a strong incentive to be customer-focused. Further, we note that: • Ministers of the Crown and officials will themselves continue to be subject to the OIA, and officials will continue to be subject to the OA, • Air New Zealand is not subject to the OA or OIA, • the companies will be subject to the Stock Exchange's continuous disclosure regime. The OIA and OA are therefore unnecessary and could place the MOMs at a competitive disadvantage relative to other energy companies.
Other: Appointment of directors. These are nominated and appointed in accordance with the provisions of the Companies Act. In other words, they are nominated by shareholders and voted on at the annual shareholders' meeting. In the case of SOEs the Government nominates and appoints directors.	The relevant provisions of the Companies Act apply. In the case of widely-held listed companies the practice is for the existing Board to suggest at a shareholders' meeting that somebody nominate a particular director, who is then voted on by shareholders.	Boards are likely to consult with the Government and other significant shareholders before putting forward a director for nomination and election. Given that the Crown will be able to vote on a nominated director, there is little chance of someone being appointed who is not acceptable to the Government.