THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Mixed Ownership Model - Legislative Options

Date:	29 September 2011	Report No:	T2011/2150

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Note** the contents of this report for discussion at our meeting on Wednesday	3:30pm Wednesday 5 October 2011
Minister for State Owned Enterprises (Hon Tony Ryall)	**Note** the contents of this report for discussion at our meeting on Wednesday	3:30pm Wednesday 5 October 2011
Associate Minister of Finance (Hon Steven Joyce)	**Note** the contents of this report for discussion at our meeting on Wednesday	3:30pm Wednesday 5 October 2011

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
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Minister of Finance's Office Actions (if required)

None.

Enclosure: **Yes (attached)**

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Executive Summary

This report provides advice on the legislation that will be required to implement an extension to the Mixed Ownership Model (**MOM**) if the government decides to proceed with a sale programme. Our advice is based on the understanding that ministers wish to make the minimum legislative changes necessary, *[Withheld under s9(2)(f)(iv)]*

We consider that legislation will be required to achieve the following:

- removal of the SOE MOM companies from schedules 1 and 2 of the SOE Act (this could be achieved in a single piece of legislation, with the relevant parts coming into effect by Order in Council on a company by company basis). This is necessary to avoid the restriction on shareholding ministers selling shares in SOEs in section 11 of the SOE Act
- continued application of the provisions in the SOE Act relating to the transfer of land and assets by the Crown to the SOEs, and
- continued application of the offer-back provisions of the Public Works Act (in respect of certain land transferred by the Crown to the SOEs).

We consider it is also desirable to include the following measures in legislation:

- removal of Solid Energy Ltd from schedule 1 of the Official Information Act (noting that Air New Zealand is not subject to that Act and the Act will continue to apply to the Crown in relation to information it holds on the MOM companies, and noting that Meridian, Mighty River Power and Genesis can be removed from the OIA by Order in Council), and
- continued application of the Public Records Act to pre-IPO records.

Consistent with ministers' intention to make the minimum legislative changes necessary to implement an extension of the mixed ownership model, at this stage we consider that it is not necessary, by way of example, for the following provisions to continue to apply to the MOM companies once they are listed:

- the ongoing application of s.9 of the SOE Act, which provides that nothing in the SOE Act permits the Crown to act in a manner that is inconsistent with the principles of the Treaty of Waitangi. Such a provision could, however, be reconsidered prior to the passage of legislation, following consultation with Maori
- to ensure the Crown's ownership of the MOM companies is not less than 51%. This restriction could, however, be included in the companies' constitutions if considered necessary
- director appointment processes (if desired these could be codified in the companies' constitutions)
- shareholding ministers' power to give directions in relation to dividends and scope of business, as currently exists in sections 13 and 14 SOE Act
- shareholding ministers' power to obtain information, as currently exists in s.18 of the SOE Act, and

- to require the companies to be good employers and exhibit a sense of social responsibility, as currently required under s.4 of the SOE Act.

It may also be necessary for the SOE MOM companies to apply for certain exemptions or waivers under existing regulatory regimes to facilitate the sales programme to take into account, for example, the broad definition of "The Crown" (for example, in relation to the Overseas Investment Act, the Takeovers Code and related party transactions under Listing Rules). We do not, however, consider at this stage that legislative changes to those regimes are required to enable the implementation of the mixed ownership model. We will be providing further advice to you on this issue.

There are a number of specific references in legislation to state enterprises generally and each of the SOE MOM companies specifically (in addition to the SOE Act provisions already identified) which are still being considered in more detail. This exercise may result in additional legislative amendments being identified prior to drafting instructions being issued.

[Withheld under s9(2)(f)(iv)]

If a decision is made to proceed with an extension to the mixed ownership model, we recommend that drafting instructions be issued to Parliamentary Counsel Office in December 2011. This will increase the likelihood that legislation will be passed in time to enable a first IPO to be completed before the end of 2012. To achieve this, we propose that you request Cabinet's approval to issue drafting instructions when it meets on 12 December 2011.

Recommended Action

We recommend that you:

a **note** that we will draft a Cabinet paper on legislation to implement the mixed ownership model for your consideration on 5 or 6 December, with a view to submission to Cabinet for its meeting on 12 December, and

b **note** that we are scheduled to discuss this report with you at a meeting at 3:30pm on Wednesday 5 October 2011.

Andrew Blazey
Manager, Commercial Transactions Group

Hon Bill English
Minister of Finance

Hon Tony Ryall
Minister for State Owned Enterprises

Hon Steven Joyce
Associate Minister of Finance

Treasury Report: Mixed Ownership Model - Legislative Options

Purpose of Report

1. This report identifies the legislation that will be required to implement an extension to the Mixed Ownership Model (**MOM**). It also identifies discretionary provisions that ministers may wish to consider.

Analysis

General Comment

2. Section 11 of the SOE Act prohibits the sale of shares in the SOE MOM companies. Legislation is therefore required to remove those companies from schedules 1 and 2 and therefore from the ambit of the Act.

3. However, there are some provisions in the SOE Act which need to continue to apply to these companies, in particular the provisions relating to the transfer of land and assets by the Crown to the SOEs, and the offer-back provisions of the Public Works Act.

4. We understand that ministers wish these companies to operate as far as possible on the same basis as other listed companies, *[Withheld under s9(2)(f)(iv)]* *[Withheld under s9(2)(f)(iv)]* On this basis, we consider that the legislation and Orders in Council should also remove these companies from the ambit of the Official Information Act and the Ombudsmen Act.

5. These proposals, together with other provisions that could be legislated but that we do not recommend, are discussed further below.

Timing

[Deleted - Not Relevant to Request]

9. [Deleted - Not Relevant to Request] Given that legislation typically requires at least 6 months to pass through all stages in the House [Withheld under s9(2)(f)(iv)], it will be prudent for Cabinet to consider approving drafting instructions in December, ideally at its meeting of 12 December. This in turn means that ministers would need to consider a draft Cabinet paper on 5 or 6 December. Later dates for decisions place a greater imperative for a simple, short bill in order to achieve the above timeframe.

10. Because of the very tight timeframes, we seek your guidance on proposed legislation now, although we note that it is possible that further issues may come to light as we consult with other agencies and undertake further research.

Necessary Legislative Provisions

11. The following are the three provisions which we believe are essential for implementing the Government's MOM programme:

    a Removal of the SOE MOM companies from schedules 1 and 2 of the State Owned Enterprises Act. This is necessary to avoid the restriction on selling shares in SOEs in section 11 of the SOE Act. This could be achieved in a single piece of legislation, with the relevant parts coming into effect by Order in Council on a company by company basis;
    b Provisions relating to land: Sections 23 to 30 of the SOE Act set out the process for the transfer of assets and land by the Crown to SOEs. Some of the land previously transferred to the SOEs is still in the process of being formalised, and the continued application of these provisions is required to assist with this process; and
    c Continued application of the offer-back provisions of the Public Works Act in respect of certain land transferred by the Crown to the SOEs (such a provision also still applies to certain land transferred by the Crown to Contact Energy).

Desirable Legislative Provisions

12. We consider that it would also be very desirable to include the following two measures in legislation:

    a Official Information Act: We consider that Solid Energy, Meridian, MRP and Genesis should be removed from the ambit of the Official Information Act 1982 (OIA) and the Ombudsmen Act 1985 (OA). All four companies can be removed from the OA by Order in Council. The effect of this will be that the OIA will cease to apply to Meridian, MRP and Genesis (organisations that are listed in the OA are subject to the OIA). However, as Solid Energy is also *separately* listed in the schedule to the OIA, legislation will be required to address this and to remove Solid Energy from the ambit of that Act.

      The purpose of the OIA is to increase progressively the availability of official information to the people of New Zealand in order to:

      (i) enable their more effective participation in the making and administration of laws and policies, and

      (ii) promote the accountability of ministers of the Crown and officials,...(s.4)

The purpose of the Ombudsmen Act is to "provide Parliament (and the New Zealand public) with an impartial, independent check that the New Zealand government's administrative practice, and exercise of decision-making, at central, regional and local level, is robust, fair, transparent and accountable." (Ombudsmen's SOI of 2008).

These accountability mechanisms are not in our view appropriate for SOEs that cease to be subject to the accountability framework in the SOE Act and instead become subject to the accountability framework implicit in the reporting requirements of the NZX listing rules.

Application of the OIA would put the MOM companies at a competitive disadvantage to other listed entities for the following reasons:

- Investors who are not generally very familiar with the workings of the OIA may worry about the extent to which commercially valuable information can be protected from the companies' competitors, and are therefore likely to discount to some extent the price of the shares compared with the shares of companies that are not subject to the OIA; and

- The SOEs consider that the administrative compliance costs of the OIA in particular impose a significant cost burden on them.

We note that once listed, the companies will be subject to the NZX Listing Rules including the continuous disclosure regime. This regime requires, subject to certain exceptions, the continuous disclosure to the public of information that a reasonable person would expect to have a material effect on the price of the company's shares. The regime is designed to ensure that material information is disclosed to all investors at the same time.

We also note that Air New Zealand is not subject to the OIA. Both the OIA and the OA will continue to apply to the Crown in relation to information it holds on the MOM companies.

In 1990 a Parliamentary Select Committee reviewed the application of both the OIA and the OA. In summary, it concluded that, given the SOEs' good employer and social responsibility obligations and the Government's oversight of the SOEs, the OIA and the OA provide a measure of accountability for the public, particularly on matters that affect individuals. It recommended that the jurisdiction of both Acts over SOEs should continue. We therefore consider that the application of these two Acts to the SOE MOM companies should be decided in tandem with the good employer and social responsibility provisions, and that both should be removed (see below). However, we are currently consulting with the Chief Ombudsman and wish to conclude that before coming to a final view.

b Public Records Act 2005: The purpose of the Public Records Act as set out in s.3 is to "enable the Government to be held accountable by—

(i) ensuring that full and accurate records of the affairs of central and local government are created and maintained; and

(ii) providing for the preservation of, and public access to, records of long-term value;"

The Act applies to every public office, which is defined to include SOEs. It does not apply to Air New Zealand or Contact Energy, and would most likely not apply to the MOM companies if they are simply removed from the SOE Act.

We have discussed this with the Chief Archivist's office. They advise that there could be a continued public interest in records held by the companies relating to the period of public office. There is likely to be a long-term value for historical research. They consider that in principle, the ideal solution might be for the Act to continue to apply to old records, but that it does not need to apply to future records.

Some Discretionary Provisions – Not Recommended

13. Consideration needs to be given to a number of provisions in the SOE Act which could be made to continue to apply to MOM companies. There are also certain new provisions which ministers may wish to consider. The most obvious ones are listed below. Finally, there are a number of specific references in legislation to state enterprises generally and each of the SOE MOM companies specifically (in addition to the SOE Act provisions already identified) which are still being considered in more detail. This exercise may result in additional legislative amendments being identified prior to drafting instructions being issued.

14. We do not consider it necessary or desirable to legislate the items listed below, in the interests of keeping the legislation as brief as possible and ensuring the competitive neutrality of the MOM companies:

    a Treaty of Waitangi (s.9 of the SOE Act): This section states that "Nothing in this Act shall permit the Crown to act in a manner that is inconsistent with the principles of the Treaty of Waitangi." It does not impose obligations on the SOEs themselves. We would expect that Maori will attach importance to the continued application of this provision given the significant contribution section 9 has made to Treaty of Waitangi jurisprudence.

    If this section was retained, it would however be likely to create uncertainty for minority investors in the companies, which is likely to have an impact on the value of the offer of any shares. Retention of such a provision is also inconsistent with the objective of making MOM companies as similar as possible to Air New Zealand and other listed companies.

    The ongoing application of this section could, however, be reconsidered at a later date following consultation with Maori.

    b The legislation could provide that ministers may not sell shares below 51%. This could be written either as an obligation on ministers, which would mean that the Government would be obliged to contribute capital whenever a company made a rights issue, or alternatively, it could be written as an obligation on the company, which would mean that the company would be prevented from making rights issues if the Government was unable or unwilling to contribute capital.

    An alternative to legislation would be to insert a provision in the company constitutions that prevents companies from issuing more shares beyond the point where the Crown's ownership falls below 51%.

    The other alternative to legislation is to do nothing and rely on political undertakings by the Government. This would put the obligation on Government to ensure that it is not diluted below 51% ownership.

    We do not consider that a legislative provision is necessary. In our view it would be inconsistent with the objective of making these companies as similar as possible to Air New Zealand and other listed companies. However, ministers

may consider that it would provide greater perceived certainty to the public about the Crown's majority shareholding.

Possible amendments to company constitutions will be the subject of a report in the New Year.

c Appointment of directors: Treasury report T2011/1972 identified the following options available to ministers:

1. Nominations		
COMU recommends, ministers nominate and all shareholders vote	Shareholders vote on external Nominating Committee's nomination	Shareholders vote on Board's recommendation

2. Voting	
Government votes on all positions	Government votes on some positions only

3. Chair		
Crown elects chair	Board elects chair subject to ministerial approval	Board elects chair

4. Diversity		
Requirements on composition of Board	Guidelines on, and disclosure of, Board composition	No particular guidelines

It also identified that the arrangements could be codified in legislation, in the company constitutions or they could simply be implemented by way of practice.

In our view it is not necessary for legislation to include special provisions relating to the appointment and removal of directors. We consider that the Crown should retain its full shareholder rights and that any restriction on that should be implemented by way of practice, or by way of a provision in the company constitutions. We will provide further reports on possible amendments to company constitutions in due course.

d Power to give directions in respect of:

a. dividends (s.13 of the SOE Act), and

b. scope of business as set out in an SOE's Statement of Corporate Intent (s.14 of the SOE Act).

Without this power, ministers' ability to intervene in a company that is not being run as desired is effectively limited to replacing the Board. Ministers may consider that to be too blunt an instrument.

However, retaining these powers would be inconsistent with the principle of equal rights for all shareholders and would be seen by the market as creating scope for non-alignment between the interests of the Crown and those of other shareholders. It would likely result in a reduction in the value of the companies. Monitoring by the share market should replace the disciplines which previously the Government needed to provide.

We therefore consider that these rights should not be retained.

e Power to obtain information (s.18 of the SOE Act): In the absence of this power, ministers' ability to obtain information will be governed by s.178 of the Companies Act 1993, which provides that a shareholder may request information, but the company can refuse to provide it. A court can decide whether a company has sufficient reason to refuse the request.

Ministers may consider that this provision is insufficient in that it does not guarantee them access to information they need. However, we consider that in practice companies could still choose to make information available provided an appropriate confidentiality deed is entered into. This is the mechanism by which ministers are currently able to obtain information from Air New Zealand.

We also note that once listed, the companies will be subject to the NZX Listing Rules including the continuous disclosure regime. In our view retaining a legislative power for shareholding ministers to obtain information directly from the MOM companies is inconsistent with this regime and is not necessary.

f Good employer and social responsibility provisions (s.4 of the SOE Act): This section provides that SOEs need to be good employers and exhibit a sense of social responsibility. These provisions do not apply to Air New Zealand. Our initial investigations suggest that they have had little practical impact on the operations of SOEs, as competition in the employment and electricity markets drive them to be good employers and to be socially responsible within the communities they operate in. They cannot afford to perform worse in these respects than their industry peers that they compete with. To the extent that it is desirable to achieve competitive neutrality between the MOM companies and other listed companies, it seems appropriate in respect of these provisions to subject the MOM companies to the general law only.

g Audit: S.19 of the SOE Act provides that SOEs must be audited by the Auditor-General. Retention of this provision in legislation is not necessary because s.4 of the Public Audit Act 2001 provides that the Auditor-General is the auditor of every public entity, which includes any organisation controlled by the Crown. This provision would continue to apply to the MOM SOEs once listed. It also applies to Air New Zealand.

The Auditor-General usually subcontracts the audit function to a private auditor. We therefore see no disadvantage to shareholders if the Public Audit Act continues to apply to the SOE MOM companies.

h Facilitative legislation: It may be necessary for the SOE MOM companies to apply for certain exemptions or waivers under existing regulatory regimes to facilitate the sales programme to take into account, for example, the broad definition of "The Crown" (for example, in relation to the Overseas Investment Act, the Takeovers Code and related party transactions under Listing Rules). We do not, however, consider at this stage that legislative changes to those regimes are required to enable the implementation of the mixed ownership model. We will be providing further advice to you on this issue.

We do not consider at this stage that it is necessary to give ministers new powers of direction over the SOE MOM companies to implement the MOM programme, given the aims of the Boards and shareholding ministers should be aligned.

We note that such powers of direction were not required for previous sales of SOEs, for example in the cases of the sale of Contact Energy, Auckland Airport or Capital Properties. If such provisions were to continue to apply to the SOE MOM companies then it is likely that the exercise of this power would increase the Crown's liability as the Board will inevitably require protection against 3rd party claims in following any direction.

[Withheld under s9(2)(f)(iv)]

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