THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Mixed Ownership Model: Cabinet Paper

Date:	13 December 2011	Report No:	T2011/2446

Action Sought

	Action Sought	Deadline
Prime Minister (Rt Hon John Key)	**Note** the contents of this report	For Cabinet on 14 December 2011
Minister of Finance (Hon Bill English)	**Submit** the attached Cabinet paper	For Cabinet on 14 December 2011
Associate Minister of Finance (Hon Steven Joyce)	**Note** the contents of this report	For Cabinet on 14 December 2011
Minister for State Owned Enterprises (Hon Tony Ryall)	**Submit** the attached Cabinet paper	For Cabinet on 14 December 2011
Associate Minister of Finance (Hon Dr Jonathan Coleman)	**Note** the contents of this report	For Cabinet on 14 December 2011

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Dominic Milicich	Senior Analyst, Commercial Transactions	9176 087 (wk)	*[Withheld under s9(2)(a)]*	✓
John Crawford	Deputy Secretary, Commercial Transactions	917 6251 (wk)		

Minister of Finance's and Minister of SOEs' Office Actions (if required)

Submit the attached Cabinet paper.

Enclosure: Yes (attached)

(Progressing the Mixed Ownership Model Programme:2190472)

Treasury Report: Mixed Ownership Model: Cabinet Paper

Executive Summary

Attached to this report is a Cabinet paper covering *[Deleted - Not Relevant to Request]*

and agreement on legislative requirements and the direction to PCO to draft legislation.

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Recommended Action

We recommend that the Minister of Finance and the Minister for State Owned Enterprises **submit** the attached Cabinet paper to Cabinet.

John Crawford
Deputy Secretary, Commercial Transactions Group

Rt Hon John Key
Prime Minister

Hon Bill English
Minister of Finance

Hon Steven Joyce
Associate Minister of Finance

Hon Tony Ryall
Minister for State Owned Enterprises

Hon Dr Jonathan Coleman
Associate Minister of Finance

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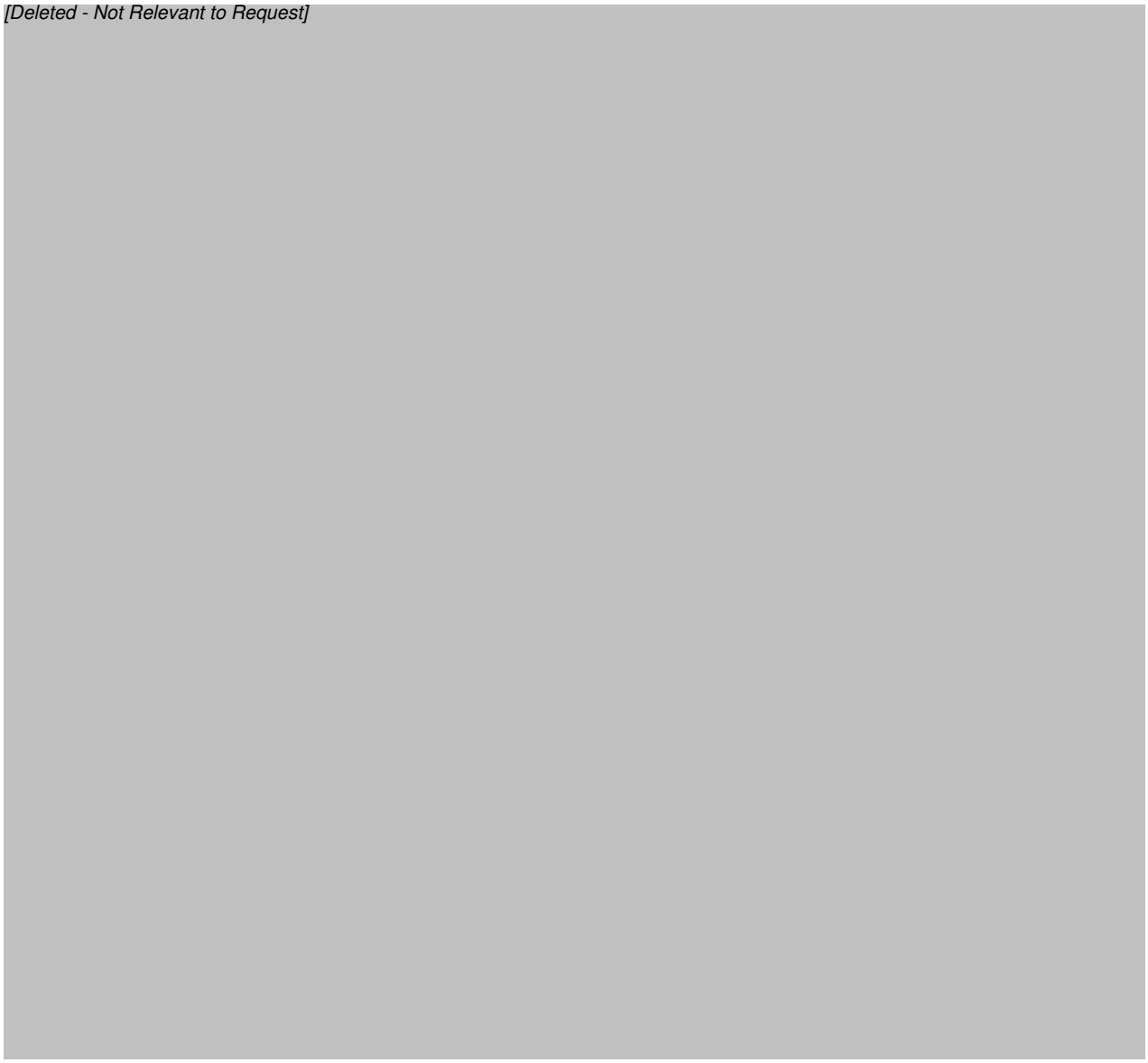

11. The proposed approach to legislation follows ministers' desire for a minimalist approach. The general intent has been that the companies should look and act in the same manner as other listed entities. The approach has been to remove the companies from the coverage of the State Owned Enterprises Act (SOE Act), the Official Information Act, and the Ombudsmen Act. The only parts of the SOE Act to be preserved are the sections covering land transfers as these will continue to be necessary. This means that ministers will lose some powers that they currently hold but our judgement is that the powers that they will retain as shareholders through the Companies Act and the Listing Rules will be sufficient to protect the Crown's interests. In accordance with the United Future agreement, the legislation will include provisions requiring the government to retain 51% ownership of the companies and restricting all other individual shareholders to maximum shareholdings of 10%.

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Minister of Finance
Minister for State Owned Enterprises

Chair
Cabinet

PROGRESSING THE MIXED OWNERSHIP MODEL PROGRAMME

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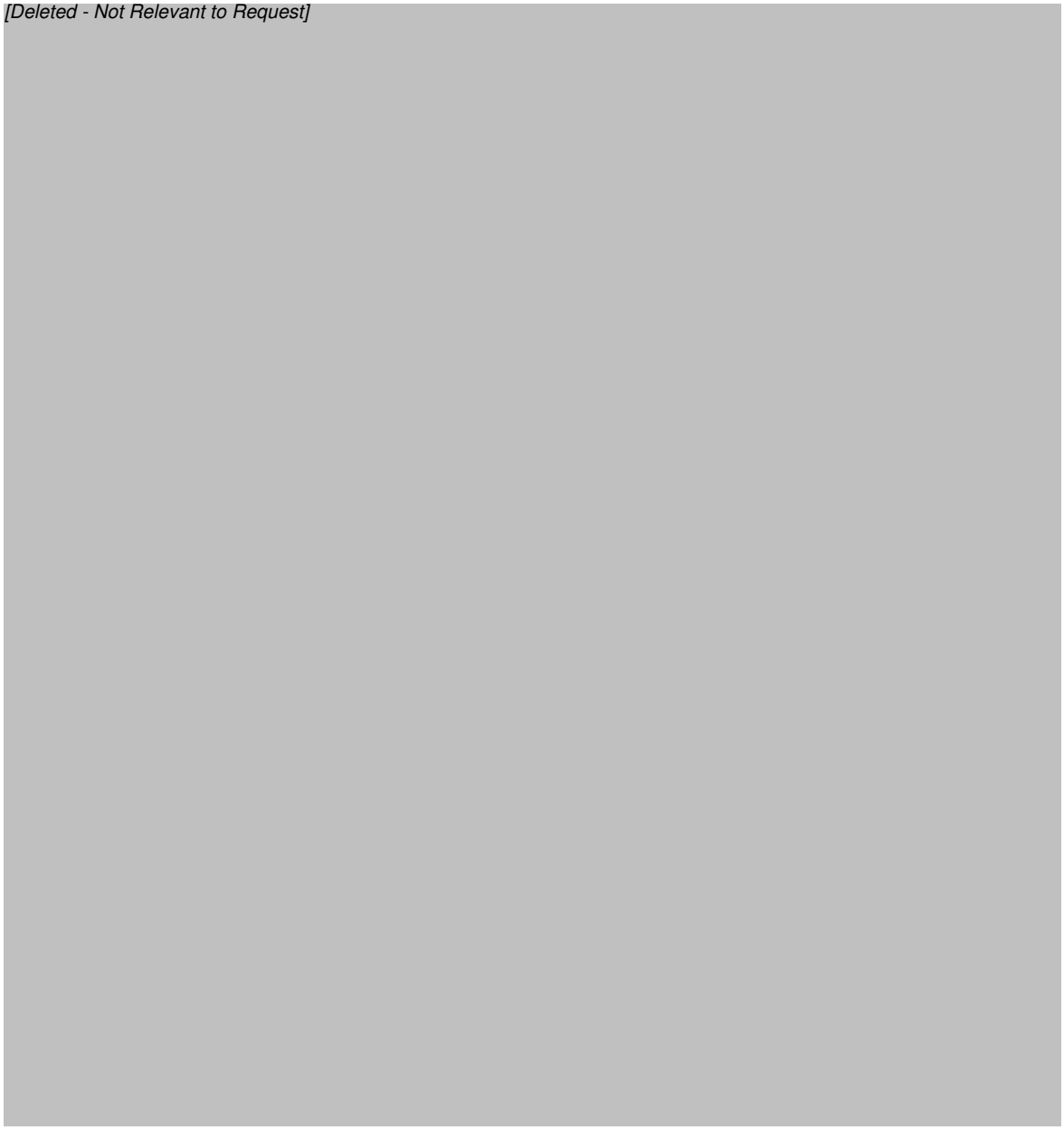

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9. Legislation will be required. It is our intention to keep this legislation as simple as possible. Legislation is to be limited to removing the SOE MOM companies from the schedules of the SOE Act, including the undertakings to the United Future Party, ensuring continued application of the sections of the SOE Act that allow for the necessary transfer of assets and land by the Crown to the SOEs, and removing the MOM companies from coverage of the Official Information Act and the Ombudsmen Act. Continued application of the Public Records Act 2005 in respect of pre-IPO records is to be allowed.

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Legislative Implications

63. The following are the 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, which will come into effect by Order in Council on a company by company basis;

b Provisions relating to land: Sections 22 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. These sections also provide for the 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).

c Consequential amendments: There are a number of other Acts which refer to "State enterprises" or a variant of that term. Amendments to a number of these Acts will be necessary to ensure that they continue to apply to MOM companies, in order to preserve the property rights of third parties, the property rights of MOM companies or the general policy intent of those Acts.

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

a Official Information Act and Ombudsmen Act: We consider that Solid Energy, Meridian, Mighty River Power 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, Mighty River Power 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. Alternatively, the legislation could itself provide for the removal of all the MOM companies from the OA. The Acts would cease to apply to the companies at the point in which the decision to proceed with an IPO was taken and prior to lodging a prospectus.

One of the purposes of the OIA is to increase progressively the availability of official information to the people of New Zealand in order to enable effective participation in government processes and promote accountability of ministers and officials. Under the OA, an Ombudsman can investigate complaints about the administrative acts and decisions of central and local Government agencies.

We note that the primary role of the MOM companies will be to operate on a commercial basis and act as any other listed company. We also note that Ministers of the Crown and Departments will continue to be subject to the OIA and the OA, including in relation to information they hold on the MOM companies.

We do not consider that the accountability mechanisms in the OIA and the OA are appropriate for companies that cease to be subject to the SOE Act and are no longer wholly owned by the Crown. They will instead become subject to the accountability framework and reporting requirements that apply to listed entities under the NZX Listing Rules.

The MOM companies are intended to behave in the same way as other listed companies in the private sector, and will be subject, to the greatest extent possible, to the same accountability framework that applies to those companies. In particular, while the Crown will maintain a controlling interest in these companies, its role and powers will be limited to that of a majority shareholder in a listed company, including in relation to the exercise of voting rights and the appointment and removal of directors.

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. In our view, this provides a suitable alternative accountability mechanism to the OIA.

Application of the OIA may also put the MOM companies at a competitive disadvantage to other listed entities as investors may be concerned that it could result in the disclosure of commercially sensitive information to the public, including the companies' competitors. The companies would also face an administrative burden and cost in complying with the OIA, which is not faced by their listed competitors.

We note that Air New Zealand is not subject to the OIA even though Ministers hold the majority of shares in that company.

Initial discussions have been held with the Chief Ombudsman but a final view on whether the companies should remain subject to the OIA and OA has not been sought. Treasury will seek a formal view from the Chief Ombudsman before reporting to Cabinet Committee with the draft legislation.

b Public Records Act 2005: This Act ensures that records of the affairs of central and local government are created and maintained and that records of long-term value are preserved and provided for public access. 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.

The Treasury has 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 Act should continue to apply to old records, but that it does not need to apply to future records.

Discretionary Provisions - Recommended

Retaining at Least 51%

65. The legislation could provide that the Crown may not sell shares below 51%. This could be written either as an obligation on the Crown, which would mean that the Government may also be obliged to subscribe to further shares issued by the company in order to maintain a majority shareholding. Alternatively, it could be written as an obligation on the company, which would mean that the company would be prevented from issuing further shares if the effect would be to dilute the Government's shareholding to below 51%.

66. 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%. However, this would not legally bind the Government.

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

68. It would be simplest to insert a clause in MOM company constitutions restricting the companies from taking actions that would have the effect of diluting the Crown's ownership below 51%. We note, however, that the United Future agreement specifies that the 51% restriction is to be inserted into legislation so propose to include this in drafting instructions to PCO. *[Withheld under s9(2)(f)(iv)]*

10% Limit on Individual Shareholding

69. As with the 51% Crown ownership constraint, this could be put into legislation or into the company constitutions.

70. Legislation could provide for a limit on the voting rights in specified companies that may be held or controlled by any one person other than the Crown. A precedent for this exists in the Securities Markets Act 1988, which provides for such control limits to be imposed by Order in Council on registered securities market exchanges (in practice this means the NZX).

71. Alternatively, the company constitutions could be amended to achieve the same result. This approach was taken in the case of Air New Zealand and Telecom (both of which have a

limitation of 10% on ownership). Once in place, the provision can't be removed without shareholders passing a special resolution (i.e. a resolution approved by 75% of the shareholders voting on the issue).

72. Again, the United Future agreement requires that this restriction be included in legislation.

Some Discretionary Provisions – Not Recommended

73. 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 Cabinet 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 legislation being finalised.

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

Treaty of Waitangi

75. This section (s.9 of the SOE Act) 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.

76. 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.

77. It would be preferable for the consultation process to identify and address any specific Treaty-related concerns around the MOM process.

Appointment of Directors

78. In our view it is not necessary for legislation to include special provisions relating to the appointment and removal of directors. Under the Companies Act the Government, as majority owner of the companies, will have the ability to appoint and remove directors.

Power to Give Directions

79. The power to give directions is in respect of:

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

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

80. To the extent that the Crown wishes to influence the governance of the company, it retains the power to replace the Board.

81. In our view, retaining the power to give directions 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.

82. We therefore consider that these rights should not be retained.

Power to Obtain Information

83. In the absence of this power (s.18 of the SOE Act), 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.

84. 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.

85. We also note that once listed, the companies will be subject to the NZX Listing Rules including the continuous disclosure regime.

Good Employer and Social Responsibility Provisions

86. This section (s.4 of the SOE Act) provides that SOEs need to be good employers and exhibit a sense of social responsibility. These provisions do not apply to Air New Zealand. They appear to 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. The electricity generators will still be subject to the Electricity Authority's protocols on the treatment of low income, medically dependent, or vulnerable consumers.

Audit

87. 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.

88. 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.

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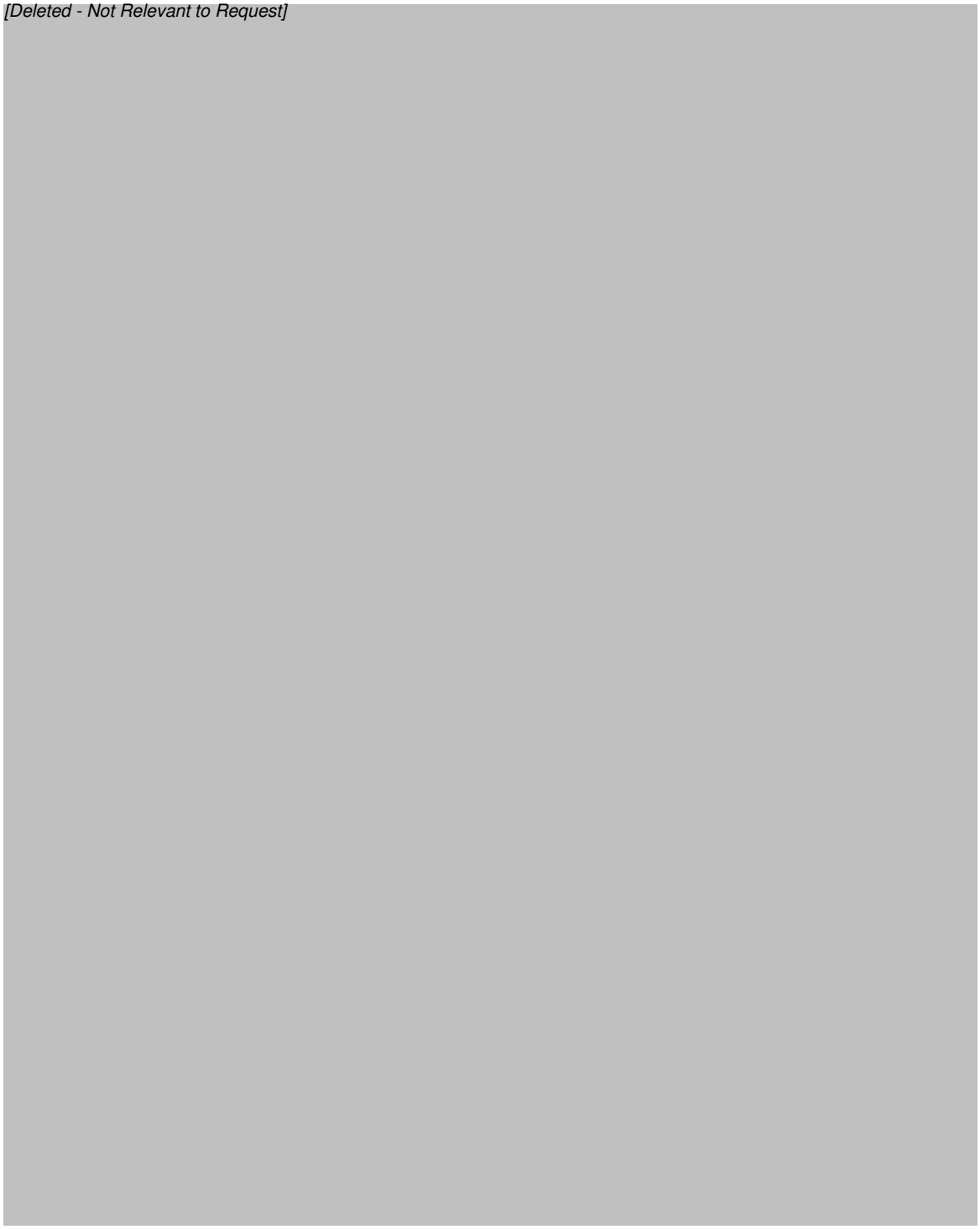

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23. **agree** in principle that legislation implementing the Mixed Ownership Model programme should include the following:

    23.1. removal of the SOE MOM companies from schedules 1 and 2 of the State Owned Enterprises Act 1986

    23.2. continued application of sections 22 to 30 of the SOE Act

    23.3. removal of Solid Energy Ltd from schedule 1 of the Official Information Act 1982 and potentially the removal of all the MOM companies from the Ombudsmen Act 1975

    23.4. consequential or related amendments to other legislation including the continued application of the Public Records Act 2005 in respect of old records

    23.5. a restriction on reducing the Crown's shareholding in the MOM companies below 51%

    23.6. a maximum size limit on non-Crown individual entity shareholdings of 10%

24. **authorise** officials to issue drafting instructions to Parliamentary Counsel

25. **note** that further consultation will be required on the proposed legislation before final decisions are made, including with Maori

26. **agree** to the inclusion of the proposed legislation in the 2011 legislation programme, with a priority 5

27. **delegate** authority to the Minister of Finance and Minister for State Owned Enterprises to:

27.1. make minor policy decisions relating to the proposed legislation

27.2. decide whether to release a draft of the legislation as part of the consultation process with Maori, and

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Hon Bill English
Minister of Finance

Hon Tony Ryall
Minister for State Owned Enterprises

Date:

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