Submission of the New Zealand Council of Trade Unions Te Kauae Kaimahi

to the

Finance and Expenditure Committee

on the

Mixed Ownership Model Bill

P O Box 6645

Wellington

13 April 2012

Contents

Summary of recommendations **3**

1. Introduction **5**

2. The sale of assets should not proceed **6**

Principles *8*

Specific issues with these asset sales – electricity *11*

Specific issues with these asset sales – Solid Energy *18*

3. Specific aspects of the Mixed Ownership Model Bill **19**

Objectives *19*

Clause Analysis *23*

4. Conclusion **28**

Summary of recommendations

1. The “mixed ownership” or partial privatisation proposal is fundamentally flawed and the bill should be withdrawn.

Without prejudice to the first recommendation, should the bill proceed we make the following recommendations:

2. The implications of Investor-State Dispute Settlement alongside other provisions of international commercial agreements, such as New Zealand’s free trade agreements with ASEAN and China and the proposed Trans Pacific Partnership Agreement, in undermining or making impractical future regulation or control of the activities of partially privatised companies should be fully explored before these privatisation and international treaty proposals proceed.

3. Similarly, the potential effect of demands by the US in the Trans Pacific Partnership Agreement for limitations on the activities of state-owned entities which could include mixed-ownership companies as well as SOEs and other arms of government should also be fully explored before these proposals proceed.

4. The Government should clarify its objectives for this legislation and commission a Regulatory Impact Statement that reflects its true objectives before the bill goes any further.

5. The companies should remain subject to the Official Information Act, the Ombudsman, the non-financial objectives for State-Owned Enterprises under that Act, direction by the government, the requirement to act in a manner consistent with the principles of the Treaty of Waitangi, and the Public Records Act (ref. Clauses 3-7 of the bill).

6. The State-Owned Enterprises Act should be reviewed to greatly broaden the objectives of the organisations that are subject to it.

7. There should be specific protections to prevent the sale of significant company assets without Parliamentary approval.

8. The requirement for “Crown” ownership of 51 percent should be for 51 percent ownership in the responsible Minister’s name.

9. The operational management of the electricity companies should not be regarded as an essential service under the Employment Relations Act.

10. The protection given to Lakes Manapouri and Te Anau under the Manapouri-Te Anau Development Act will no longer be sufficient if the Manapouri power station is operated by a partially or fully private company with solely commercial objectives. A power of government intervention is required.

11. Amendments to the Māori Purposes Act and Land Act should be considerably rethought given the commercial objectives of the companies.

1. Introduction

1.1. This submission is made on behalf of the 39 unions affiliated to the New Zealand Council of Trade Unions Te Kauae Kaimahi (CTU). With 350,000 members, the CTU is the largest democratic organisation in New Zealand.

1.2. The CTU acknowledges Te Tiriti o Waitangi as the founding document of Aotearoa New Zealand and formally acknowledges this through Te Rūnanga o Ngā Kaimahi Māori o Aotearoa (Te Rūnanga) the Māori arm of Te Kauae Kaimahi (CTU) which represents approximately 60,000 Māori workers.

1.3. The CTU opposes privatisation of the important state assets affected by this bill, whether it is partial or full sale. This submission gives some of the reasons for that position. We note that opinion polls over a long period show that this view is widely supported in the New Zealand community. It is rational for New Zealanders to take this position given the appalling record of privatisations in the last quarter of a century.

1.4. Many workers have been hurt not only as citizens or consumers of services provided by these privatised arms of government but also as employees through unemployment and losses in wages and conditions during the privatisation process.

1.5. It begs the question why the Government is proceeding with these sales when the beneficiaries are a privileged minority of people with the discretionary funds to purchase shares, and the financial markets, investment bankers, advisors, consultants and brokers who stand to gain directly from the sales.

1.6. This submission proceeds as follows. We outline our reasons for opposition to these asset sales. We then address some of the specific aspects of the Mixed Ownership Model Bill.

2. The sale of assets should not proceed

2.1. New Zealand has had an appalling experience of privatisations. The sale of New Zealand Rail and Air New Zealand went so wrong that renationalisation was an imperative. Among the others there was the abject failure of Telecom to develop our telecommunications system despite monopoly profits, most of which went overseas with little reinvestment, the handover of our banking system to the Australian banks through the sale of the Trustee Savings Banks, the Bank of New Zealand and Postbank, only marginally remedied to date by the creation of Kiwibank; the scandalous bargain price sale of the Government Printing Office to kick start the empire of New Zealand's wealthiest man, Graeme Hart; continuing dysfunction in the partially privatised electricity system which created blackouts, rapid price increases, inadequate investment and still fails to provide reasonably priced and secure power; conferral of duopoly status in commercial radio through the sale of Radio New Zealand's commercial stations; and the loss of huge potential for further processing in the sale of forestry cutting rights.

2.2. To give just two examples of the effect on New Zealand's liabilities: the Ameritech/Bell Atlantic/Fay, Richwhite, Gibbs, Farmer syndicate bought Telecom for $4.25 billion in July 1990, when the company had shareholder funds of $2.5 billion. Shareholder funds declined over the next several years despite cost-cutting because of large capital payments to its shareholders who walked out of the company from 1997 with a realised capital profit of $7.2 billion, in addition to a share of over $4.2 billion in dividends[1] – adding approximately $10 billion to New Zealand's international liabilities. Between 1990 and 1998 the company's shareholder funds halved to $1.1 billion by when it was heavily in debt. In the decade from 1995 to 2004, Telecom paid out dividends of $6.7 billion from net earnings declared in New Zealand of $5.4 billion, of which approximately $5.0 billion went overseas[2]. We are now effectively subsidising Telecom to build a broadband infrastructure it could and should have built out of its monopoly profits.

---

[1] "Testing years ahead for Telecom", by Brian Gaynor, *New Zealand Herald*, 26 May 2001.
[2] "Telecom: What a winner!", financial report on winner of the 2004 Roger Award, Sue Newberry, available at http://canterbury.cyberplace.org.nz/community/CAFCA/publications/Roger/Roger2004.pdf.

2.3. The New Zealand Rail sale in 1993 was organised by Faye Richwhite who then proceeded to benefit from it hugely by taking a substantial shareholding – a conflict of interest fit for a post-Soviet state. The main shareholders of the purchaser, TranzRail, were Faye Richwhite, Berkshire Fund and Wisconsin Central of the US, and Alex van Heeren. They bought a company which had been freed of debt by a $1.6 billion injection by the government. The price was $328 million, of which they paid only $107 million and borrowed the rest. According to Brian Gaynor they "were responsible for stripping out $220.9 million of equity in 1993 and $100 million in 1995"[3]. By the time they had sold out, they had made total profits of $370 million, mainly tax free because of the lack of capital gains tax, and darkened by accusations of insider trading[4]. Under Wisconsin's management the safety record was appalling (by 2000, fatal accidents for employees were eight times the national average) and reinvestment and maintenance were abysmal, leaving the operation in a crippled state. They sold out to Toll of Australia who similarly failed to maintain the system, and who then sold it back to the government in two tranches for a total of over $700 million plus ongoing costs to the government of several hundred million dollars to repair the rail network and replace the antiquated rolling stock. It is difficult to estimate the total costs to the country, but the total cost to the government will be almost $4 billion[5], greatly magnified by the neglect of the private owners.

2.4. The previous Government has been accused of paying too much to buy back the rail company, and they probably did, but that was just one element of the huge financial and opportunity losses to the people of New Zealand as a result of the privatisation that were evident well before the renationalisation. The story starkly illustrates the difficulty and cost in reversing privatisation once committed.

[3] "Investment: Track record costly to public", by Brian Gaynor, *New Zealand Herald*, 21 October 2000
[4] "A tough case ... and a long one", by Brian Gaynor, *New Zealand Herald*, 16 October 2004.
[5] "Government Toll buy a sad indictment", by Brian Gaynor, *New Zealand Herald*, 10 May 2008.

Principles

2.5. Assets such as those in question are owned by the state not principally to make a financial return but for a range of objectives. Their main value is their "use value" which, depending on the asset, may address social, cultural, environmental and economic objectives. The debate cannot be reduced solely to one over the financial returns from the assets, no matter how sophisticated the definition of financial return might be.

2.6. For example, the state historically developed the electricity system because of the inability of the private sector to do so, and continued to own it to provide low cost electricity for residential consumers and to support industry. There are growing needs to conserve energy, and to ensure that electricity is generated in sustainable ways. Electricity is an essential for households and its price is a significant factor in New Zealanders' health and living standards. Market regulation and mechanisms such as emissions trading and competition can assist achievement of these objectives but the record is clear that these are insufficient, as will be discussed below.

2.7. Publicly owned assets have multiple functions, the balance of which will differ in each case. They include

- Preventing excess profits in important services which are a monopoly or are otherwise less than fully competitive;
- Ensuring essential services are provided equitably and affordably;
- Providing security of services;
- Social solidarity mechanisms such as social welfare benefits and ACC;
- Providing services which are considerably more efficient to provide universally than individually;
- Providing services in the public interest which the private sector is unlikely to provide;

- Assisting in economic development;
- Providing additional income to the government.

2.8. The critical issue in asset sales is therefore that of control, and our ability to take action in the public interest to address the multiple needs of New Zealanders in order to make improvements in our economy, environment and society, often in the face of powerful forces in the market which can take advantage of their position.

2.9. The actions needed may not be possible in a firm that is acting solely in its shareholders' interests to maximise profits in the short or long run. Therefore the partial privatisation of a publicly owned operation may do almost as much damage as full privatisation. The only public benefit that may remain is the flow of profits from the company to the public purse. That is not to be dismissed, but it may be a far smaller benefit than what is achievable if the operation were run to optimise the wider benefits to New Zealand.

2.10. The case for public ownership and control of a particular asset therefore rests on the nature and use of the particular asset, and on the weight given to the various benefits – an inherently political judgement.

2.11. The public reasons given for the current sales is almost solely around financial return (we discuss this further below), putting zero weight on other potential benefits from the full ownership of these assets. On that basis it is logical to sell them if the government considers it can get a higher return from their sale in lowered costs of debt or in returns from investing the proceeds elsewhere. Even in this narrow approach there is intense debate including among financial market commentators as to whether the government can get a better return by selling the assets. Treasury's own estimates in the 2012 Budget Policy Statement that the loss of dividends from the companies would exceed debt finance cost savings by $94 million by 2016 illustrates the problem.

2.12. But the fundamental problem with the Government's approach is that it ignores or writes off the other potential benefits of holding these assets.

2.13. This is an inconsistent approach in both rhetoric (see below) and substance. One spin that the Government has put on these sales is repeated in the Explanatory Note to the bill: “The main purpose of moving these companies to the mixed ownership model is to raise $5 billion to $7 billion, which the Crown will invest through the Future Investment Fund in new schools, hospitals, roads and rail, and other public assets and use to control debt.”

2.14. The idea that “investing” the proceeds of the sales in a fund somehow changes the nature of the sales is voodoo economics. As supporter of partial privatisation, Terry Mclaughlin, FCA, chief executive of the New Zealand Institute of Chartered Accountants, wrote in the *Dominion Post* recently[6]:

> The decision to spend elsewhere is a separate one, which needs to be sensibly weighed up against other options, that has the effect of increasing debt.
>
> To draw an analogy, if you have a mortgage on your house and sold off your back section in order to fund your child’s education, the sale proceeds go to your bank in the first instance – and your mortgage decreases. Your decision to then increase your mortgage to fund your child’s education is a separate one. At the end of your child’s education, your debt is the same, but the value of your property has declined.

2.15. It is disturbing that such irrationality is the “main reason” for the asset sales.

2.16. Even if we were to accept the voodoo beliefs of the Government (in the interests of New Zealand’s traditional respect for religious freedom), the “Future Investment Fund” justification is inconsistent for another reason. It puts great weight on the benefits of “new schools, hospitals, roads and rail, and other public assets”. We agree they have great benefits – but few of them are financial benefits. The benefits are social, environmental, cultural and economic. So the Government ignores non-financial benefits when it

[6] Progress bogged by lack of debate”, by Terry Mclaughlin, Business Forum, *Dominion Post*, 12 March 2012, p.C4.

sells assets, but then uses the existence of non-financial benefits in the use of their proceeds to justify their sale.

Specific issues with these asset sales – electricity

2.17. What are the matters other than financial returns that should influence the case for public ownership and control of these particular assets?

2.18. For the electricity companies, we identify at least the following:

- Fair and affordable prices
- Security of supply
- Conservation and sustainable generation
- Commercial innovation nursery

2.19. The argument has been made in the past that fair and affordable prices and security of supply can be obtained by a competitive industry accompanied as necessary by light-handed regulation.

2.20. Competition is very limited in an industry dominated by five firms with very large economies of scale and largely undifferentiated products. Their very low cost baseload generating capacity makes entry to the market extremely difficult for new competitors who must rely on much more costly alternatives such as most new generating capacity and lower environmental impact or renewable technologies. Competitors find it difficult to differentiate their products by quality because to the consumer all electricity is the same.

2.21. Differentiation on the basis of reliability of supply might suit some commercial and industrial users but is likely to mean low income people would have to put up with the most unreliable supplies. Differentiation on the basis of environmental impact of electricity generation might have some attraction, and some companies advertise on that basis, but it is unlikely to have a major impact on competition.

2.22. The current regulatory regime has been soundly criticised by expert and long-time observers such as economist Geoff Bertram and Molly Melhuish of the Domestic Energy Users Network. The effect of it has been to hold down real industrial prices while residential prices have risen 73 percent faster than inflation since 1991 according to Melhuish.

2.23. Bertram considers that "Consumers have been price-gouged, natural-monopoly positions have been exploited, and competitive market disciplines to innovate and change have been fought off by an industry that has successfully protected its de-facto cartel against the arrival of independent generators, demand-side efficiencies, smart meters, smart grids, feed-in tariffs, lifeline tariffs – in short, most of the big innovations in the worldwide electricity industry since the 1980s."[7]

2.24. Both agree that the current system of regulation and spot markets favours the large participants and leads to the price being set at the short run marginal cost of the most expensive electricity. While some commercial and industrial users can deliberately choose to buy at spot market rates, and bigger ones have the clout to bargain down prices, residential users have only limited choice and appear to be bearing the brunt of the rapidly rising prices.

2.25. In a more rational system, base usage prices would be set at or below average costs and only excess usage charged at short run marginal cost. This would allow both affordable supply for essential needs and an incentive to reduce use. To achieve this would require either direct instructions to the companies – impossible for companies with private shareholding – or much more directive regulation.

2.26. It is frequently claimed by the companies that they need to charge at the highest short run marginal cost in order to justify investment in higher costs of new generation. But despite much higher prices, investment since the 1990s reforms and privatisations has been very erratic[8]. Little investment is likely for

[7] "Another approach to state asset sales programme", by Geoff Bertram, *Dominion Post*, 28 march 2012, p.B5.
[8] "Paths not taken in electricity restructuring: alternatives to the asset sale programme", seminar presentation by Geoff Bertram, Institute of Policy Studies, 13 April 2012.

the next few years with electricity demand reduced by the recession. In any case, the same prices do not need to be charged for all electricity supplied in order to justify investment in more expensive sources.

2.27. It is a sign of the market power of the companies that they can use such an argument: in a competitive market, companies pricing at the highest marginal cost would be constantly threatened by other companies offering power from cheaper sources.

2.28. Another industry with high fixed costs and economies of scale is the airline industry where full service providers are constantly threatened by low-budget airlines charging the marginal cost of an additional passenger and cherry-picking profitable routes. To an extent the full service providers in the airline industry can survive by differentiating through their level of service, but in practice the industry is very unstable with constant creation and destruction of airlines except where they have either regulated markets (such as on many international routes), reduction of competition through inter-airline alliances, or an unassailable monopoly (as Air New Zealand effectively has on many of its provincial routes). There is very little possibility for differentiation on the level of service in the power industry because all electricity is the same to the consumer.

2.29. A fully competitive electricity industry would therefore be uneconomic and lead to power shortages and bankruptcy of firms. This shows why the structure of the electricity industry cannot survive without either strong regulation – or price collusion by participants. Evidence of the latter was found in the 2009 report to the Commerce Commission by Professor Frank Wolak which concluded that consumers had been overcharged $4.3 billion during three dry-year events:

> Professor Wolak estimated that the wholesale prices charged over the period 2001 to mid-2007 resulted in an extra $4.3 billion in earnings to all generators over those that they would have earned under competitive conditions. This suggests that wholesale prices were, on average, 18 per cent higher than they would have been if the wholesale market had been

more competitive, and the gentailers had not been able to exert market power. Less competition was especially evident in the wholesale market during the dry years of 2001 and 2003, when additional earnings attributable to the exercise of market power are estimated at $1.5 billion in each of those years[9].

2.30. There was no suggestion of conspiracy to raise prices (though the Commission did issue a warning to Trustpower and has also warned both Contact Energy and Trustpower over a bid-rigging attempt over the purchase in 2002 of the Cobb hydroelectric power station[10]), but the Commerce Commission in effect recognised the reality of the industry and condoned this behaviour, finding that it was neither wrong nor illegal:

> The Commission considers that each of the four largest gentailers – Contact, Genesis, Meridian and Mighty River Power – is likely to have held substantial market power on a recurring basis, particularly during dry years," said Dr Mark Berry, Chair of the Commerce Commission. "Each of these companies has the ability and incentive unilaterally to exercise market power and increase wholesale prices during certain periods. The price increases in dry periods are well above any increases in input costs, including the higher opportunity cost of water when hydro storage is low. However, the Commission concludes in the case of this investigation that the gentailers are using that market power to maximise their profits in a purely legitimate way within the current market structure, design and rules. The Commission has found no evidence of an anti-competitive purpose," said Dr Berry.

2.31. It is therefore an illusion to think that by privatising the companies and/or heightening their commercialism through partial or full private ownership that this will lead to efficiencies and lower prices. It is more likely to lead to private benefit from the market power that exists in the industry.

2.32. Fair and affordable prices are not part of this mix.

---

[9] See "Commerce Commission finds that electricity companies have not breached the Commerce Act", 21 May 2009, http://www.comcom.govt.nz/media-releases/detail/2009/commercecommissionfindsthatelectri/.

[10] "Contact, Trustpower warned over bid-rigging attempt", *New Zealand Herald*, 24 November 2009.

2.33. An internationally recognised aspect of the electricity market is the tendency to avoid or "redline" low use customers who are relatively costly to maintain because fixed costs are similar for all customers. There is some recent evidence that this is happening, particularly with the privately owned companies Contact Energy and Trustpower. *Dominion Post* business journalist Patrick Smellie commented in August 2011 that "Like Contact, TrustPower has traditionally had both the highest electricity prices in the market, and resisted taking on new customers at low tariffs during the last three years of increasing retail electricity market competition." [11]

2.34. The observation that the private companies have higher prices is born out both by the prices shown on the Consumer Institute's "Powerswitch" web pages[12], and in the following table compiled by energy expert Molly Mellhuish:

Energy component of electricity prices: Nov 2010, price rise since 1998

company	ownership	2010 kWh price	% rise since 1998
TrustPower	private	18.88	189%
Contact Energy	private	17.21	171%
Genesis Energy	SOE	15.46	125%
Mercury Energy	SOE	15.03	90%
Meridian Energy	SOE	14.72	120%

source: MED quarterly survey of electricity retail prices., calculated by Molly Melhuish
Notes: energy (KWh) prices from each company are averaged over all networks where each is the incumbent supplier
Listed in order of the 2010 energy price
Counting Trustpower's "Friends" discount for long-term customers probably drops Trustpower one place down the list.

2.35. Contact Energy lost customers as a result of public relations debacles and higher prices. Its customer numbers fell 13.6 percent between September 2008 and July 2011. The "Whatsmynumber?" campaign is credited with losing it 7,700 customers in June 2011 alone. Contact responded with a reduced tariff aimed at customers who paid online and early, picking up 4,600 new accounts between September and December 2011. Such a targeted reduction in tariffs is likely to attract computer-confident households with good cash flows such as higher income younger to middle-aged households.

[11] For this and following information, see "Contact in battle to keep customers ", by Patrick Smellie, *Dominion Post*, 10 Aug 2011, p.C4; and "Contact's eye on customer growth", *Dominion Post*, 22 February 2012, p.C1.
[12] http://www.powerswitch.org.nz/powerswitch/site-info/price-trends

Pensioners who are not confident with computers may find it difficult to take advantage of the offer for example. However Contact appeared reluctant to attract more customers: “The recruitment was despite the fact that network costs and Contact’s own cost inflation had seen its retail expenses increase by $3m more than its increase in income.” It seems likely it was trying to find a way to attract only those with lower costs and higher power usage.

2.36. Meanwhile, Trustpower’s strategy is to “not enter ‘market share’ pricing wars” according to its Chief Executive[13]. Instead it is trying to expand sales to commercial and industrial customers, and retain residential customers through loyalty programmes and “bundling” with other products. It sold 35,000 telecommunication (phone and internet) services in its 2011 financial year for example. It appears to accept declining customer numbers under these circumstances: “Customer numbers are expected to decline in the face of increased retail competition”, it said in its 2011 Annual Report. “Strategies to mitigate the effect of this include strengthening customer loyalty programmes and securing sales to the commercial and industrial segments”[14]. Its sales targets were for falling “mass market” electricity sales, and customer numbers, but rising half-hourly metered sales, overheads per electricity customer and telecommunication sales.

2.37. Neither is security of supply assured as generators follow demand rather than anticipate it. For example in November 2011, Trustpower warned that “new investment in renewable energy will require clear signs of a pick-up in demand, despite hailing the performance of its newest wind farm.”[15]

2.38. In fact they have an incentive to delay new capacity because that constrains supply, pushing up prices and profits. For any single generating company it is better to delay outlaying the cost of new generation until prices have risen well past the point where new investment will pay its way, meanwhile making windfall profits on existing low cost generation as a result of increasing supply shortages.

---

[13] Trustpower Annual Report 2011, Chief Executive’s report.
[14] See http://annualreport.trustpower.co.nz/2011/Our-Customers.aspx.
[15] “Let’s see demand first – Trustpower”, *Dominion Post*, 1 November 2011, p.C6.

2.39. It would instead be worth considering returning to monopoly public ownership of the main generating capacity under tight oversight and control to ensure efficiency, give it a responsibility for energy conservation as much as new generating capacity, require it to charge average costs or below for a base usage allocation for households, and require a proportion of small-scale sustainable generation such as from wind and tidal sources which could come from independent providers. Feed-in tariffs for firms and households producing their own electricity from small-scale renewable generation should also be part of the mix. The monopoly public generator should also act as default retailer to ensure there are reasonably priced services for low income and other households which may be considered undesirable to for-profit retailers. However, competition among retailers may still be useful and produce innovative products though it needs to be realised that retailing is only around 20 percent of the cost of electricity to the residential consumer[16].

2.40. New generating capacity should be required to be increasingly renewable, and the need for new capacity should be as far as possible replaced by conservation measures. This seems unlikely to happen quickly enough with the only incentives being a weak ETS scheme which pushes up all power prices, so regulation is likely to be required. This could be seen as an opportunity to make use of the publicly owned power companies to support local development of not only generating capacity and energy-saving devices or services but also the underlying technology required. Some of these could lead to export opportunities.

2.41. For private or semi-privatised commercially driven companies, this would either require explicit subsidies or regulation. However, regulation would run the risk of being attacked by investors as reducing their profits or the value of the company. Overseas investors could consider taking a case against the New Zealand government under Investor-State Dispute Settlement provisions of international agreements such as the free trade agreements with China or ASEAN, a longer standing Investment Protection Agreement with Hong

[16] Estimated at 18 percent in "International and domestic electricity tariffs and tariff structures", by Toby Stevenson & René Le Prou, LECG, May 2008, available at http://www.pce.parliament.nz/assets/Uploads/Reports/pdf/LECG_Report_Tariffs.pdf.

Kong, or the Transpacific Partnership Agreement (TPPA) if US insistence that it contains such provisions prevails despite Australian opposition. Their case could be on the basis that changing the rules was a breach of "Fair and Equitable Treatment" or "equivalent to an expropriation". The shareholders would not need to be resident in one of those countries – they need only have an associated company resident in a one of the countries to have standing to make such a claim.

2.42. The implications of such investor undermining or making impractical future regulation of the activities of partially privatised companies should be fully explored before these privatisation and international treaty proposals proceed.

2.43. For a publicly owned power company, however, these would simply be matters of government directive, funded largely from profits.

Specific issues with these asset sales – Solid Energy

2.44. Solid Energy is the corporatised form of state coal mines which have been in public hands for over a century. Part of the rationale for public ownership of mines was the poor safety record of private mine owners skimping on safety precautions in the interests of maximising profits. The Pike River tragedy sadly makes it evident that that is still a very relevant concern. Solid Energy has a better safety record than many of the private operators, though we are not suggesting either that it is perfect or that Pike River is typical of all private operators. But it would certainly be easier for the government to ensure that mines operated by Solid Energy are operated safely than for private mines. It could for example give a direction to Solid Energy as an SOE to make safety as important a priority as its financial rate of return, and follow that up with appropriate actions.

2.45. State ownership also undoubtedly assisted the development of the coal mining industry. Those needs have changed and it is a matter of public debate whether in the context of climate change New Zealand should increase or reduce its coal mining activities. It is most unlikely that the current Emissions Trading regime will be anything like sufficient to enable us to

safely leave those decisions to “the market”. Indeed some use of coal is free from carbon charges[17].

2.46. CTU affiliates have an interest in both jobs in mining and responsible mining and recognise that balance needs to be debated. However, if at any time the government of the day decides for example that large scale lignite mining is not in the interests of New Zealand or the Earth, if Solid Energy is in full public ownership the financial penalties are simply ones of possible profits foregone. If it were in even partial private ownership, the private shareholders could demand compensation, and, again, overseas shareholders could use Investor-State Dispute Settlement provisions of international agreements to sue the government for deprivation of asset value and future profits.

2.47. Finally, Solid Energy has shown initiative in developing new products and technologies. Some of them have been controversial, but its potential as an innovator in the energy industry is there. As suggested for the electricity SOEs, it could use its capital base and experience as the basis for encouraging further new technologies and services and developing them commercially, perhaps in conjunction with private inventors and scientists.

3. Specific aspects of the Mixed Ownership Model Bill

Objectives

3.1. The Government is inconsistent in stating its objectives for this legislation. The objectives are a moving target that shows its lack of confidence that any hold water. The Explanatory Note to the bill states (p.2) that:

> “The main purpose of moving these companies to the mixed ownership model is to raise $5 billion to $7 billion, which the Crown will invest through the Future Investment Fund in new schools, hospitals, roads and rail, and other public assets and use to control debt.”

3.2. The responsible Minister, Tony Ryall, when introducing the bill into Parliament, stated a different objective:

[17] See for example “State Coal to Mine New State Subsidies”, Sustainability Council of New Zealand, 20 September 2009, http://www.scoop.co.nz/stories/PO0909/S00322.htm

“This legislation and debate is about debt. It is not about the Treaty of Waitangi, it is not about foreign ownership, and it is not about other considerations; it is about controlling our nation's debt.

3.3. Yet Treasury’s Regulatory Impact Statement, which is referred to readers of the bill (Explanatory Note p.2), states that “Treasury’s analysis has been limited to options that meet” objectives laid out by the Prime Minister in his 26 January 2011 speech:

3.3.1. broadening the pool of investments for New Zealand savers and deepening capital markets;

3.3.2. sharper commercial disciplines, more transparency and greater external oversight for the companies involved; and

3.3.3. providing the opportunity for the companies involved to obtain more capital to grow further, without depending entirely on a cash-strapped government to support them.

3.4. A Regulatory Impact Statement has not therefore been carried out for the “main” or “only” objectives as stated by the Minister and in the bill. One should be commissioned before the bill goes any further.

3.5. We have dealt with the “Future Investment Fund” objective above (2.13). It is economic nonsense.

3.6. As to reducing debt, this is not necessarily desirable in itself if the levels of debt are sustainable. It is sensible for governments to borrow at times for investment in socially and economically valuable infrastructure and during times of economic stress such as during the Global Financial Crisis which began in 2008. As we have pointed out repeatedly and the International Monetary Fund did so again in its recent review of New Zealand’s economy[18], New Zealand’s public (government) debt is modest, and at the low end of the OECD. This is not a reason for panic action such as selling off major assets.

[18] “New Zealand- 2012 Article IV Consultation Preliminary Concluding Statement”, April 2, 2012 http://www.imf.org/external/np/ms/2012/040212.htm.

3.7. Reducing debt is done for two purposes: to reduce debt servicing costs and to improve the government's balance sheet. We have already dealt with debt servicing costs (2.11).

3.8. The balance sheet will only be improved if the partial sale of these assets brings in more than their value on the government books – in other words if they are undervalued on the books. The main reason they might be undervalued, given that most observers agree that the companies are well run, is that a private owner could demand a higher return, achieved by hiking electricity prices, more redlining of customers (as the private electricity companies already do), and skimping on investment and customer services. In that case, the Government is simply transferring an economic cost from its books to those who are most vulnerable to this kind of predatory corporate behaviour. In Solid Energy's case it could be by pushing ahead aggressively with environmentally sensitive schemes, cutting its spending on innovation and research, and accelerating output from existing mines, with the risk that safety is compromised.

3.9. Paying off the government's modest debt in this way is economically self-harming for New Zealand.

3.10. "**Broadening the pool of investments for New Zealand savers and deepening capital markets**" is an objective that has no obvious end to it. How many of New Zealand's public assets should be sold off under this objective? In any case, the New Zealand share market is already overloaded with energy companies, encompassing Contact Energy, Horizon Energy, Infratil, NZ Windfarms, New Zealand Refinery, TrustPower, and Vector (most of them formerly publicly owned). It is arguably unwise to advise investors to have Energy so overweight in their portfolios. It may also starve the share market of funds for IPOs (initial public offerings) for the start-up companies that are the real scarcity in New Zealand's share market and economy.

3.11. It also needs to be remembered that according the most recent Statistics New Zealand Survey of Family, Income and Employment, the median

household had less than $600 in financial assets (in both 2004 and 2006)[19]. Over half New Zealand's households (and probably many more) are therefore most unlikely to be able to invest in these shares directly. Those that do invest directly are more likely to do so by moving savings from elsewhere rather than increasing savings. Some may gain an interest in a few shares through a Kiwisaver or other pension fund. But this is little improvement over holding these shares through the government's current ownership. The so-called "Mum and Dad" investors are a very small comparatively wealthy minority.

3.12. If the experience of the electricity company privatisations of the 1990s are any guide, the shares will end up in investment funds and probably three-quarters of them will be owned overseas. For example, 60 percent of Contact Energy's shares were originally made available to small investors when it was privatised in 1999, while 40 percent were sold to US company Edison Mission Energy. The company is now only 16.5% New Zealand owned according to the Overseas Investment Office[20]. Many of the local government owned network companies became fully corporate and/or overseas owned.

3.13. "**Sharper commercial disciplines, more transparency and greater external oversight for the companies involved**" is of value only to the extent that companies are seen to have only financial value. The markets' external oversight will focus almost entirely on financial matters, and only on their social and environmental value – or poor behaviour – if it impacts their profitability. In any case, the companies are acknowledged to perform efficiently and compete successfully with private companies and in some cases internationally. The "oversight" will in practice provide further pressure to act in a single-mindedly commercial manner.

3.14. "**Providing the opportunity for the companies involved to obtain more capital to grow further, without depending entirely on a cash-strapped**

[19] "Household Wealth and Saving in New Zealand: Evidence from the Longitudinal Survey of Family, Income and Employment", by Trinh Le, John Gibson and Steven Stillman, Motu Working Paper 10-09, September 2010, p.3. Exact figures were $590 in 2004 and $580 in 2006.

[20] See for example an approval given to Contact Energy by the Overseas Investment Office 27 May 2011 to buy 417.0816 hectares of Taupo land (Case Number 201110058).

government to support them" is as much a political commentary as a financial or economic one. Governments have decided not to invest in these companies, preferring them to use their own plentiful cash or other sources for expansion. That is a political decision which can be changed. Governments can and do spend even when "cash-strapped" and it may be advisable for many reasons such as those enumerated in 2.7. Further, the companies can and do raise finance through bond issues, and lately have done so very successfully with their offerings rapidly taken up. The use of equity bonds (essentially non-voting shares) which is permitted under the State-Owned Enterprises Act, does not appear to have been tested. Cash does not appear to be a problem for these companies.

3.15. We note that the even Treasury Regulatory Impact analysis of these objectives is decidedly lukewarm with at best "small" or "moderate" improvements to wider government objectives – which are almost all financial or economic and omit most social and environmental outcomes.

3.16. In any case, the companies will still be dependent on "a cash-strapped government to support them" because under this bill the government is required to maintain its 51 percent ownership and will therefore have to contribute proportionately to any share issues if and when it sells the full remaining 49 percent.

Clause Analysis

3.17. This section of our submission addresses only issues of concern to the CTU and does not seek to be a complete clause by clause analysis. Comments and recommendations are made without prejudice to our unequivocal position opposing the sale of any part of the shares in these companies.

3.18. **Clauses 3-7** take the companies out of the State-Owned Enterprises Act 1986 (SOE Act). This has a number of consequences which are significant losses to New Zealand citizens including

3.18.1. Removing them from scrutiny under the Official Information Act;

3.18.2. Removing them from being subject to the Ombudsman;

3.18.3. Removing their statutory objectives (s.4 of the SOE Act) which include important non-financial objectives:

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;

3.18.4. Removing the ability of the government to direct the companies to undertake non-commercial activities (s.7 of the SOE Act);

3.18.5. Removing the requirement of the company as a whole, under direction of the government, to act in a manner that is consistent with the principles of the Treaty of Waitangi (s.9 of the SOE Act) despite the proposed s.45Q;

3.18.6. Removing the ability of the government to direct the companies in other ways (s.13 of the SOE Act);

3.18.7. Removing the requirement for their records to be available under the Public Records Act from the time they become subject to this proposed legislation (see Schedule 2 to this Act).

3.19. We oppose the loss of these powers and responsibilities. They are required for continuing public scrutiny of these systemically important companies, control of their behaviour in industries whose structure frequently leads to private firms acting against the wider public interest, and to carry out the intent and spirit of the Treaty of Waitangi.

3.20. If these are known conditions under which the companies operate, investors can make their decisions on purchasing shares on that basis. They will know that the companies have operated successfully under these conditions for many years.

3.21. We do not suggest that the SOE Act was perfect. Far from it. The priority given to operating as a successful commercial business has meant that we have seen some bad behaviour from the state-owned companies in the electricity markets very similar to that shown by their private competitors. It has meant that the social, environmental and broader economic potential of these companies has not been realised.

3.22. The SOE Act was set up to “park” public assets before privatisation. It should be reviewed to greatly broaden the objectives of the organisations that are subject to it. The current legislation is taking them entirely in the opposite (and wrong) direction.

3.23. We are not at all assured by Ministers who state that companies will be well behaved in their own commercial interests. The behaviour of the Pike River Mine management, of the many crashed finance companies, of the fishing quota owners willing to use near-slave labour on foreign charter vessels, multiple examples of large scale tax evasion and avoidance, and employers willing to breach privacy and use mass lockouts and contracting out of labour in attempts to defeat decent working conditions – just in New Zealand and leaving aside international examples – leave us no confidence that good behaviour can be left to “the market”.

3.24. The public value of government assets is further under threat from US proposals to restrict the activities of state-owned entities being proposed in the Trans Pacific Partnership Agreement (TPPA). If similar to provisions in the Singapore-US FTA, these would restrict such entities from anything but strictly commercial behaviour and from undertaking activities in conflict with the TPPA. It would require the government to progressively reduce its ownership of state-owned entities. Such entities would certainly include the ones in question in this bill but could also include a wide variety of others

such as public broadcasting, ACC, Crown Research Institutes, and even hospitals and tertiary educational institutions to the extent they might compete with commercial suppliers from other TPPA countries such as the US.

3.25. The proposed **section 45R** requires 51 percent Crown control. While this potentially confers a significant degree of control to the Crown, if it is used for purposes that are not in the commercial interests of the company it will be challenged by minority shareholders and directors representing them. If the control is used in a way that is beneficial to New Zealand as a whole but reduces the profitability of the company then shareholders may have grounds for action and compensation under international agreements as described in 2.41 above.

3.26. In addition, we raise the possibility of conflict over sale of company assets. Take for example the credible possibility that the owners of the Bluff Smelter make an attractive offer to Meridian Energy for the Lake Manapouri power station from which the Smelter takes most of its electricity, an offer which is judged to be in the interests of the company. There would be widespread opposition to a sale given the sensitivity of the environment around Lakes Te Anau and Manapouri, both of which are subject to the operation of the station, and in the Deep Cove branch of Doubtful Sound where the water outfall occurs. In addition the importance to the electricity system of this large power station producing very low cost base load power should not be underestimated.

3.27. A purely commercial decision would be in conflict with the public interest. The company would in theory be able to undertake the sale, being less than half the value of the company’s assets, without consulting shareholders unless there are other provisions in law or the company rules.

3.28. While in the specific case of Manapouri, there may be some constraints placed on Meridian by the Manapouri-Te Anau Development Act, the above argument applies to any asset owned by any of the partially privatised energy

companies and many of those assets are almost as sensitive as Manapouri without any specific legislative protection.

3.29. The 51 percent provision is therefore an inadequate protection of the public interest. There should be specific protections to prevent the sale of significant company assets without Parliamentary approval.

3.30. The requirement is for 51 percent “Crown” ownership, not Ministerial ownership. Other Crown entities such as the New Zealand Superannuation Fund and ACC’s investment funds are likely to become owners of these shares. The question arises whether any of those shareholdings are regarded as “Crown ownership”. If they are, then the Minister’s shareholding could be allow to slip well below 51 percent on the basis that total Crown ownership is still 51 percent, but the Minister would no longer have the 51 percent voting power to direct the company. It would also become increasingly difficult to police adherence to the 51 percent rule. The 51 percent requirement should be explicitly that the number of shares held in the Minister’s name should not fall below 51 percent.

3.31. **Schedule 2, amending the Employment Relations Act 2000**, has the effect of including “the operational management” of partially privatised electricity companies among essential industries in which industrial action has conditions placed upon it. The same does not apply to fully private electricity companies except to the extent that it affects the “production or supply of electricity”. The Government cannot have it both ways. Either it wants the “mixed ownership” companies to behave as if they were private or it does not. We oppose the operational management of these companies being covered under essential services.

3.32. **Schedule 2, amending the Manapouri-Te Anau Development Act 1963**, gives a partially privatised company, with solely commercial objectives and very limited ability for a government to direct it, the power that arms of the government and then a state-owned enterprise had over the management of the sensitive environment of Lakes Manapouri and Te Anau, Deep Cove, the Waiau River and the Manapouri power station. We submit this is no longer

appropriate and requires a power for the government to intervene in these matters.

3.33. Similarly, **Schedule 2, amending the Maori Purposes Act 1959**, gives “any officer, employee, or agent” of a partially privatised electricity company rights to enter in and upon Lake Rotoaira without being the holder of an entry permit. The amendment to the **Land Act 1948** retains for these companies the limitations to establishment of rights of way by users that apply to the Crown and State Owned Enterprises. These changes need considerably more thought given the commercial objectives of the companies.

4. Conclusion

4.1. The CTU opposes privatisation of the important state assets affected by this bill, whether it is partial or full sale. We have outlined our reasons for this.

4.2. Without prejudice to this position, there are in addition many aspects of this bill which either underline or make worse the negative effects that heightened commercialisation will bring.

4.3. The Government’s motivations for sale of the assets are muddled, inconsistent, and do not stand scrutiny. The bill does not make clear whether the Government regards these hybrid creations as primarily public bodies with some private shareholding or primarily private with some public shareholding.

4.4. There are far more positive and effective ways to address real problems, such as the current level of government debt and poorly functioning capital markets, which do not lead to the long term disadvantages that this bill brings.

4.5. The bill should therefore be withdrawn.