APPENDIX TO THE JOURNALS
OF THE
House of Representatives
OF
NEW ZEALAND
2011–2014
VOL. 9
I—REPORTS AND PROCEEDINGS OF SELECT COMMITTEES

IN THE REIGN OF HER MAJESTY
QUEEN ELIZABETH THE SECOND

Being the Fiftieth
Parliament of New Zealand

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ARRANGEMENT OF THE PAPERS

I—Reports and proceedings of select committees

VOL. 1
Reports of the Education and Science Committee
Reports of the Finance and Expenditure Committee
Reports of the Government Administration Committee

VOL. 2
Reports of the Health Committee
Report of the Justice and Electoral Committee
Reports of the Māori Affairs Committee
Reports of the Social Services Committee
Reports of the Officers of Parliament Committee
Reports of the Regulations Review Committee

VOL. 3
Reports of the Regulations Review Committee
Reports of the Privileges Committee
Report of the Standing Orders Committee

VOL. 4
Reports of select committees on the 2012/13 Estimates

VOL. 5
Reports of select committees on the 2013/14 Estimates

VOL. 6
Reports of select committees on the 2014/15 Estimates
Reports of select committees on the 2010/11 financial reviews of Government departments, Offices of Parliament, and reports on non-departmental appropriations

VOL. 7
Reports of select committees on the 2011/12 financial reviews of Government departments, Offices of Parliament, and reports on non-departmental appropriations
Reports of select committees on the 2012/13 financial reviews of Government departments, Offices of Parliament, and reports on non-departmental appropriations
VOL. 8  
Reports of select committees on the 2010/11 financial reviews of Crown entities, public organisations, and State enterprises

VOL. 9  
Reports of select committees on the 2011/12 financial reviews of Crown entities, public organisations, and State enterprises

VOL. 10  
Reports of select committees on the 2012/13 financial reviews of Crown entities, public organisations, and State enterprises

VOL. 11  
2012 Reports of select committees

VOL. 12  
2013 Reports of select committees, Vols 1 to 3 (see also Vol. 13)

VOL. 13  
2013 Reports of select committees, Vols 4 to 6 (see also Vol. 12)

VOL. 14  
2014 Reports of select committees

J—Papers relating to the business of the House

VOL. 15  
Government responses to select committee reports
Inter-parliamentary relations reports

VOL. 16  
Inter-parliamentary relations reports
Responses under Standing Orders 156–159
Reports by the Attorney-General pursuant to section 7 of the New Zealand Bill of Rights Act 1990 and Standing Order 262
Document tabled under the authority of the House of Representatives by Hon Shane Jones
Summaries of annual returns to the registrar of pecuniary interests of members of Parliament
Prime Minister’s Statements to Parliament
Notification by the Prime Minister of the 2014 General Election date
<table>
<thead>
<tr>
<th>Shoulder Number</th>
<th>Date</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.21B</td>
<td>–</td>
<td>Reports of select committees on the 2011/12 financial reviews of Crown entities, public organisations, and State enterprises, May 2013</td>
</tr>
</tbody>
</table>
Reports of select committees on the 2011/12 financial reviews of Crown entities, public organisations, and State enterprises

Fiftieth Parliament
May 2013
## Contents

<table>
<thead>
<tr>
<th>Crown entity/public organisation/State enterprise</th>
<th>Select Committee</th>
<th>Date presented</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abortion Supervisory Committee</td>
<td>Justice and Electoral</td>
<td>12 Dec 12</td>
<td>11</td>
</tr>
<tr>
<td>Accident Compensation Corporation</td>
<td>Transport and Industrial Relations</td>
<td>22 Mar 13</td>
<td>13</td>
</tr>
<tr>
<td>AgResearch Limited</td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>Air New Zealand Limited</td>
<td>Finance and Expenditure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Airways Corporation of New Zealand Limited</td>
<td>Transport and Industrial Relations</td>
<td>1 Mar 13</td>
<td>41</td>
</tr>
<tr>
<td>Alcohol Advisory Council of New Zealand</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>43</td>
</tr>
<tr>
<td>Animal Control Products Limited</td>
<td>Primary Production</td>
<td>1 Feb 13</td>
<td>45</td>
</tr>
<tr>
<td>Arts Council of New Zealand Toi Aotearoa</td>
<td>Government Administration</td>
<td>21 Mar 13</td>
<td>47</td>
</tr>
<tr>
<td>AsureQuality Limited</td>
<td>Primary Production</td>
<td>1 Feb 13</td>
<td>49</td>
</tr>
<tr>
<td>Auckland District Health Board</td>
<td>Health</td>
<td>15 Feb 13</td>
<td>53</td>
</tr>
<tr>
<td>Bay of Plenty District Health Board</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>55</td>
</tr>
<tr>
<td>Broadcasting Commission</td>
<td>Commerce</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Broadcasting Standards Authority</td>
<td>Commerce</td>
<td>15 Feb 13</td>
<td>61</td>
</tr>
<tr>
<td>Canterbury District Health Board</td>
<td>Health</td>
<td>16 Nov 12</td>
<td>63</td>
</tr>
<tr>
<td>Canterbury Earthquake Recovery Authority</td>
<td>Finance and Expenditure</td>
<td>31 Jan 13</td>
<td>65</td>
</tr>
<tr>
<td>Capital and Coast District Health Board</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>105</td>
</tr>
<tr>
<td>Career Services <em>(reported with the 2011/12 financial review of AgResearch Limited)</em></td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>Careers New Zealand <em>(reported with the 2011/12 financial review of AgResearch Limited)</em></td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>Charities Commission</td>
<td>Social Services</td>
<td>11 Apr 13</td>
<td>107</td>
</tr>
<tr>
<td>Children's Commissioner</td>
<td>Social Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Civil Aviation Authority of New Zealand <em>(reported with the 2011/12 financial review of the Airways Corporation of New Zealand Limited)</em></td>
<td>Transport and Industrial Relations</td>
<td>1 Mar 13</td>
<td>41</td>
</tr>
<tr>
<td>Commerce Commission</td>
<td>Commerce</td>
<td>22 Mar 13</td>
<td>111</td>
</tr>
<tr>
<td>Counties Manukau District Health Board</td>
<td>Health</td>
<td>28 Mar 13</td>
<td>137</td>
</tr>
<tr>
<td>Crown Health Financing Agency</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>143</td>
</tr>
<tr>
<td>Drug Free Sport New Zealand</td>
<td>Government Administration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earthquake Commission <em>(reported with the 2011/12 financial review of the Canterbury Earthquake Recovery Authority)</em></td>
<td>Finance and Expenditure</td>
<td>31 Jan 13</td>
<td>65</td>
</tr>
<tr>
<td>Crown entity/public organisation/State enterprise</td>
<td>Select Committee</td>
<td>Date presented</td>
<td>Page</td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>-----------------</td>
<td>---------------</td>
<td>------</td>
</tr>
<tr>
<td>Education New Zealand (reported with the 2011/12 financial review of AgResearch Limited)</td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>Electoral Commission</td>
<td>Justice and Electoral</td>
<td>19 Apr 13</td>
<td>145</td>
</tr>
<tr>
<td>Electricity Authority</td>
<td>Commerce</td>
<td>15 Apr 13</td>
<td>151</td>
</tr>
<tr>
<td>Electricity Corporation of New Zealand Limited</td>
<td>Commerce</td>
<td>1 Mar 13</td>
<td>171</td>
</tr>
<tr>
<td>Energy Efficiency and Conservation Authority</td>
<td>Local Government and Environment</td>
<td>15 Mar 13</td>
<td>185</td>
</tr>
<tr>
<td>Environmental Protection Authority</td>
<td>Local Government and Environment</td>
<td>1 Feb 13</td>
<td>189</td>
</tr>
<tr>
<td>External Reporting Board</td>
<td>Commerce</td>
<td>19 Apr 13</td>
<td>193</td>
</tr>
<tr>
<td>Families Commission</td>
<td>Social Services</td>
<td>9 May 13</td>
<td>205</td>
</tr>
<tr>
<td>Financial Markets Authority</td>
<td>Commerce</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Genesis Power Limited</td>
<td>Commerce</td>
<td>15 Apr 13</td>
<td>211</td>
</tr>
<tr>
<td>Government Superannuation Fund Authority</td>
<td>Commerce</td>
<td>9 Nov 12</td>
<td>235</td>
</tr>
<tr>
<td>Guardians of New Zealand Superannuation</td>
<td>Commerce</td>
<td>22 Mar 13</td>
<td>237</td>
</tr>
<tr>
<td>Hawke's Bay District Health Board</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>259</td>
</tr>
<tr>
<td>Health and Disability Commissioner</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>261</td>
</tr>
<tr>
<td>Health Quality and Safety Commission</td>
<td>Health</td>
<td>6 Dec 12</td>
<td>263</td>
</tr>
<tr>
<td>Health Research Council of New Zealand</td>
<td>Health</td>
<td>28 Mar 13</td>
<td>265</td>
</tr>
<tr>
<td>Health Sponsorship Council</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>271</td>
</tr>
<tr>
<td>Housing New Zealand Corporation</td>
<td>Social Services</td>
<td>11 Apr 13</td>
<td>273</td>
</tr>
<tr>
<td>Human Rights Commission</td>
<td>Justice and Electoral</td>
<td>28 Mar 13</td>
<td>279</td>
</tr>
<tr>
<td>Hutt District Health Board</td>
<td>Health</td>
<td>15 Feb 13</td>
<td>283</td>
</tr>
<tr>
<td>Independent Police Conduct Authority</td>
<td>Law and Order</td>
<td>28 Mar 13</td>
<td>285</td>
</tr>
<tr>
<td>Industrial Research Limited</td>
<td>Education and Science</td>
<td>21 Mar 13</td>
<td>305</td>
</tr>
<tr>
<td>Institute of Environmental Science and Research Limited (reported with the 2011/12 financial review of AgResearch Limited)</td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>Institute of Geological and Nuclear Sciences Limited (reported with the 2011/12 financial review of AgResearch Limited)</td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>Kordia Group Limited</td>
<td>Commerce</td>
<td>12 Apr 13</td>
<td>309</td>
</tr>
<tr>
<td>Lakes District Health Board</td>
<td>Health</td>
<td>29 Nov 12</td>
<td>335</td>
</tr>
<tr>
<td>Landcare Research New Zealand Limited (reported with the 2011/12 financial review of AgResearch Limited)</td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>Landcorp Farming Limited</td>
<td>Primary Production</td>
<td>1 Feb 13</td>
<td>337</td>
</tr>
<tr>
<td>Crown entity/public organisation/State enterprise</td>
<td>Select Committee</td>
<td>Date presented</td>
<td>Page</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------------------------------------------------</td>
<td>---------------------------------------</td>
<td>----------------</td>
<td>------</td>
</tr>
<tr>
<td>Law Commission</td>
<td>Justice and Electoral</td>
<td>12 Dec 12</td>
<td>343</td>
</tr>
<tr>
<td>Learning Media Limited</td>
<td>Education and Science</td>
<td>21 Mar 13</td>
<td>345</td>
</tr>
<tr>
<td>Maritime Safety Authority of New Zealand (reported with the 2011/12 financial review of the Airways Corporation of New Zealand Limited)</td>
<td>Transport and Industrial Relations</td>
<td>1 Mar 13</td>
<td>41</td>
</tr>
<tr>
<td>Mental Health Commission</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>349</td>
</tr>
<tr>
<td>Meridian Energy Limited</td>
<td>Commerce</td>
<td>19 Apr 13</td>
<td>351</td>
</tr>
<tr>
<td>Meteorological Service of New Zealand Limited (reported with the 2011/12 financial review of the Government Superannuation Fund Authority)</td>
<td>Commerce</td>
<td>9 Nov 12</td>
<td>235</td>
</tr>
<tr>
<td>MidCentral District Health Board</td>
<td>Health</td>
<td>29 Nov 12</td>
<td>375</td>
</tr>
<tr>
<td>Mighty River Power Limited</td>
<td>Commerce</td>
<td>15 Apr 13</td>
<td>377</td>
</tr>
<tr>
<td>Museum of New Zealand Te Papa Tongarewa Board (reported with the 2011/12 financial review of the Arts Council of New Zealand Toi Aotearoa)</td>
<td>Government Administration</td>
<td>21 Mar 13</td>
<td>47</td>
</tr>
<tr>
<td>National Institute of Water and Atmospheric Research Limited</td>
<td>Education and Science</td>
<td>21 Mar 13</td>
<td>405</td>
</tr>
<tr>
<td>Nelson Marlborough District Health Board</td>
<td>Health</td>
<td>7 Nov 12</td>
<td>409</td>
</tr>
<tr>
<td>New Zealand Antarctic Institute</td>
<td>Foreign Affairs, Defence and Trade</td>
<td>22 Mar 13</td>
<td>411</td>
</tr>
<tr>
<td>New Zealand Artificial Limb Board</td>
<td>Social Services</td>
<td>1 Feb 13</td>
<td>417</td>
</tr>
<tr>
<td>New Zealand Blood Service</td>
<td>Health</td>
<td>19 Oct 12</td>
<td>419</td>
</tr>
<tr>
<td>New Zealand Film Commission (reported with the 2011/12 financial review of the Arts Council of New Zealand Toi Aotearoa)</td>
<td>Government Administration</td>
<td>21 Mar 13</td>
<td>47</td>
</tr>
<tr>
<td>New Zealand Fire Service Commission (reported with the 2011/12 financial review of the Arts Council of New Zealand Toi Aotearoa)</td>
<td>Government Administration</td>
<td>21 Mar 13</td>
<td>47</td>
</tr>
<tr>
<td>New Zealand Forest Research Institute Limited (reported with the 2011/12 financial review of AgResearch Limited)</td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>New Zealand Historic Places Trust (Pouhere Taonga)</td>
<td>Government Administration</td>
<td>21 Mar 13</td>
<td>421</td>
</tr>
<tr>
<td>New Zealand Lotteries Commission (reported with the 2011/12 financial review of the New Zealand Historic Places Trust (Pouhere Taonga))</td>
<td>Government Administration</td>
<td>21 Mar 13</td>
<td>421</td>
</tr>
<tr>
<td>New Zealand Post Limited</td>
<td>Commerce</td>
<td>2 Apr 13</td>
<td>423</td>
</tr>
<tr>
<td>New Zealand Productivity Commission</td>
<td>Commerce</td>
<td>21 Mar 13</td>
<td>443</td>
</tr>
<tr>
<td>Crown entity/public organisation/State enterprise</td>
<td>Select Committee</td>
<td>Date presented</td>
<td>Page</td>
</tr>
<tr>
<td>--------------------------------------------------</td>
<td>------------------</td>
<td>---------------</td>
<td>------</td>
</tr>
<tr>
<td>New Zealand Qualifications Authority (reported with the 2011/12 financial review of AgResearch Limited)</td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>New Zealand Railways Corporation</td>
<td>Transport and Industrial Relations</td>
<td>22 Mar 13</td>
<td>469</td>
</tr>
<tr>
<td>New Zealand Symphony Orchestra</td>
<td>Government Administration</td>
<td>10 May 13</td>
<td>493</td>
</tr>
<tr>
<td>New Zealand Teachers Council</td>
<td>Education and Science</td>
<td>10 May 13</td>
<td>495</td>
</tr>
<tr>
<td>New Zealand Tourism Board</td>
<td>Commerce</td>
<td>9 Nov 12</td>
<td>501</td>
</tr>
<tr>
<td>New Zealand Trade and Enterprise</td>
<td>Commerce</td>
<td>19 Apr 13</td>
<td>503</td>
</tr>
<tr>
<td>New Zealand Transport Agency</td>
<td>Transport and Industrial Relations</td>
<td>28 Mar 13</td>
<td>527</td>
</tr>
<tr>
<td>New Zealand Venture Investment Fund Limited (reported with the 2011/12 of the Broadcasting Standards Authority)</td>
<td>Commerce</td>
<td>15 Feb 13</td>
<td>61</td>
</tr>
<tr>
<td>New Zealand Walking Access Commission</td>
<td>Local Government and Environment</td>
<td>9 Nov 12</td>
<td>553</td>
</tr>
<tr>
<td>Northland District Health Board</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>555</td>
</tr>
<tr>
<td>Office of Film and Literature Classification (reported with the 2011/12 financial review of the New Zealand Historic Places Trust (Pouhere Taonga))</td>
<td>Government Administration</td>
<td>21 Mar 13</td>
<td>421</td>
</tr>
<tr>
<td>Pharmaceutical Management Agency</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>555</td>
</tr>
<tr>
<td>Privacy Commissioner</td>
<td>Justice and Electoral</td>
<td>8 May 13</td>
<td>561</td>
</tr>
<tr>
<td>Public Trust (reported with the 2011/12 financial review of the Government Superannuation Fund Authority)</td>
<td>Commerce</td>
<td>9 Nov 12</td>
<td>235</td>
</tr>
<tr>
<td>Quotable Value Limited (reported with the 2011/12 financial review of Animal Control Products Limited)</td>
<td>Primary Production</td>
<td>1 Feb 13</td>
<td>45</td>
</tr>
<tr>
<td>Radio New Zealand Limited</td>
<td>Commerce</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real Estate Agents Authority (reported with the 2011/12 of the Broadcasting Standards Authority)</td>
<td>Commerce</td>
<td>15 Feb 13</td>
<td>61</td>
</tr>
<tr>
<td>Reserve Bank of New Zealand</td>
<td>Finance and Expenditure</td>
<td>13 Dec 12</td>
<td>567</td>
</tr>
<tr>
<td>Retirement Commissioner</td>
<td>Social Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social Workers Registration Board</td>
<td>Social Services</td>
<td>9 May 13</td>
<td>595</td>
</tr>
<tr>
<td>Solid Energy New Zealand Limited</td>
<td>Commerce</td>
<td>19 Apr 13</td>
<td>601</td>
</tr>
<tr>
<td>South Canterbury District Health Board</td>
<td>Health</td>
<td>13 Dec 12</td>
<td>679</td>
</tr>
<tr>
<td>Southern District Health Board</td>
<td>Health</td>
<td>6 Dec 12</td>
<td>681</td>
</tr>
<tr>
<td>Sport and Recreation New Zealand (reported with the 2011/12 financial review of the New Zealand Historic Places Trust (Pouhere Taonga))</td>
<td>Government Administration</td>
<td>21 Mar 13</td>
<td>421</td>
</tr>
<tr>
<td>Crown entity/public organisation/State enterprise</td>
<td>Select Committee</td>
<td>Date presented</td>
<td>Page</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------------------------------------------------</td>
<td>-------------------------------------------</td>
<td>----------------</td>
<td>------</td>
</tr>
<tr>
<td>Standards Council <em>(reported with the 2011/12 financial review of the Government Superannuation Fund Authority)</em></td>
<td>Commerce</td>
<td>9 Nov 12</td>
<td>235</td>
</tr>
<tr>
<td>Tairawhiti District Health Board</td>
<td>Health</td>
<td>28 Mar 13</td>
<td>683</td>
</tr>
<tr>
<td>Takeovers Panel</td>
<td>Commerce</td>
<td>15 Feb 13</td>
<td>689</td>
</tr>
<tr>
<td>Taranaki District Health Board</td>
<td>Health</td>
<td>28 Feb 13</td>
<td>703</td>
</tr>
<tr>
<td>Te Reo Whakapuaki Irirangi <em>(Māori Broadcasting Funding Agency)</em></td>
<td>Māori Affairs</td>
<td>22 Feb 13</td>
<td>709</td>
</tr>
<tr>
<td>Te Taura Whiri I Te Reo Māori <em>(Māori Language Commission)</em> <em>(reported with the 2011/12 financial review of Te Reo Whakapuaki Irirangi <em>(Māori Broadcasting Funding Agency)</em>)</em></td>
<td>Māori Affairs</td>
<td>22 Feb 13</td>
<td>709</td>
</tr>
<tr>
<td>Television New Zealand Limited</td>
<td>Commerce</td>
<td>2 Apr 13</td>
<td>711</td>
</tr>
<tr>
<td>Tertiary Education Commission</td>
<td>Education and Science</td>
<td>10 May 13</td>
<td>739</td>
</tr>
<tr>
<td>Testing Laboratory Registration Council <em>(reported with the 2011/12 of the Broadcasting Standards Authority)</em></td>
<td>Commerce</td>
<td>15 Feb 13</td>
<td>61</td>
</tr>
<tr>
<td>The New Zealand Institute for Plant and Food Research Limited <em>(reported with the 2011/12 financial review of AgResearch Limited)</em></td>
<td>Education and Science</td>
<td>31 Jan 13</td>
<td>39</td>
</tr>
<tr>
<td>Transport Accident Investigation Commission <em>(reported with the 2011/12 financial review of the Airways Corporation of New Zealand Limited)</em></td>
<td>Transport and Industrial Relations</td>
<td>1 Mar 13</td>
<td>41</td>
</tr>
<tr>
<td>Transpower New Zealand Limited</td>
<td>Commerce</td>
<td>21 Mar 13</td>
<td>745</td>
</tr>
<tr>
<td>Waikato District Health Board</td>
<td>Health</td>
<td>21 Mar 13</td>
<td>759</td>
</tr>
<tr>
<td>Wairarapa District Health Board</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>765</td>
</tr>
<tr>
<td>Waitemata District Health Board</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>767</td>
</tr>
<tr>
<td>West Coast District Health Board</td>
<td>Health</td>
<td>1 Feb 13</td>
<td>769</td>
</tr>
<tr>
<td>Whanganui District Health Board</td>
<td>Health</td>
<td>6 Dec 12</td>
<td>771</td>
</tr>
</tbody>
</table>
Introduction

The Standing Orders provide for the annual financial review of Crown entities, State enterprises, and organisations the House deems to be public organisations. These procedures now apply to 119 organisations. This is a compendium of the select committee reports on the financial reviews for the reporting year of these organisations.

For the purposes of these financial reviews, a Crown entity is one named or described in Schedules 1 and 2 of the Crown Entities Act 2004 and a State enterprise is defined as in the State-Owned Enterprises Act 1986. On 1 March 2012, the House resolved to include in this scrutiny the examination of the Abortion Supervisory Committee, the Reserve Bank of New Zealand, and Air New Zealand Limited. These organisations were, accordingly, deemed public organisations for the purposes of the Standing Orders.

At the time of producing this compendium, the financial review examinations of the Broadcasting Commission, the Financial Markets Authority, Radio New Zealand Limited, Drug Free Sport New Zealand, the Children’s Commissioner and the Retirement Commissioner had not been completed.

Consideration of reports by the House

The reports on the performance and current operations of Crown entities, public organisations, and State enterprises are not debatable when presented to the House. But a debate (of 3 hours) is provided for. The Government selects a date and sets the item down as a Government order of the day.

Financial reviews of Government departments and Offices of Parliament, and the reviews of the reports on non-departmental appropriations

Select committees also conduct financial reviews of Government departments and Offices of Parliament, and review the reports on certain non-departmental appropriations. Similar processes are followed but there is a separate timetable for examination, report, and debate. The reports of select committees on these examinations were published in a separate compendium (I.20B) in February 2013.
The Justice and Electoral Committee has conducted the financial review of the 2011/12 performance and current operations of the Abortion Supervisory Committee and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Tim Macindoe
Chairperson
2011/12 financial review of the Accident Compensation Corporation

Report of the Transport and Industrial Relations Committee

Contents
Recommendation 2
Introduction 2
Financial matters 2
Organisational matters 3
Administration of scheme 3
Appendix A 5
Appendix B 6
Accident Compensation Corporation

Recommendation

The Transport and Industrial Relations Committee has conducted the financial review of the 2011/12 performance and current operations of the Accident Compensation Corporation, and recommends that the House take note of its report.

Introduction

The Accident Compensation Corporation is responsible, as a Crown agent, for providing no-fault personal injury cover for those eligible in New Zealand, including overseas visitors. ACC works to prevent injury, to treat it when it occurs, and to rehabilitate people to productive life as soon as practicable and at a reasonable cost.

Financial matters

Investment committee

At the end of the year under review, ACC held total investments of $21.753 billion. The net value of funds managed by ACC was $20.426 billion. The chair told us that she considers that the corporation has one of the best teams of fund managers in New Zealand. Two of the seven members of the investment committee were from outside the corporation, and five were board members, three of whom had changed since May. We were told that the chair of the investment committee had disclosed to the corporation details of a Financial Markets Authority investigation related to one of his previous roles, and that this had been discussed by the board.

Accredited employers

We heard that the number of employers taking part in accredited schemes was fairly steady. The corporation considers that the most promising avenue for extending the scheme would be to have employers also administer their employees’ non-work accidents. This approach is being trialled, with particular attention being paid to ensuring that employers do not have any more access to the details of non-work injuries than they should.

We were told accredited employer schemes were audited every two years, and that Mainzeal was almost due for an audit at the time of its collapse, having last been audited almost two years previously. ACC has not yet calculated the cost of covering Mainzeal’s outstanding liabilities, but does not expect it to be large. It will review the circumstances to see what can be learnt from the situation.

Discount rate

The corporation explained that the discount rate that is applied when calculating the liability from outstanding claims is derived from a yield curve in the short term; the official Treasury rate must be used thereafter. A 0.5 percent decrease in the long-term component would effectively reduce the net value of the corporation by $700 million.
Organisational matters

Privacy and data security

The chair acknowledged that the number of privacy breaches by the corporation was still unacceptably high, at an average for the last quarter of about 75 per month. While affirming that any breach is unacceptable, the chair told us that not all recorded breaches involve personal details (for example, an invoice for a levy being sent to the wrong employer is counted as a breach), and not all breaches result from errors by ACC staff (for example, if a doctor has put information regarding a different patient with the same name on a file, this cannot be picked up by ACC staff).

We were told that the corporation will be responding to all 44 recommendations of the privacy review undertaken in response to a serious breach in March 2012, and that 22 of the recommendations are scheduled to be addressed by the end of the year. As a first step, material leaving the corporation is now checked centrally; we note that some files can be 10,000 to 15,000 pages long, so this is not a simple process. Many of ACC’s 80 million files are still in hard copy; we heard that the corporation will be better able to reduce the incidence of privacy breaches once more of its files are held in digital form, but that this is likely to take a long time.

Client satisfaction and public trust and confidence

While ACC has reported a stable rate of client satisfaction over the past two years (70 percent), there has been a decline in public trust and confidence (from 58 percent in June 2011 to 45 percent in June 2012). Members of the public most often cited media coverage of privacy breaches as influencing their trust and confidence in ACC; we were told that the corporation needs to deal with the number of privacy breaches to regain public confidence.

Administration of scheme

Engagement with healthcare sector

ACC believes that it needs to make it easier for GPs, surgeons, and providers to decide whether claims they are entering meet ACC criteria, and it has been working with some professional groups to jointly develop guidelines on what constitutes a legitimate ACC claim in their area. The corporation will seek to develop this approach in future. It also believes that the move to digital processes will help, by enabling real-time interaction between the provider and ACC in the claim submission process.

Sensitive claims clinical pathway

The chair acknowledged that progress had been limited in implementing some of the recommendations of a review of the sensitive claims clinical pathway. We heard that more clients were making use of early access to counselling, but that the chair was concerned that ACC was not assisting some groups of clients with their sensitive claims as effectively as it should. ACC will continue to seek independent reviews of the corporation’s procedures for dealing with sensitive claims.

The corporation will conduct internal reviews or seek additional independent reviews of its assessment of entitlements in other areas. Whenever the corporation loses a court case or has a dispute decided against it, it intends to investigate whether there is a systematic problem with its interpretation and application of its governing statute, or whether the problem was a “one-off”.

3
Rehabilitation

We heard that the corporation uses several measures to assess the effectiveness of its rehabilitation work. For people in paid employment at the time of an injury, it measures both how many are able to return to work within a particular time and how many of these returns to work are “durable”. For all clients, it measures how long it takes each client to return to their maximum possible level of independence. We were told that the performance measure showing the percentage of clients who have returned to independence within 273 days (considered a critical date) is at an all-time high.

Specialist medical advisers

We asked if the corporation had considered contracting with district health boards or with medical professional associations for the provision of specialist medical advice, rather than contracting directly with specialist medical advisers as at present. ACC does not believe that specialist medical advice could be provided quickly enough through contracts with DHBs. It would like a larger pool of medical specialists to draw from, and is examining how the contracting process could be improved. ACC has recently begun informing clients referred to a specialist medical adviser that if they are not happy with the first adviser, they may choose to be referred to one of two other advisers.

Injury prevention

ACC has sought to work proactively in Canterbury to ensure high standards of safety in the rebuilding of Christchurch. We were told that this is not viewed as a new initiative, but as an opportunity to deliver its health and safety messages to a large group of workers. The corporation has been working with contractors and the Canterbury Rebuild Safety Forum, and has drawn lessons from the building programme for the London Olympics. We heard that the corporation can work well with big companies, but has difficulty reaching all of the smaller firms, which account for almost half of all workplace accidents.
Appendix A

Approach to this financial review
We met on 14 February and 21 March 2013 to consider the financial review of the Accident Compensation Corporation. We heard evidence from the Accident Compensation Corporation and received advice from the Office of the Auditor-General.

Committee members
David Bennett (Chairperson)
Chris Auchinvole
Dr Cam Calder
Darien Fenton
Iain Lees-Galloway
Sue Moroney
Simon O'Connor
Denise Roche
Mike Sabin

Evidence and advice received
Accident Compensation Corporation, responses to written questions, received 28 January and 14 March 2013.

2011/12 FINANCIAL REVIEW OF THE ACCIDENT COMPENSATION CORPORATION

Appendix B

Corrected transcript of hearing of evidence 14 February 2013

Members
David Bennett (Chairperson)
Chris Auchinvole
Dr Cam Calder
Dr David Clark
Kevin Hague
Colin King
Iain Lees-Galloway
Simon O’Connor
Phil Twyford

Witnesses
Paula Rebstock, Chair, ACC Board
David May, Acting Chief Executive
Kurutia Seymour, General Manager, Governance, Legal Policy and Research
Mark Dosser, Chief Financial Officer
John Beaglehole, General Manager, Insurance and Prevention Services

Bennett Thank you very much for coming along today. We’ve got the financial review of the Accident Compensation Corporation. We’ve got until 11.30, so we’ve started a little bit early, but basically you probably have an hour from here. What we will do is you’ve got a presentation you want to give to us. I understand it is not on the board or anything, but it is in front of members, so if you want to run through that reasonably quickly, then we can open up for questions from members. And just if anybody behind is answering any questions, if you don’t mind just standing up or speaking into the microphone. It is just easier because we are transcribing it, and it’s a bit hard for the people to do that if they don’t have you at the microphone or standing up. So we are in your hands, and welcome.

Rebstock Thank you very much, Chairman, and good morning to all the committee. It is a pleasure to be here today and I am really comfortable, too, to be asked points of clarification if it is helpful during the brief presentation.

So on the first slide we just tried to give you a bit of a sense of the scale and scope of what ACC does, and some of the headline claims in the year under review. We dealt with about 1.7 million claims, of which about 97 percent were accepted. Obviously, that translates into a very sizable amount of activity on any given day. And to give you a sense of that, we deal with about a million emails a day; we handle 25,000 letters and 24,000 phone calls. So we are a people business, and we are dealing with customers, real time—
Calder A point of clarification. How many emails a day?

Rebstock We deal with about a million emails a day, because we will be receiving emails from doctors, practitioners, and others.

Calder That is staggering. It’s a country of 4 million people.

Rebstock Yes.

?____ It’s got nothing to do with the Yahoo phishing scam, I am sure!

Rebstock And I only—you know, it’s not the critical thing here, but to understand the operation of the scheme and some of the challenges we face, you need to understand the scale of what we’re trying to address.

Auchinvole We thought we were busy with emails.

Rebstock If you turn to slide 2, we just cover what we provide. We obviously provide payments for medical fees, weekly compensation, serious injury. The key focus for the corporation this year will be on improving our performance in injury prevention, and, obviously, rehabilitation is a part of everything we do. If you turn on to the next page, which just covers the key areas I want to touch on. Obviously, in any other areas I am more than happy to take any questions. If you could turn to the fourth slide—and I’m going to try to move through it quickly.

Bennett That’s fine.

Restock You see on this slide our return to independence rates. At the two points that we monitor—obviously we monitor other points, but in terms of our statement of performance this is what we look at—the top one is the 273-day rehabilitation of clients; how many people have returned to independence by that date. That is an absolutely critical performance date, and the reason it is is that we know that if a New Zealander who is injured and is on ACC isn’t back to work by that date the probability of them regaining their pre-injury economic status is really diminished quite substantially. So we know, to give them the best chance at not just recovering from the injury but returning to their pre-injury economic status, we have got to get them back to independence by that date. You can see by the number that we are performing really well there, and in fact we are at an all-time record high.

On the other hand, if you look at the 70-day rehabilitation rate, it is pretty steady at about 70 percent. One of the things I think we need to understand right now is why are we struggling to bring it back up to the level we saw, say, in 2005. So right now some of our success at the longer end is we’re really working with people and they’re not flowing into that longer duration. And we are putting real effort into this other 70-day rate, but we’re finding that it’s really hard to shift it further to a higher level of performance, but it is a real focus for us.

If you turn to the next slide, this slide is really looking at some of the issues around effectiveness of rehabilitation, and there is no question that on some of the client surveys that we did we’ve taken a hit in the year under review. It coincides very much with the difficulties we had around, and continue to
have around, privacy. I am pretty pleased to say that some of that decline in terms of what clients were telling us has now stabilised and is moving back in the other direction. But it has still got some distance to go.

The other thing I’d like to indicate to you is that right now in the current quarter we see 67 percent of clients are very satisfied with the ACC, but, interestingly, serious injury clients are even more satisfied, with 78 percent of them either being satisfied or very satisfied with the service that they receive from ACC. Obviously, this is something that we pay very close attention to, and, frankly, we need to see the number of clients who are satisfied with ACC rise considerably above 67 percent, and we certainly have measures in place to do that.

If you look at the next page, it’s really to show you what’s happening to the cost of claims, and you can see from this that it is stabilising. There are some aspects of our claims the cost of which are increasing, but overall we see a general stabilisation of the cost of claims in the scheme.

On the next page, on slide 7, we just sought to give you a little bit of a comparison. We do benchmark what we do against other jurisdictions, and here we have the Australian benchmarks. What we have here is return to work rates. I apologise for the abbreviations. In the year under review we had a return to work rate of about 88 percent, which was 4 percent above our Australian comparator. We also have seen that performance improve steadily over the years. So if you look back in time, in 2008-09 it was at 83 percent.

We also measure durable return to work. So we look at—well, we get somebody back to work; do they stay in work? Because sometimes you see re-injury, or we don’t get the reintegration right back into the workplace. So we measure that too. Obviously, that is a critical performance issue for us. We are achieving about an 80 percent rate, which is 5 percent above our Australian counterparts. We also benchmark with them against client service dimensions, and on many of those dimensions—in fact, I think maybe even all of them—we substantially outperform our counterparts. Does that make us complacent? No, it doesn’t, but it does help us to understand how we perform relative to others who have a similar responsibility as we do.

On the next page, there has been a lot of interest recently in the resolution of disputes. ACC is very committed, and has always been committed, to ensuring that when there is a dispute our customers have access to a free and speedy dispute resolution service. However, we do know that our clients do better in their rehabilitation if we can resolve disputes before it gets to the point of having to be referred on. We have a real focus on that area. In the current year we’re certainly now up to 79 percent, which is up from, I think, about 77 percent in terms of the number of disputes that are either settled, decided, in the favour of ACC—you know, obviously resolved—and that is really moving strongly in the right direction.

I think we have to do better there. There will always be some disputes. The boundaries of the scheme will never be as clear as everyone would like. Some things will go to dispute. The important thing for us is that our staff
learn from the outcome of that and we don’t make the same mistakes over
and over where the issue has been found against us. We’re working hard
with our staff to do that. The other thing is we really have to improve our
communication both before something goes to a dispute process but also
after. That is a clear focus for us.

I want to turn to the next slide, to the privacy issue. You will all be very
aware that we had a very serious privacy breach in March of last year, and
the corporation unreservedly apologised to its customers for that incident.
It is very clear to us that the corporation must respond to all 44
recommendations of the privacy review that was undertaken, and 22 of
those are scheduled to be completed by the end of the year. We are on track
to complete them. Nine are complete, the rest are under way.

We established a privacy index, because we thought it was important to be
transparent and include both the breaches but also some of the cultural and
process things that we needed to do in the corporation to improve
performance. It’s a tough target. I was very worried in December because it
looked like we were going to struggle to meet the target. January looks more
encouraging. We had the performance improve. I think we’re going to
continue to see it go up and down. We always knew it was going to take a
long time to do it, to resolve all of the privacy breaches, but we’re
completely committed to the view that no breach is acceptable to the
corporation and we must address them.

I have asked the management to come forward with additional measures to
help us address some of the short-term issues we’re having. There is no big-
ticket item where we can put in place a measure to deal with a number of
the breaches. They are across a wide range of areas. You can tell by the
number of transactions we do a day, with the emails and the phone calls
and the letters, that there is a huge pool there that we have to get right.

We have done a number of things. One of the things that have helped us
cut down on the breaches is putting in place centralised checking of some
of the material that leaves the corporation. I think we need to look at doing
more of that, and in the short run, if that’s what we need to do to continue
to meet the targets that we’ve set, then that’s what we’ll be doing.

I will say that our people are doing their best, but it is up to us on the board
and the management team to support them with the right tools to be
effective in this space. Our people are moving quickly to do what they can
do within the current systems, but they do need far better business
processes and technology to support them. We’re looking at a major
transformation programme in order to provide that, and, hopefully, when
we talk to you the next time, Chairman, we’ll be able to give you more
information on that.

If you look at the next slide, which is around trust and confidence, if you
look over the history of the scheme, it has always struggled to reach the
level of trust and confidence with the people it serves at a level that I would
think was acceptable. Our result at the end of the year was clearly
unacceptable, and it was declining. We now see in the current year that
we’re in that that has stabilised—is stabilising at …. percent or 45 percent, and that, frankly, isn’t good enough. So we have, as part of our wider approach to addressing the privacy issues, focused on four pillars of trust and confidence that we need to improve. You see them listed there. We have initiatives under each one.

It is early days, but I have to say that our people are really focused on it and engaged. We went out and consulted staff on some of the culture issues and had a very high response rate and participation rate, which, to me, tells me we provide the right environment for our staff and the right tools and processes; you know, the vast majority of our staff want to do the right thing for our customers.

If we look at the final slides, page 11, injury prevention initiatives, we’ve had some really fantastic successes in this space. We did focus on, as an example, some of the priority sports where a lot of accidents have happened in the past: rugby union, league, netball, and football. We set a target, really, from our injury prevention work of seeing a 2 percent reduction in entitlement claims. We’ve actually seen a 5 percent reduction over the year under review. It really demonstrates what you can do when you get the people involved in helping address those issues.

The board, however, has said to management that injury prevention is a core part of our purpose. If we look at the investment we’ve made in injury prevention over recent times it’s fallen off quite considerably. We have learnt a lot about what works in this space, and the board has asked management to come back in March and April with a new injury prevention strategy. The Act requires us to show that we can make a return on any investment we make using levy funding. I actually think that the corporation has tended to take too short a view on the payback period. If you take a slightly longer view on it, I think you’ll find that there are very effective injury prevention measures that the corporation can and should invest in.

If you turn to slide No. 12, you can see the progress that we’re making towards financial solvency. We are very much on track to reach full funding by 2019. It’s certainly the case that we are to that point already on the earners account. We are very close indeed on the work account. And we are on track with the motor vehicle account to reach the targets that have been set for us. That is, in fact, a really pleasing result and basically sets us up really for an overall situation where, I think, going forward we could see significant reductions at some point in levies. We think those significantly reduced levies can be sustained, on our projections, for very long periods of time. So, just slide 13; I just want to mention the investments performance.

Bennett Just with your financial solvency, sorry Paula, but OCL—what’s that?

Rebstock It’s the outstanding claims liability. To be fully funded we have to be able to cover all of the future cost of past accidents, and that’s how we measure it. I apologise.

On the investment side, on slide 13, ACC has had nothing short of a stunning performance on its investments over a very long period, and that
has continued. We are well ahead of benchmark last year and this year. Very strong this year, I must say. We did celebrate last year our investment performance over a 10-year period. When we compared ourselves to diversified funds in New Zealand and around the world the only fund we could find that performed as well the ACC fund was really funds like the Yale University fund. This is a really good-news story, because obviously the better we do with this, the less we have to collect from levy payers and the more we can ensure the sustainability of the scheme.

Calder Perhaps you should go into financial management yourself.

Rebstock I could ask every day if ACC would consider managing other funds, because we have an exceptional team. We’ve managed to keep them because they are committed to working on behalf of the public, and it’s great to see the public being served by probably the best fund managers in the country.

So I just want to sum up by saying a few short things. Rehabilitation performance over the period was good, but we’re not complacent about the results. We want to see our customers continuing to feel satisfied and very satisfied with what we’re doing, and we want to see those levels increase. We’re very proud of the service we provide to the seriously injured clients that we have. We are investing. It’s an area where we are investing more money, and we have no difficulty in doing that, because we want to not only help them return to work if they can but we also want to ensure they have a quality of life that can be made a bit easier by some of the investments that we can make.

On the privacy side, we are on track to meet the targets that we’ve set for ourselves and respond to the report into the privacy breach that we had. To be honest with you, I remain dissatisfied with where we’re at, not because our people aren’t giving it everything they’ve got but we are still continuing to see a high number of breaches, and we simply have to do better. I am looking for the corporation to step up and put even greater focus on this area.

Trust and confidence: I’m pleased that we’ve stabilised what was a rapidly falling index, and we’re starting to see that improve again. There are a lot of things we have to get right in order to see that turn round. I am confident we have the right initiatives in place, but I also want to see far more urgency around making progress there.

Injury prevention: we’ve had some really quite spectacular initiatives, but I think the corporation has tended to under-invest in injury prevention. We are in a strong position financially right now. We need to get a return on those investments, but where there is an investment to improve injury prevention, we’re going to look hard at it, and I expect to see a much stronger effort in that space.

Finally, the corporation’s financial position is strong. It’s strong because underlying economic factors over which we have no control have moved in our favour. That was not the case last year but is strongly the case this year. As interest rates go back up our forward liability falls very quickly. But,
importantly, the bits that we do have some control over or a lot of control
over, which is on the claims management side and also on the performance
of the investments, they have continued to be strong in the current period
and they were strong over the year under review. Obviously, we want to
make sure that we can continue that performance. So that is the comments
I wanted to make, Chairman. I am very happy to take questions.

Bennett Thank you very much, Paula. I just wanted to thank you and your team for
picking it up as you have. It’s a delicate time that you’ve come in, and I
think the sense that you’ve given us today of your desire to actually see
some of those measures improve for the sake of the corporation, but also
the realism of the hard work that your team, especially all the ACC staff
around the country, have put in to some very difficult situations. So on
behalf of the committee I think everyone would like to let your staff know
that we support them and we understand some of the challenges but also
the good work that they do. So thank you, personally, for the way that
you’ve approached that this morning. We’ll have questions from members
now.

Twyford I wanted to start with a couple of questions about the privacy breaches.
Three or four months after the Bronwyn Pullar affair, we see 104 privacy
breaches in July, which seems very high. I wondered if you have at your
fingertips the number of breaches for the last quarter of last year. It would
just be interesting to see—you know, it was 104 in July, 80 in August,
according to an OIA.

Rebstock I think for the last quarter the average was 75. I’ll check that, and if I’m
wrong I will let you know. It’s a rolling average. We do a rolling average
because it is moving up and down quite a bit month to month, so, for
instance, January was 55, but, I mean, we had people working but it was a
short month. So, really, until we get to the end of the quarter, and we see
what the quarter average is, we won’t be able to know.

Twyford You talked a little bit about some of the things that are being done to try to
lift the performance in this area, but you also expressed some dissatisfaction
that the organisation is not there yet. What’s the gap? I mean, what do you
think needs to happen?

Rebstock Well, first of all, from a board member’s perspective, it was really hard to
get my head around why are we having the scale of the problem that we
have to address and why can’t we get on top of it. So one of the things that
is quite helpful is actually to go out and understand that right. So, if you
look at, for instance, what we are doing in the centralised services where
files are checked by two people before they’re sent out to a client, there are
still breaches occurring after it’s been checked by two people. Now, some
of the files are as much as 10,000 to 15,000 pages long. They might have
been in place—the client might have been with the corporation for 40 or
50, or even longer, years. Some of the breaches—we count breaches that
weren’t breaches we’ve done, but, say, a doctor has put somebody else’s
information in a file that then goes onto our file and counts as a breach for
the corporation. The doctor happened to put onto a file information about
another client with the same name. It doesn’t matter how many times we check it; we’re not going to find the breach, unfortunately.

We have invested a very considerable amount of money and time and effort and our very best people to do the checks, but they’re still missing some of the things. We’ve cut quite a bit of it now. We think that in some areas we have cut it by 50 percent. But, you know, emails—we’ve cut back down the number of breaches that are happening in emails. But it’s very intensive. It’s pretty stressful on people doing the checks. We had a breach recently with one of our longstanding staff members, and she was totally distraught about it. We can only push them so far. There’s only so much they can do.

So we have systems that were built for a paper system. A lot of our files are still in a paper-based system. Until we can really move strongly into a digital world, it is really hard to support our people to fully deal with those breaches. How long will it take us to clean up the file—you know, the 80 million files that we have? I think it could take us a long time. It’s really frustrating when you look at it from the outside. It is heart-breaking to think of it from the client’s perspective. And it is soul-destroying for the staff who are trying desperately to deal to the breaches. So, yeah, I’m not satisfied with it, and my own fear is that if we’re not finding the right way to organise our staff and support them to get through those breaches as quickly as possible and get those files in a much more secure basis, then we’re going to keep working at it and finding people who can tell us how to do it.

We count as breaches other things like if we send an invoice for a levy to the wrong place. We count that as a breach. If we’ve got two employers who have the same name, or something, or if it goes to the wrong address, we count that as a breach. They’re not all medical breaches. And I’m not trying to discount it, but part of what’s happened in this process is we’ve said that any time a mistake is made, that the wrong information is sent to the wrong place, it will count as a breach. I’m sure, and we’ve told our staff, that we want them to come forward with the breaches. Until we surface all of them, we can’t really address the underlying issues that we have. I’m sure that we have surfaced far more than anyone ever knew about in the past, so, you know, when you look at where the opportunities for breaches to occur are, it is vast in the corporation, not just on any one day, but because of the length of the files and the life cycle over which many of our claimants are with the scheme.

It’s a big job, but I kind of think that one of the really positive things that is going to come out of this is when we looked at how we really get in front of this, we could look at it in terms of an information management problem, or you could take the opportunity to say: “Well, fundamentally what do we need to do in understanding that people are the real asset of this corporation, and their information with it?”. Put the customer at the centre of what we do, re-engineer business processes with that in mind, and take this opportunity, which hasn’t happened in the corporation for many decades, to really invest in re-engineering business processes around the customer at the centre of the business. Until we really do that and we have
the systems to support that, we won’t fix things properly and we won’t support our people the way they should be supported to do what they are trying to do for our clients. So, while I’m impatient with what’s happening in the short run, we are on track with the targets we set. I always think: “Gosh, we should have been able to get on top of it even faster.” We haven’t been able to.

Twyford You seem to be acknowledging that the numbers are still unacceptably high.

Rebstock They are unacceptably high. And any breach is unacceptable. But we have to move this ship at two points. We have to deal with the short-term issue, but we have to find the right business processes and the business strategy for the longer term, and we are going to have to invest in the corporation’s infrastructure in order to provide the long-term solutions. We know that.

Twyford I’d like to move on to the investment committee. Can you put a figure on the value of the funds that are currently under management?

May Yep. $20.5 billion is the last figure. I think it’s the biggest fund in New Zealand. There’s about $20.5 billion.

Twyford $20.5 billion?

Rebstock At the end of the year under review. It’s up a little bit higher now, isn’t it?

May Yep.

Twyford And how many members of the investment committee that manages the funds—how many have changed since May?

Rebstock Since May? All but—well we’ve got two external members of the committee, and they’ve stayed on the committee. Of the board members, we lost three of the committee members, and two of the board members are still on the committee.

Twyford So quite a big turnover?

Rebstock Yeah, three out of the seven.

Twyford How many meetings were cancelled or inquorate during the year under review?

Rebstock How many were cancelled? I don’t think any.

Bennett You might have to check. You don’t have to—

Rebstock I don’t know, but I don’t think any. I can check on that for you, but I don’t think there were any.

Twyford Does Trevor Janes chair the committee?

Rebstock He’s chairing the committee now.

Twyford And what has he disclosed about his involvement with Capital + Merchant Finance?

Bennett I’m not sure if—

Rebstock I can come back to you on that. I can’t tell you off the top of my head, but there has been a disclosure made.
Twyford Has he disclosed that he is being investigated by the Financial Markets Authority?

Rebstock He has made a disclosure. I wouldn’t want to guess at the exact nature of it, but we will come back to you.

Bennett Yeah, I think—

Twyford Does it concern you that a fund this big is being chaired by someone who is being investigated by the Financial Markets Authority?

Bennett I think we’ll just—

Clark Are you shutting that down, are you?

Bennett No, no. If you want to speak, you put your hand up, but—

Twyford We’re talking about $20.5 billion.

Bennett No, no, Phil. Just wait, OK? It’s just that committees are public, as you know, and sensitive issues like that—I think we just need to take a bit of time. I’m not shutting your question down or anything like that.

Twyford Well, I think it’s a matter of public accountability, and I’m asking the question.

Bennett Yes, I know, but it has to go through the chair. I don’t know whether you can or can’t answer it, Paula and your team, I just want to give you a chance on what’s the appropriate mechanism for that to be answered, OK?

Rebstock I would like to come back and answer it in detail. I would say that I know that when the appointment was made, the officials involved did due diligence on that, including talking to the authority, so I have been given assurances about the appropriateness of having Mr Janes chair that committee. So I probably can’t say anything more than that, but it is something that was investigated prior to him coming on to the board.

Twyford The matters I raised?

Rebstock Yes. It was.

Twyford The Financial Markets Authority investigation and his role in Capital + Merchant Finance were disclosed and discussed?

Rebstock Those issues were disclosed and discussed.

Bennett If you want to come back to us, Paula, with that.

Rebstock I’ll check just to make sure that if there is any more information I can give you, I am really happy to do that.

Twyford Thank you. The accredited employers scheme—how often are employer schemes audited?

Rebstock Every 2 years.

Twyford Every 2 years? OK. And how does ACC assess the requirement that an employer will be able to meet its expected financial obligations that it is solvent and financially sound?
Rebstock  I might just ask, if it’s all right, Chairman, for someone who has the detail of that, if you wouldn’t mind.

Beaglehole  Thank you, Paula. Yes, we’ve got a series of tests that we use to run across the solvency of the various companies who are in the AEP scheme. There are some companies, whose finances are felt to be significantly complex—for those we use an external auditor. Otherwise it’s a test that is done by ACC staff.

Twyford  When was the last audit of Mainzeal?

Beaglehole  Approximately 2 years ago.

Twyford  And as a result of that audit Mainzeal continued in the scheme as an accredited employer?

Beaglehole  Yes, they did.

Twyford  What’s the expected cost to ACC of picking up Mainzeal’s liabilities?

Beaglehole  That cost is yet to be calculated. There is some outstanding levy. On the other hand, they were up to date with their levy payments until late January. It’s not unusual for employers in the accredited employers scheme to be on a time-payment scheme, simply because the amount of money that is required is quite large. So they prefer to pay that over time. There will be some money coming from their claims coming back to ACC. There’s not a terrific number of claims involved. Those will need to be actuarially assessed, but we don’t envisage that that would be a large sum.

Twyford  Can you put a ballpark figure to it?

Beaglehole  No.

Rebstock  We have moved very quickly to accept responsibility, because we would have eventually got there, and we did not want to add stress to any injured workers out there about their coverage. It might have been ideal to have all that information at the point we made that decision, but at this point in time the right thing to do is to look after the injured workers, and that’s what we intend to do. But if we can get that information for you, we will do so.

Twyford  Given the quite extensive commentary about Mainzeal’s finances—it’s been in the public domain since the company went into receivership—do you have any reflections on the auditing process? I mean, I know hindsight’s a very precise science.

Rebstock  I think it is one of these things where the corporation will need to debrief it and see if there are lessons we have to learn in terms of it. Obviously the time frame over how often you want to do the audits come to mind, or whether there should be some triggers that might lead to greater frequency of audit if certain circumstances occur. But, to be honest, we haven’t got to that point right now. We’ve simply been focused right now on picking up the clients and making sure that they’re being looked after. But, you know, this is something where we need to, obviously—the corporation doesn’t like being in a situation where other levy payers are, in a sense, going to pick up
the cost of this now. But that is part of the scheme, and we provide for that, and we have to provide for it. We will look at—you know, we will have to debrief this and see if there are any lessons from it.

O'Connor I just want to have you touch on the elements of engagement that you have out in the community. One of it is around the accredited employers programme and how you see that developing. Are more coming on board? How are you engaging with the health care sector in the wider sense? You are a conduit of health care, and that provides you, I suppose, some leverage in the health care market. Then, just a linkage into that, too, in terms of that information exchange, whether the work’s beginning, with the GPs and so forth, to use a digital management of information across to you, rather than by email and so forth? So it’s those engagement protocols that you have at the moment.

May I think that’s one of our big challenges going forward—is to make it easier for a GP or a surgeon or a provider to decide whether or not the claim they’re putting in is one that meets the ACC criteria. I think the whole digital process will assist in doing that because there will be instant interreaction. So we are gradually building that facility to do that. It is one of our strong ambitions going forward. I think one of the reasons for the fact that there are quite a high number of surgeries that we don’t go ahead with is because of a lack of understanding at that stage. We can improve that.

So, yes, we are also looking—I mean, we’re not really into the Facebook age as an organisation yet, but we’ve started. We started doing some work on Facebook on injury prevention as a communication mechanism. We’re about to, in terms of setting up forums with clients, as well, to do that—and that, again, is a big way forward. The digital age is, in the long run, going to be a big contributor to assisting us to solve once and for all the privacy problem, because you’ve got password access and things like that, rather than having to email stuff out. It’s going to make a big difference, but it’ll take time. It will take time to get there.

O’Connor I assume, like a digital conduit, it is not going to just remove all the problems that you have with paperwork, but are you engaging with best practice overseas, and there are some rather large, in this case, private health insurance—Kaiser comes to mind. But are you looking at best practice and how they’re managing client files and so forth?

May I think the response of the organisation to privacy has probably been—and I ought to put this context, because I’ve just arrived at the organisation in the last few months—as wide as anything I’ve ever seen. It was taken very seriously, both in terms of the response of the staff—people, as Paula said, get very devastated where things go wrong in terms of setting of short-term measures. But one of the things that didn’t change—you’re right—is the systems didn’t change and the volume of transactions didn’t change, and the quality of some of the historical data. So in order to address that, we recognised that we need to do something really big. So we’ve started on this big transformational programme, and we are in the process of engaging an international partner with lots of international experience in this area in
order to help us map out that path over the next few years. But it will take

time.

O’Connor Oh, and that’s quite understandable. I think that is the positive there: that
you are engaged in looking.

Rebstock Can I come back to this health—how we engage with health providers—
because I think there is a lot of potential there. We’ve been developing a
few strategies recently with parts of the medical profession and I think
what we’ll find is if they help us prepare the guidelines for the professionals
in their group on what constitutes an ACC claim in that particular case. So,
for instance, if we think about traumatic brain injury claims or, in the
orthopaedic area, the sort of gradual process - type injuries that really are
hard ones for the corporation to deal with—if we engage with the
profession to help us come up with the guidelines and those guidelines are
far more likely to be in sync with the way the medical profession thinks
about and approaches an injury, I think we can do quite better in that space.

Now, we’ve got a couple of those initiatives under way, and I think that’s
the way of the future for us. You know, we’ve to get the buy-in of the
medical profession at the beginning, not when it comes time to make a
difficult decision. It’s too late then if the relationship isn’t built and they
haven’t bought in to what the corporation is trying to do. If we use their
expertise and we draw them in to work alongside us, I think we’ll get a
much better result, and that’s certainly some of the early indications of what
we’re seeing.

O’Connor So you’re finding this positive engagement with the various colleges, like
physicians and orthopaedics?

Rebstock Yeah. But, you know, the critical thing with that is to engage early and let
them be involved in the initial phase of setting the guidelines. Don’t just try
to get them involved once you’ve got a problem and everyone’s unhappy
with the way you’re interpreting the legislation. This is, you know, a
common theme you get across all of Government. You often hear this: why
don’t they engage us early? If they engage us early, we can help them find a
way to make this work in a way that meets the doctors’ requirements to do
what’s best for their customer, and meets the corporation’s desire to live
and work within the boundaries of its legislation and also help rehabilitate
people. But it really means going back to the beginning of the process when
you set down the guidelines on how to think about the services you’re going
to provide under what circumstances.

O’Connor I think that’s incredibly positive. Just on the third part of the question
around the accredited employers side of things, are the numbers of those
employers increasing?

Rebstock They are pretty steady.

May But one of the things we are looking at doing—but we haven’t actually
made that decision yet because it’s still got to go up through the various
approval processes, I think, including the Minister—is extending the
scheme to cover non-work related accidents. So the same people who are
administering the injury in respect of both work related and non-work related accidents. So we’re looking at doing a trial, and that’s a service, really, using the same people to provide the service. The liability still ends up with the ACC, quite obviously. But that’s promising. That’s the most promising way of looking at extension.

Rebstock That’s one where we really have to consult and demonstrate that we can manage the interests of the injured person who has a non-work injury right. So there are some issues around satisfying people—what information goes to the employer—so we have to be able to satisfy people that the employer won’t get information they shouldn’t get about non-work injuries. So the onus is on the corporation to establish that that can be done in a safe and appropriate way. So it’s a complex area but there is potential there, but it has to be handled.

O’Connor I suppose it highlights the whole intricacies that we’ve been talking around privacy and all—but I’m conscious there are other questions. Thanks, Mr Chair.

Hague Can I begin, first of all, by saying I’ve probably been ACC’s harshest critic, and I want to begin, therefore, by saying that I really appreciate the tone and nature of the presentation you’ve given to us today. And, in particular, I contrast that with the approach of your predecessor to this committee, and certainly the sequence that you’ve addressed the issues in, the time that you’ve taken, suggests that there is an encouraging goodwill towards the kinds of changes that are necessary. And, as you know, it is actually the delivery that will make the difference to those trust and confidence measures.

There are several issues that I want to traverse if I can. Mainly for the continuity’s sake I’ll pick up on one that was related to one of Simon’s questions. In your “Return to Independence” slide, where you look at the 70 and 273-day rates, there’s an obvious dip and then rise in the 09-10 year. My contention, and I’d be surprised if anyone disputed it, would be that that coincided with the project that Denise Cosgrove led around reinterpretation of the Act and therefore entitlement under the Act. Now, in the various streams of that project the only one, so far as I’m aware, that has been independently assessed for whether it was done appropriately or not is in the sensitive claims area, which was the Barbara Disley review.

So there’s two parts to the question. One is in the report last year on progress with implementing Barbara Disley’s recommendations; progress had been poor to date, overall. Where’s ACC at in implementing those recommendations now? And the second part is, in relation to all of the other areas where the statute’s interpretation was changed in that process, is there now a commitment to independent review of those?

Rebstock In terms of the sensitive claims area, there were areas where the progress had not been what we would hope for and we have focused on that. We have seen some really good outcomes in terms of early access to counselling. So that uptake has gone up really considerably, and I think in terms of one of the things which she pointed out to us in terms of impact
on clients and how fast they are able to move forward, that was a critical issue and we’ve certainly seen very strong results in that. What impact, ultimately, they’re having, it’s too early to say, but we know the uptake is strong and we’re pleased with that.

One of the other areas that we weren’t as effective with some groups of the population than others—so, for instance, a big concern of mine is we really seem to be underperforming in assisting people with sensitive claims and I don’t think that we’ve got to the bottom of that in the way that we need to. I suspect, but I’m not certain, but I suspect that there’s an overlap there generally with the way the corporation performs for Māori claimants across the whole of the scheme, so we know that we don’t do as well in that space as we need to.

So we are still developing our response on that. We did decide to have Dr Disley come back again and do another review. So I think it’s really important that we keep doing those, since she’s done a fantastic job for us, and I’m not satisfied yet that we’re where we need to be on sensitive claims. To be honest with you, I think, for a period, I have the impression for the scheme it felt like an odd fit having sensitive claims within the corporation, if I’m honest with you. I think we’re over that now, and, if we’re not, we’d better be soon. But, you know, I think probably we’re slow to really take responsibility and lead on this in a way that gets as quickly as we could the best outcomes for these claimants. I see a different attitude in the corporation. So I see a willingness to invest in helplines and in other things that really will make a difference to these claimants and I don’t think we saw that in the past.

But my own view is we need to continue to do the audits because we’ve got some distance to go and it’s an area we simply—no one in this country would want us to underperform for a single client in that group. We must, absolutely must, deliver for them. We have to look at them like we look at serious injury claimants. We want to be in a space where even more sensitive claimants are positive about the corporation and what it does for them if they receive a serious injury, because we understand the need that is there, and we respond to it appropriately, so we will continue to do that.

In terms of other areas, you know, the board itself is very clear about people’s entitlement. A person who has an entitlement under the Act, they are to get services, and be no question about that. So in some places we may do independent reviews; in other places we will do reviews ourselves and adjust our policy. But one thing’s for sure. You know, we have to have a culture in the place that learns from its mistakes and understands that it must adjust. So if we lose a court case, you know, there must be a means by which all of our case managers learn from that and adjust. If we lose a dispute, the same thing has to happen and if we have to do root cause analysis so we understand “Do we have a systematic problem here?” or is it a one-off. And if it’s a systematic problem, then, you know, chances are we have to go right back to culture and attitude and process. You know, we’re going to have to work our way through the whole chain of what influences
the way somebody approaches the issue. So can I commit to doing an independent review in all cases? Probably not—

Hague Sorry to interrupt you, it’s just the length of your answers is—I wonder if perhaps you could come back to the committee with an indication of the areas in which ACC will commission an independent review of the reinterpretation of the Act. Because, as you are probably aware, medical specialists in the areas of head injury, orthopaedics, and so on actually have big issues with that interpretation. So if you could commit to come back to the committee on it.

Rebstock I’m happy to come back to you. Dealing with that issue, there’s more than one option. There’s more than the option of independent reviews.

Hague Can I move to the—

Bennett Perhaps, if you’re to come back, you don’t have to specifically answer that question in the response, but just give us the—

Rebstock Yeah, I’m really—

Hague So the next question is relating to the same slide, because what you’re tracking there is what you call return to independence. I’m interested to know what “independence” is and why you’ve used that rather than the “durable return to work”, which you’ve used in the comparison with Australia.

Rebstock We use both measures.

Hague So, if we were to, instead of “Return to Independence” on this slide have a graph of “Durable Return to Work”, what would that graph look like?

Rebstock Well, I gave you the durable return, so the return to work percentages are 85 percent and the durable return are 80. So I think—

Hague But independence isn’t return to work, is it?

Seymour Perhaps I can assist with the definition. When we say return to independence, it means to return someone to the maximum possible levels of independence, but the phrase “Return to Independence” is a catch-all phrase that covers everybody, including people who work and people who are not in paid employment, such as children and superannuitants. The return to work description only applies to those people in paid employment at the time of their injury. We also have to consider that for some of our seriously injured people, they may not ever return to exactly their previous work, so that’s one of the reasons why we use the phrase return to maximum levels of independence. Our role is to support their return to maximum levels of independence as fast as possible, so that we can reintegrate people back into their previous lives as soon as possible.

Hague Yeah. So it would be great to actually see for those claimants who were in work prior to their accident what the graph looks like for those claimants and how independence, return to independence, relates to whether they actually return to durable work. I mean, I’m conscious of the time, Mr Chair, so if I ask you one more, which is in relation to an area that I was
pursuing last year and that was ACC’s use of specialist medical advisers. I think it’s generally been conceded that the way that ACC has contracted with specialist medical advisers has been problematic, at least. Is ACC going to pursue contracting with DHBs or with professional medical organisations to provide specialist medical advice instead of the direct contracts that ACC currently has?

Rebstock I’m not sure if we’ve looked at DHBs, but I’d be surprised if that would—maybe it’s as part of a solution, but part of our goal is to move quickly and I’m not sure the DHBs would meet the time frames that we have.

Hague You already have contracts with DHBs—

Rebstock Yeah, we do.

Hague —and they already have specialists.

Hague So it would seem to be quite a quick and easy way to solve the problem.

Rebstock We have looked at this area, and we can come back to you, and I’ll check with our staff whether we’ve looked at those particular options. We have spent quite a fair time on this one, actually, because we felt that issues came out of it that did raise some questions—serious questions—for us and we have looked at it. Some is about how we contract and we want to do better in that space. We want to have more medical specialists that we can turn to. If I put my competition hat on, I’d like to have a bigger pool that we can draw from. The other thing—

Hague There are hundreds on your list.

Bennett Perhaps if Paula came back to us on that. That might be the best way at the moment.

Rebstock The one think I would say that has made an immediate difference is when contact our clients now and we send them to a medical specialist to have an assessment done, we inform them immediately in writing that if they are not happy with who we have sent to them, they can have an option of two others. And we’re seeing quite a positive response to that. I mean the policy was there but no one was told it was there and they have been told now. So we’re looking at both a combination of those sorts of things that can be easily and quickly done, and we’ve seen a big response to it, but we’re also looking more broadly about how to improve the contracting.

Auchinvole Paula, thanks very much for the presentation. I have a particular interest in Christchurch and I go through it quite a lot. There’s a huge level of physical activity there at the moment. I remember reading some reports that specify there will be accidents because of the sheer volume of activity. What strategies does ACC have—because you’ve talked about prevention; you don’t cause the accidents so I guess it’s all got to be at arm’s length stuff, incentives or penalties, or whatever—and did you draw information from London’s building the Olympic village and that sort of thing?

May I’m not sure about London’s building of the Olympic village—
Beaglehole: Yes, we did.

May: Yes, we did. I am now sure.

King: Instant recall.

May: Instant recall, yeah. We are being quite proactive in this area. I mean, we’re doing a lot of work down there with contractors to actually educate, get the information out on safety standards. We’re doing a lot of work with the Canterbury Rebuild Safety Forum, in terms of getting statistics out there, in terms of communication. We see it as a major opportunity, not necessarily to do something new, but just as a concentrated effort where we can actually go out and really hammer the message on what safety is. So we are being very proactive both with individual companies and with getting around to those companies and with the health and safety workforce down there. So we are trying very hard.

Auchinvole: Just finally, Mr Chairman, I know there was quite an effect with the earthquake on ACC. Has that plateaued out?

Rebstock: You mean—

Auchinvole: Well, with the—simply the event itself put strain and stress—

Rebstock: I think it would have, like with all Government agencies, but if I think about where we’re at, I’ve never heard that it in any way was something we couldn’t respond to effectively. So, you know, the corporation really demonstrated a high degree of resilience in our ability to respond.

The critical thing for us right now is to be working alongside the building sector and others in Canterbury, so that as the rebuild happens a different approach to health and safety is taken and we can work with people. So it’s really critical that we do that right now. I saw some of the housing projections on what needs to happen in Christchurch, and we’re working really well with the big companies. But they’ll start pulling in contractors or subcontractors and some of the smaller players will come in, and we know in the building sector almost half the accidents happen with the small players. So we just have to keep extending out the reach of the work that we’ve found easy to do with the large players. We need to actually draw that down through into the subcontractors and into the smaller players.

So I think it’s an exciting opportunity for us because it’s one of these—you know, it provides a chance for us to do new things in a more innovative way and the market’s ready for it. Like in many areas of government right now we’re trying new things in Christchurch, and we’re thinking “Well, why don’t we do that?”.

Clark: I’ve got a question about the discount rate. ACC adopts the Treasury prescribed discount rate—this is presumably for future liabilities planning. What would the difference be or the value of the difference be if the ACC adopted the cost of lending to the Government for that liability?

Dosser: Yes, so the discount rate which currently applies is a combination of the short-term yield curve and the long-term rate set by Treasury. If you
changed the long-term portion of that, I think a 1 percent, sorry 0.5, percent movement is around $700 million ______[inaudible].

Clark So, sorry, what is the average effective rate of that for future liabilities of the Treasury rate?

Dosser The average rate is around 4.3 percent.

Clark And the cost of borrowing for the Crown is what, roughly, at the moment?

Dosser I’m not sure, but the Government bond rates sit at around 3 [inaudible]

Clark Yeah, so there’d potentially be $1 billion worth. The future liabilities would be valued at about $1 billion less, roughly, if the cost of borrowing was used rather than the Treasury discount rate?

Dosser [inaudible] the opposite, so as the discount rate falls, the liability increases.

?: Because you’re discounting the future payment. So the lower the interest rate, the higher the liability. You’re discounting a future liability to pay.

Calder Thank you very much, Paula. You mentioned that you were very concerned about the trust and confidence being about 45 percent. But I note that customer satisfaction is much higher, at 70 percent approximately. Any comments as to why there should be this difference? So the clients are expressing with satisfaction with what you’re doing at 70, yet the public say, when they are asked, much lower.

Rebstock You know, we’ve looked into this a bit. In a way it’s not surprising that people who are dealing with the corporation are basing their view primarily on their interaction with the corporation in real time. But in the survey of trust and confidence when we asked them what has influenced their level of trust and confidence the biggest factor has been what they’ve heard in the media about the privacy breach. So it’s really clear to us that if we want to regain customer confidence we have to deal with this. So the survey is clear enough to alert us. I think it’s 28 percent, which was the single biggest influence on the way they think about the corporation has been what they’ve learnt in the media about the privacy breaches. So the emphasis here isn’t the media, don’t get me wrong. It’s the breaches. The public are concerned about it and—it’s really clear in the detailed results—that is what has had a major impact on trust and confidence.

Calder Client satisfaction has been reasonably stable at 70—OK—and over a period of time. Any strategies particularly at trying to raise that, over and above the trust and confidence issues?

Rebstock Yeah, I mean, the four pillars that we’re working on, we actually think will all work towards that. The key one really is communication with the customer, and we’ve got initiatives across the board. The initiatives around the customer in the centre of the business and designing work processes that support that are critical.

My experience in this is, and I experienced this when I was at the Commerce Commission, when you get those things working well together you kind of hit a tipping point where you can sort of jump from—if you
look across lots of Government agencies they sit at about 60 percent. When they kind of find the sweet spot where you get those things all working well together, you’ll see it tip suddenly to, like, 80 percent. You know, the police, see they’re at about 80 percent right now. We had that experience at the commission. We tipped from 60 percent to well over 80 percent at some point, and people often would say to me: “What did you do right?” I always said: “Well, we changed about a thousand small things.” There is no single lever you can pull, I’m afraid, and the corporation is really aware of that. So I wish I could give you a simple answer about the things we need to do in order to kind of get to that tipping point, but we’re really focused on it and I think we do understand the dynamics of it, and I think the four pillars that we’re focusing on, the combination will give us that.

Bennett Thank you Paula and David, and your team. We really appreciate the way that you’ve come in here today and answered the questions, and also your presentation as well. David Clark still doesn’t understand that financial stuff, so would you be able to put that on the list of things that you’d be able to give us information on?

May Yeah, sure.

Clark I’d like to get a sense of the sensitivity around that for future liability. Thank you.

May Yeah, sure. It should, in theory, be the same, but—

conclusion of evidence
The Education and Science Committee has conducted the financial review of the 2011/12 performance and current operations of AgResearch Limited, Career Services, Careers New Zealand, Education New Zealand, Landcare Research New Zealand Limited, the Institute of Environmental Science and Research Limited, the Institute of Geological and Nuclear Sciences Limited, the New Zealand Forest Research Institute Limited, The New Zealand Institute for Plant and Food Research Limited, and the New Zealand Qualifications Authority, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Colin King
Deputy Chairperson
2011/12 financial review of Airways Corporation of New Zealand Limited, the Civil Aviation Authority of New Zealand, the Maritime Safety Authority of New Zealand, and the Transport Accident Investigation Commission

Report of the Transport and Industrial Relations Committee

The Transport and Industrial Relations Committee has conducted the financial review of the 2011/12 performance and current operations of Airways Corporation of New Zealand Limited, the Civil Aviation Authority of New Zealand, the Maritime Safety Authority of New Zealand, and the Transport Accident Investigation Commission, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

David Bennett
Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance of the Alcohol Advisory Council of New Zealand, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
The Primary Production Committee has conducted the financial review of the 2011/12 performance and current operations of Animal Control Products Limited and Quotable Value Limited, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Shane Ardern
Chairperson
The Government Administration Committee has conducted the financial review of the 2011/12 performance and current operations of the Arts Council of New Zealand Toi Aotearoa, the Museum of New Zealand Te Papa Tongarewa Board, the New Zealand Film Commission, and the New Zealand Fire Service Commission, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Hon Ruth Dyson
Chairperson
2011/12 financial review of AsureQuality Limited

Report of the Primary Production Committee

Contents

Recommendation 2
Introduction 2
Financial performance 2
Software update 2
Meat inspection regulation changes 2
Overseas investment in food safety 3
Imported seed inspection 3
Future expansion 3
Appendix 4
AsureQuality Limited

Recommendation
The Primary Production Committee has conducted the financial review of the 2011/12 performance and current operations of AsureQuality Limited, and recommends that the House take note of its report.

Introduction
AsureQuality Limited, a state enterprise and a registered company, is a provider of food safety and biosecurity services. It is responsible to the Minister for State Owned Enterprises, and the Minister of Finance. Its chief executive is Michael Thomas, and the chair of the board of directors is Janine Smith.

AsureQuality owns six subsidiaries (AsureQuality Asia Pacific Limited, AsureQuality Australia Pty Limited, AsureQuality Singapore Pte Limited, AsureQuality Holdings No. 1 Limited, AsureQuality Holdings No. 2 Limited, and AsureQuality Holdings No. 3 Limited) and has a 60 per cent holding in Global Proficiency Limited and Global Proficiency Pty Limited.

Financial performance
In 2011/12, AsureQuality’s total revenue was $154.368 million, the cost of sales was $102.396 million, and operating expenses were $41.689 million, resulting in a profit after costs and tax of $10.283 million.

Software update
We were advised that AsureQuality’s laboratory software was updated during the period to meet international standards, and the company is preparing for efforts to persuade the EU and the USA to accept New Zealand meat exports following changes in New Zealand’s meat inspection regulations.

Meat inspection regulation changes
New meat inspection regulations allow trained meat company inspectors to check product for issues unrelated to food safety or quality. At present these assessments are among the AsureQuality meat inspectors’ duties. The change will make the New Zealand meat inspection regime consistent with that of other countries, but will have revenue and employment implications for AsureQuality.

AsureQuality’s annual revenue from meat inspections is currently around $45 million, but a fall in revenue to $22 million is projected once the full impact of the changes is felt in 18 months’ to two years’ time. At present 700 meat inspectors carry out equal numbers of food safety inspections and meat quality inspections; after the full implementation of the changes, AsureQuality will retain some 300 inspectors who will carry out food safety inspections only. Two meat plants have adopted the new regulations so far and three more...
will do so over the next few months, resulting in 21 redundancies at AsureQuality. Some of these inspectors have been employed by the meat companies.

AsureQuality has been advising meat companies for several years on the regulatory changes and has intensified its efforts in the last year to help the adjustment process. The company is unsure if the process will result in financial or efficiency savings for the meat industry overall, but concedes that using trained meat factory workers as inspectors will introduce more flexibility to the industry workforce.

We heard that some stakeholders have expressed concern about the changes, arguing that New Zealand is sacrificing its commitment to quality assurance and food safety; but this is very much a minority view and the company is satisfied that the quality of inspection will not suffer under the new regulations.

**Overseas investment in food safety**

We heard that AsureQuality’s overseas investment in and development of laboratory work involved both risk and opportunity. So far, the results from establishing a laboratory in Singapore employing 35 staff have been positive, and it has built a good reputation among the multinational companies in the area including Fonterra. Investment in Australia is also showing positive returns and AsureQuality is investigating investment in China and Saudi Arabia. The company said it is confident it has the right disciplines, governance, and management structures to succeed in overseas markets, despite risks arising from different employment and commerce laws and working cultures.

**Imported seed inspection**

We were informed that AsureQuality collaborates closely with both the Ministry for Primary Industries and the Customs Service on imported seed inspection, and provides a service at a technical level. AsureQuality is accredited to international standards, in areas including the inspection and assessment of genetically modified seeds and crops.

**Future expansion**

With changes to the meat inspection regulations and growing investment overseas, AsureQuality’s income streams are changing, and it sees opportunities to expand its operations to provide a “one-stop-shop” for inspection and food safety services. The company is investigating these possibilities, and hopes to discuss options at board meetings.
Appendix

Approach to this financial review
We met on 6 December 2012 and 31 January 2013 to consider the financial review of AsureQuality Limited. We heard evidence from AsureQuality Limited and received advice from the Office of the Auditor-General.

Committee members
Shane Ardern (Chairperson)
Steffan Browning
Hon Shane Jones
Colin King
Ian McKelvie
Hon Damien O’Connor
Eric Roy

Evidence and advice received
Office of the Auditor-General, Briefing on AsureQuality Limited, dated 6 December 2012.

Organisation briefing paper, prepared by committee staff, dated 26 November 2012.

AsureQuality Limited, Responses to the committee questions received 3 December 2012.

AsureQuality Limited, Responses to additional committee questions, received 20 December 2012.
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Auckland District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
# 2011/12 financial review of the Bay of Plenty District Health Board

Report of the Health Committee

## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation</td>
<td>2</td>
</tr>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Financial and service performance</td>
<td>2</td>
</tr>
<tr>
<td>Health disparities</td>
<td>3</td>
</tr>
<tr>
<td>Research and development</td>
<td>3</td>
</tr>
<tr>
<td>Innovation</td>
<td>4</td>
</tr>
<tr>
<td>Oral health</td>
<td>4</td>
</tr>
<tr>
<td>Heart and diabetes checks</td>
<td>5</td>
</tr>
<tr>
<td>Appendix</td>
<td>6</td>
</tr>
</tbody>
</table>
Bay of Plenty District Health Board

Recommendation
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Bay of Plenty District Health Board, and recommends that the House take note of its report.

Introduction
The Bay of Plenty District Health Board (DHB) has the second-fastest-growing population in New Zealand, of approximately 214,170 people spread throughout Tauranga, Katikati, Te Puke, Whakatane, Kawerau, and Opotoki. Its eastern and western districts have distinctly different demographics in terms of average age, ethnicity, and socio-economic status.

The DHB has the highest percentage increase in people aged over 65, and a higher proportion of Māori, and a lower proportion of Pacific peoples than the New Zealand population generally. The DHB funds and provides primary and secondary health services, and receives tertiary services, mainly through the Waikato and Auckland DHBs. It operates the Tauranga and Whakatane hospitals.

Financial and service performance
In 2011/12, the DHB’s total revenue was $639.732 million, with a total expenditure of $639.706 million, resulting in a surplus of $26,000.

The Office of the Auditor-General (OAG) rated its management control environment and financial information systems and controls as “good”. Its service performance information and associated systems and controls were assessed as needing improvement. All results were the same as those from the previous year.

Annual report
The OAG found a number of deficiencies in the DHB’s annual report, including a lack of performance information such as impact and outcome reporting. The OAG recommended that the DHB provide a clear and comprehensive account of their performance, and include impact and outcome performance information in their 2012/13 annual report. We note improvements in the performance framework in the 2012/13 statement of intent and expect to see better reporting in the 2012/13 annual report.

We are disappointed that the DHB had not included any information on microbiology laboratory testing, considering that this has been a contentious issue, with 4,142 members of the community signing a petition urging the DHB to reinstate the routine microbiology department at Whakatane hospital. We have written a separate report in response to this petition. The DHB assured us that the Whakatane laboratory has consistently complied with timeframes required in its contract, as it did the previous year. We expect to see figures demonstrating this compliance in the 2012/13 annual report.

We also note that service performance information was reported differently from previous years, making it difficult to compare current with past performance. The DHB is
improving the linkages between reporting systems to allow seamless tracking and reporting against the measures set out in the report.

**Health disparities**

The OAG reviewed the 2010/11 annual reports of DHBs and found that the overall lack of information on Māori health needs and related targets made it hard to gauge progress on reducing disparities. We note the DHB intends to report performance against its 2012/13 Maori health plan in its 2012/13 annual report, and has shown its commitment to reducing the health disparities for Māori by appointing a manager with responsibility for Māori health. We are aware that health indicators for the Bay of Plenty population show significant disparities for Māori, including substantially worse indicators regarding asthma, oral health, and teenage pregnancy among Māori children and young people.

**Breast and cervical screening**

The DHB said it has seen a substantial improvement in breast screening rates recently, and is applying universal interventions to ensure improvement throughout the population. The DHB recognises the disparity between Māori and non-Māori women for breast and cervical screening rates, and is targeting intervention. In March 2012, 58 percent of eligible Māori women had been screened for cervical cancer, compared with 86.4 percent of non-Māori women. In July 2012, 54 percent of eligible Māori women had been screened for breast cancer, compared with 67 percent of non-Māori. We also heard that the DHB is collecting data by ethnicity to monitor performance against the Māori health plan, in order to report to the board quarterly. We would also like to see the DHB disaggregate results by ethnicity in future annual reports so we can monitor disparities more easily.

**Te Kaha**

Te Kaha is a remote area on the East Cape, with a population in winter of 1,500 most of whom identify as Māori. We understand that Te Kaha has had difficulty attracting general practitioners because of its physical isolation, yet has achieved close to 100 percent coverage in breast and cervical screening, and immunisation. We asked the DHB what contributed to this success, in order to establish whether particular measures could be used more widely. We heard that the general practitioner maintains a close relationship and connection with whanau, and is supported by a large team of nurses embedded in the community. The DHB told us they have invested in the education of the nurse practitioners by paying them for full-time hours while allowing them to work in the community part-time, and using the rest of the week for education and training. We would like to congratulate all those involved.

**Research and development**

In 2011 we carried out an inquiry into New Zealand’s environment for clinical trials, which resulted in the establishment of an innovation hub to foster development in this area. We asked how the DHB is contributing to health research and development, and heard that the DHB has two multi-disciplinary clinical schools, one operating in Tauranga under a “mainstream” model, with the other in Whakatane focusing on rural training. The clinical schools collaborate with Auckland and Waikato universities and provide opportunities for learning, teaching, and research.

The DHB also recently had its research on the sterilisation of surgical instruments published in a neuroscience journal. We are pleased with the DHB’s efforts in this area.
Innovation

Ward Views

We are impressed with the Ward Views system, which provides screen snapshots of ward and staffing capacity in Tauranga and Whakatane hospitals. The system is updated every 12 minutes to allocate resources more effectively, and provides real-time, graphical reporting of the status of every patient, ward, theatre, and emergency department of both hospitals. It operates alongside the operations centre, a clinically-led initiative that helps staff ensure safe staffing and an appropriate quality of care.

We understand that the operations centre also evaluates performance from previous days, anticipates and responds to demand today, and forecasts demand and pressures for the following day throughout the system. We are pleased with the many benefits Ward Views brings to the DHB, such as shorter emergency department treatment times, shorter stays for inpatients, more throughput in operating theatres, and more flexible staffing arrangements.

We were told that Ward Views has already delivered efficiency savings of $436,000 over the financial year, and $2.24 million has been saved by reducing the average length of stay, with further savings forecast. We wish to congratulate the DHB on developing Ward Views in-house at a much lower cost than purchasing a similar system, and gifting the technology to four other DHBs.

Bay Navigator

The DHB also explained another innovative development called Bay Navigator, an online tool for hospital clinicians and general practitioners to plan patients’ treatment. The major benefits are streamlined treatment for certain conditions, faster access to information to support clinical decisions, and fewer acute presentations to emergency departments. The emergency department has already seen a 1.5 percent reduction in emergency department presentations thanks to the implementation of Bay Navigator.

Oral health

We are aware that the DHB has spent $6.4 million to upgrade fixed facilities, build new facilities, and commission mobile units for oral health care, and we are pleased with the DHB’s detailed reporting on oral health services. The DHB told us that thanks to concerted efforts in this area rates of attendance by Māori school aged children at oral health clinics are better than those of Pākeha children.

We heard that the mobile clinics often see adolescents during school holidays and proactively follow up children who are falling below the target of seeing a dental therapist every 12 months. The monitoring is conducted via the Titanium clinical information system, which has improved data tracking and performance monitoring. Staff are also given a clear direction to prioritise treatment of children whose care has lapsed beyond 12 months.
Heart and diabetes checks

We recognise the commendable performance by the DHB in achieving the best results of all DHBs in the new heart and diabetes checks health target for the first quarter in 2012/13. The DHB told us this was done by strong partnerships with the Primary Health Organisations.
Appendix

Approach to this financial review

We met on 12 December 2012 and 30 January 2013 to consider the financial review of the Bay of Plenty District Health Board. We heard evidence from the Bay of Plenty District Health Board and received advice from the Office of the Auditor-General.

Committee members

Dr Paul Hutchison (Chairperson)
Shane Ardern
Dr Jackie Blue
Dr Cam Calder
Kevin Hague
Iain Lees-Galloway
Andrew Little
Barbara Stewart
Hon Maryan Street
Dr Jian Yang

Evidence and advice received

Bay of Plenty District Health Board, responses to questions, received 10 December 2012.

Bay of Plenty District Health Board, responses to additional questions, received 17 January 2013.

Office of the Auditor-General, Briefing on Bay of Plenty District Health Board, dated 12 December 2012.

Organisation briefing paper, prepared by committee staff, dated 26 October 2012.
The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of the Broadcasting Standards Authority, the New Zealand Venture Investment Fund Limited, the Real Estate Agents Authority, and the Testing Laboratory Registration Council, and has no matters to bring to the attention of the House.

We acknowledge and appreciate the efforts that these entities have gone to in order to provide relevant and detailed information. Given the size and resource base of some of these entities, we acknowledge the information that they provide contributes to the parliamentary process of accountability and transparency.

The committee recommends that the House take note of its report.

Jonathan Young
Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Canterbury District Health Board. We recognise the commendable way that the DHB has handled the extraordinary circumstances it has been faced with in the aftermath of the earthquakes. We would also like to congratulate the DHB on maintaining high standards of care, and their performance against health targets. We have no other matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2011/12 financial review of the Canterbury Earthquake Recovery Authority, the Earthquake Commission, and the non-departmental appropriations for Vote Canterbury Earthquake Recovery

Report of the Finance and Expenditure Committee

Contents
Recommendation 2
Introduction 2
Canterbury Earthquake Recovery Authority 2
Recovery plans and rebuilding progress 2
Zoning issues 3
Earthquake Commission 4
Review of the Earthquake Commission Act 1993 4
Reinsurance arrangements and costs 4
Affordability of insurance 5
Settling claims 6
Managing repairs 6
Complaints 7
Risk of fraud 7
Non-departmental appropriations 8
Appendices
A Committee procedure 9
B Corrected transcript 10
Canterbury Earthquake Recovery Authority, the Earthquake Commission, and the non-departmental appropriations for Vote Canterbury Earthquake Recovery

Recommendation
The Finance and Expenditure Committee has conducted the financial review of the 2011/12 performance and current operations of the Canterbury Earthquake Recovery Authority and the Earthquake Commission, and has reviewed the report on the 2011/12 non-departmental appropriations for Vote Canterbury Earthquake Recovery. The committee recommends that the House take note of its report.

Introduction
We combined our financial review of these earthquake-related organisations and non-departmental appropriations in one hearing, and report on them together, in order to give a broad overview of the challenges resulting from the Canterbury earthquakes.

We wish to record our appreciation of the invaluable and intensive work carried out by both organisations to help the Canterbury community recover from the earthquakes. From a financial perspective, we consider it commendable that both entities gained an unmodified audit opinion on their financial statements despite the scale of the challenges and the pressures they have been working under.

Canterbury Earthquake Recovery Authority
The Canterbury Earthquake Recovery Authority (CERA) was established at the end of March 2011 to plan and administer the implementation of the recovery from the earthquakes in Canterbury. It is the only government department located entirely outside Wellington, and is expected to have a limited lifespan of five years.

Recovery plans and rebuilding progress
Over the past year CERA has published two key plans setting out how the recovery will proceed. The Recovery Strategy for Greater Christchurch sets out the overarching long-term plan, while the Christchurch Central Recovery Plan focuses on the city centre, and specifies four anchor projects to be developed there: the Avon River precinct, a stadium, a sports facility, and a convention centre. The authority is now working with the city council to progress the projects. A further plan covering transport options is in draft form at present, and open for submissions.

We note that in CERA’s view the central city recovery plan drew on extensive consultation with Christchurch residents, and has been well received. Some of us are of the view that many in the community would have a contrary view to that of CERA. We sought more information about how the anchor projects were selected, and whether CERA is considering public-private partnerships for their construction and operation. We heard that CERA is now seeking proposals from any market participants who might wish to own and
operate facilities such as the library and performing arts centre, and is open to considering expressions of interest. It says it does not have a view on whether the town hall should be restored or replaced.

We asked why the provision for a built heritage recovery plan in the draft recovery strategy appeared to have been dropped from the final strategy. We were told that the recovery strategy includes goals for “cultural recovery”, which includes programmes for arts, culture, and heritage collections and for heritage buildings and cultural places. These programmes are being developed by the Ministry for Culture and Heritage, but CERA and the city council remain involved to monitor progress. Some of us are concerned about the slow progress.

Most work on demolitions in the central city is expected to be completed by mid-2013. The repair and rebuilding of infrastructure has also been progressing, with $380 million spent to date and 90 projects, valued at $228 million, under construction. A further 178 projects valued at about $1.1 billion are at the design stage. CERA also aims to acquire 760 properties in the city centre; so far it has concluded three contracts, but it expects to negotiate more than 130 over the next few months.

**Zoning issues**

Land zoning has been a key part of CERA’s work to date, and is nearly complete. About 8,000 properties have been zoned red and therefore fall under the Government’s acquisition offer. So far nearly 6,400 householders have signed an agreement to sell their properties, and CERA has settled just over 5,000. Land zoning in the Port Hills has been particularly difficult and contentious, with about 140 householders appealing CERA’s decisions. Interestingly, equal numbers are seeking to switch from red to green designations and vice versa, depending on their individual appetite for risk.

**Deadline for leaving the red zone**

We are aware that some property owners in the red zone face logistical difficulties vacating their properties by the 30 April 2013 deadline for final settlement, and asked CERA whether it had provided any advice about extending the deadline. We were told that it was gathering information from residents and discussing the issue with the Minister. Since our hearing, the Minister has announced a three-month extension to the deadline for a small group of red-zone property owners to ease such pressures.

**Maintenance and infrastructure**

The deterioration of vacant properties in the red zone is of concern. CERA told us it employs 30 to 40 maintenance workers to try to keep the area tidy, and its community liaison workers try to respond to issues raised by residents. As for the long-term use of land in the red zone, CERA told us it has done little planning work so far, but is happy to discuss with local authorities their thoughts on the infrastructure needed, such as through-roads to access parts of the green zone.

**Commercial properties**

Some of us consider it inequitable that the Government offer for bare sections and commercial land in the residential red zone is only 50 percent of the most recent rating valuation, while other red zone residents are offered 100 percent of the rating value. CERA’s chief executive pointed out that the Government was making such offers voluntarily; EQC does not insure commercial property, and it provides limited insurance.
cover for land. He noted that no decisions have yet been taken on whether people will be compelled to accept the acquisition offers.

Some of us also consider that the offers being made to business owners in the red-zoned central business district are inadequate. CERA’s chief executive said that deciding on a fair value involves balancing taxpayers’ interests with those of property owners. If the Government were not involved, land values in the central city would be far lower. CERA believes many business owners will accept the offer to allow them to get back into business somewhere in the city.

**Earthquake Commission**

The Earthquake Commission (EQC) is charged with insuring residential property against loss or damage from natural disasters. Its role has expanded greatly since the Canterbury earthquakes to include managing a substantial part of the repair and rebuilding through a contract with Fletcher Construction, designing and supervising land remediation work, and providing engineering advice. The commission also assists with research and education about natural disaster damage and its mitigation.

**Review of the Earthquake Commission Act 1993**

EQC’s legislation is now 20 years old, and changes to its role and finances as a result of the Canterbury earthquakes have made it clear that a review of the Act’s workability is needed. The Government recently announced that it is setting up a cross-agency group, led by the Treasury, to review the Act in consultation with industry and stakeholders. It is intended that a public discussion document will be released in March 2013, and resulting legislative amendments introduced later in the year.

The review will focus on what types of property the commission insures; the structure and extent of its cover; how the commission prices its insurance; its institutional structure and roles; and how the Crown’s risk exposure is managed and financed. We will follow its progress with interest.

**Reinsurance arrangements and costs**

EQC pays out on claims from the Natural Disaster Fund and from arrangements with global reinsurers; in the event of a major disaster the Crown tops up these funds under a guarantee—in effect, an extra layer of state-provided reinsurance—for which the commission pays a fee to the Crown. While the Natural Disaster Fund stood at nearly $6 billion before the Canterbury earthquakes, this buffer has now been depleted and will take several years to rebuild. Negotiating satisfactory reinsurance cover was therefore a critical task for the commission over the past year, to ensure that New Zealanders remain covered in the event of another major disaster, and to reduce the risk borne by the Crown.

After consulting the Government about the fiscal risk it was prepared to take on, the commission has negotiated reinsurance cover on terms it considers satisfactory, albeit at significantly higher cost. Before the Canterbury earthquakes, the reinsurance arrangements entailed EQC paying the first $1.5 billion worth of claims from a single natural disaster, with reinsurers covering the next $2.5 billion and the Crown liable for damage above this $4 billion total. Under the new arrangements, the commission would pay the first $1.75 billion of claims, with reinsurers covering the next $3.25 billion, and the Crown guaranteeing costs above $5 billion.
The cost of the reinsurance has roughly trebled, from about $39 million a year to $140 million, reflecting the higher risk perceived by the markets in the wake of the earthquakes. The premium will now be reviewed annually, rather than every three years. The commission told us it is hopeful that costs will fall again over time if there are no further major quakes.

**Costs for households**

While we view the increase in reinsurance costs as an understandable market response, we are concerned about the increased burden this translates into for households, through the EQC levy they pay (for $100,000 worth of building cover, $20,000 worth of contents, and land up to a maximum area) and the premiums charged by private insurers.

Although the EQC levy is set by regulation and not directly related to EQC’s reinsurance costs, it too has trebled, from $69 a year to $207 including GST. We were told that private insurers’ premiums have roughly doubled, but much depends on the construction materials involved; anecdotally, the premium for a modern building in Christchurch is now 30 to 40 percent more than pre-quake, but much, much higher for an unreinforced brick and masonry building in Wellington.

**Risks for the Crown**

The potential liability for the Crown is also a concern. We note that until the Natural Disaster Fund’s reserves have been restocked, the Crown effectively bears liability for the first $1.75 billion of claims, as well as for damage exceeding $5 billion. In the worst-case scenario of a major Wellington earthquake, its liability could be as high as $20 billion.

**Affordability of insurance**

We believe, and the commission agrees, that the increased cost of insurance is likely to lead to significant changes in the way New Zealanders view insurance, and the types of policy the industry offers. Insurance cover in New Zealand has traditionally been very high by international standards—about 99 percent of people in the red zone were insured—and we are concerned that people may start to under-insure because they cannot afford the premiums. The commission agrees there is some risk of this, but it believes insurers will respond by offering policies that still provide a reasonable level of cover, if not the “gold-plated” approach New Zealanders are used to. Traditionally, many policies have been uncapped, and insurers have been surprised by the cost of restoring features such as rimu panelling. They may choose to offer policies that cap the total rebuilding costs reimbursed, or set a dollar amount per square foot. New Zealanders, for their part, may need to start thinking of insurance cover as protection against potentially losing their homes, rather than claiming for relative trivia such as broken windows.

The commission noted that the review of its legislation will take as its starting point the questions of what risks a society can reasonably expect citizens to cover for themselves, and what role the Government should play. Issues will include the nature of EQC’s cover, whether there should be some excess before the cover applies, and the respective roles of EQC and private insurers. A prime consideration will be ensuring that New Zealand retains an effective insurance market.

While we are concerned about the sharp increase in insurance costs, we consider it a very important achievement that the commission has successfully obtained reinsurance from the
international markets. Being able to offset risks via insurance is a critical underpinning for the whole of the recovery.

**Settling claims**

EQC has so far paid out $4 billion on claims, and estimates that it has dealt with 45 to 50 percent of the total of 340,000 claims, equating to 700,000 exposures. It settles in cash for claims under $15,000, and has so far settled 650,000, with another 10–12,000 to go. It expects that larger repairs will be completed by late 2013. Of the 20–25,000 large repairs for which it shares costs with private insurers, most need to be apportioned between the various earthquake events. So far it has completed about 12,600 apportionments and passed the files over to private insurers. The commission continues to work on about 80,000 land claims, of which about a third involve difficult technical and legal issues. It will liaise with those affected from January 2013 and start paying cash settlements shortly thereafter, but expects it to take up to two years to complete all claims.

We are very conscious of the frustration people feel while waiting for claims to be settled, but we also appreciate the size and complexity of EQC’s task. We are pleased to see the progress being made and commend the commission on its efforts.

**Managing repairs**

Fletcher Construction is acting as agent for the Earthquake Commission to manage the repair of homes where damage is estimated at under $100,000 per claim. We questioned the commission about its decision to appoint a single agent to this role, rather than allowing competition to keep costs down. The commission told us it is satisfied that Fletcher’s is providing value for money. In its view, having two project management firms would have increased costs, as they would be competing for the same pool of about 70,000 tradespeople—a constraint that will worsen once private insurers’ repair programmes start in early 2013. The commission noted that private insurers have also chosen a single-project-manager model.

The final cost of repairs has averaged about 15 percent more than EQC’s assessments. We were told that extra damage from subsequent earthquakes accounts for all but about a 1 percent difference. EQC added that discussions with trades associations around the country indicate the rates it is paying are reasonable.

**Damage assessments**

The commission aims to repair homes to their pre-earthquake condition, but accepts that some element of improvement is often needed to meet the building code, especially where maintenance had been neglected before the quakes. It uses various techniques to distinguish pre-existing damage. Drawing the line between repairs and improvements gives rise to difficult conversations with homeowners, but the commission must meet stringent audit standards, applied by the Office of the Controller and Auditor-General and international reinsurers, to ensure its funds are spent appropriately. Reviews of its files by reinsurers and a professional claims review team from Lloyd’s indicate that it is getting the balance right.

We asked about instances where EQC’s assessors have changed their minds, deciding that what had initially been categorised as earthquake damage was actually pre-existing. The commission accepts that it has not always got assessments right the first time, particularly soon after the first major quake, when there was less experience available; occasionally, a
joint re-assessment with a private insurer after subsequent quakes has led to a different conclusion. It regrets the stress caused for homeowners but says it works with the best evidence available at the time. Some of us note that processes have been legislated to cover instances where a person has suffered hardship by acting on mistaken information, and suggest the commission consider recourse to them.

We are aware that there have been complaints about some engineering assessments, and heard that the commission carried out some internal peer review of the work. So far eight complaints have gone to the Institute of Professional Engineers for independent review. We are concerned that a householder who disagrees with an assessment must pay to have an independent engineer check the work. The commission told us it with working with the Ministry of Business, Innovation, and Employment to set up an independent intermediary role, which might help resolve such cases.

**Complaints**

The commission told us that all complaints, however minor, are recorded and go through an established process; if people are not satisfied with the result, they can request their files under the Official Information Act 1982 and pursue their complaints with the Ombudsman. Disputes can also be taken to mediation. We heard that EQC has recorded about 2,100 complaints related to the rebuilding work by Fletcher’s. On the whole, we find the number of complaints unsurprising given the scale of the rebuilding work. We note for the record that complaints represent only 1.6 percent of all EQC’s customer contacts, and that it has also received over 3,000 compliments.

The commission acknowledges that it has been slow responding to Official Information Act requests, as it simply does not have the resources, and at times has had to divert staff from processing claims to deal with them. About 443 complaints have so far gone on to the Ombudsman, representing about 5 percent of the Ombudsman’s work.

We suggested that complaints might be avoided if EQC were to share the scope of works with households as a matter of course. The commission said it is working toward doing so, but there are logistical difficulties to overcome as all its processes are manual and it is still working to improve its database.

**Risk of fraud**

With billions of dollars involved in rebuilding Canterbury, it is obvious there will be opportunities for fraud. The commission sees two particular areas of risk: in the claims people make, for example claiming for non-earthquake-related damage, and in the potential for collusion between contractors and those managing them. EQC is addressing the first issue with a claims review team of 12 investigators. Over the past year it has isolated about $4 million worth of potentially fraudulent claims for further investigation—a relatively small proportion—and has passed on 11 claims to the Police for prosecution. Four prosecutions have been successful so far.

With contractors, the commission has set up processes to minimise opportunities for collusion, but it is also mindful that the 1,500 contractors it deals with are handling much greater volumes of work than their offices were set up for, so billing errors are inevitable. The commission assesses the number of actual attempts at fraud to be relatively low. However, it has recently started working with the Serious Fraud Office and other agencies involved in the recovery to minimise fraud by building a broader risk register and sharing information.
For its part, CERA has been working to improve its systems, having started from scratch in March 2011. Major payments such as those for demolitions and land acquisition are reviewed independently, and several experts are involved in planning and procurement for the large anchor projects now getting under way.

**Non-departmental appropriations**

The Minister for Canterbury Earthquake Recovery is responsible for some very substantial earthquake-related expenditure, covering the Crown’s purchases of residential red-zone properties, and its contribution to local authorities’ costs for restoring horizontal infrastructure. These non-departmental expenses totalled over $1 billion in 2011/12.

CERA monitors these expenses on behalf of the Crown, and details are provided in its annual report. The independent auditor has drawn attention to the considerable uncertainty about these expenses, and hence about the Crown’s liability.

We note that the total appropriations were significantly exceeded in 2011/12, including unappropriated expenditure of nearly $180 million. While any unappropriated expenditure is a matter for concern, we appreciate that the Canterbury earthquakes present exceptional circumstances: estimates are particularly difficult to make, and delays to the recovery are to be avoided wherever possible.
Appendix A

Approach to this financial review
We met on 5 December 2012 and 30 January 2013 to consider the financial review of the Canterbury Earthquake Recovery Authority and the Earthquake Commission, and the non-departmental appropriations for Vote Canterbury Earthquake Recovery. We heard evidence from the Canterbury Earthquake Recovery Authority and the Earthquake Commission, and received advice from the Office of the Auditor-General.

Committee members
Todd McClay (Chairperson)
Maggie Barry
David Bennett
Dr David Clark
Hon Clayton Cosgrove
Paul Goldsmith
John Hayes
Dr Russel Norman
Hon David Parker
Rt Hon Winston Peters
Hon Dr Nick Smith

Evidence and advice received
Canterbury Earthquake Recovery Authority, Response to written questions, received 4 December 2012.
Canterbury Earthquake Recovery Authority, Response to additional written questions, received 18 January 2013.
Earthquake Commission, Response to written questions, received 3 December 2012.
Earthquake Commission, Response to additional written questions, received 11 January 2013.
Office of the Auditor-General, Briefing on the Canterbury Earthquake Recovery Authority, dated 5 December 2012.
Organisation briefing papers, prepared by committee staff, dated 3 December 2012.
Corrected transcript of hearing of evidence 5 December 2012

Members
Paul Goldsmith (Chairperson)
Maggie Barry
David Bennett
Hon Clayton Cosgrove
Hon Lianne Dalziel
John Hayes
Hon David Parker
Eugenie Sage
Hon Dr Nick Smith

Witnesses
Roger Sutton, Chief Executive Officer, CERA
Michael Wintringham, Chair, Earthquake Commission
Ian Simpson, Chief Executive Officer, Earthquake Commission
Warwick Isaacs, Deputy Chief Executive, CERA
Bruce Emson, General Manager Customer Services, Earthquake Commission

Goldsmith Welcome everybody. I’m just checking—we would like this recorded and transcribed.

OK. Thank you for coming. I thought it would be worthwhile having you both at the table, but perhaps if we started with EQC, just to give us a quick summary, and then a quick summary from CERA, and then we’ll open it for discussion.

Wintringham Thank you very much. I’ll get straight in because I appreciate the committee will have a lot of questions to ask. Just a reminder, we’ve had 460,000 claims, which mean 700,000 exposures. We have settled or closed 304,000 of those exposures, and “closed” is a pretty conservative definition. For instance, it includes building repairs completed which are still within the warranty period, so my judgment is that we’re probably between 45 and 50 percent closed in terms of our exposures. We have now hit the $4 billion mark in what we’ve paid out. I won’t go into the emergency repairs and winter heat programme—that’s past history now.

Brief summary: contents claims are effectively closed. We’re following up by phone those with outstanding claims lacking information, but those will be shortly shut down.

Building repairs: again, as you know, there are something over 120,000 homes to be repaired in the Canterbury area. Of these, about 100,000 are EQC’s alone, and 20,000 to 25,000 are the private insurers to lead the
settlement. We are settling those with repairs estimated at under $15,000—we’re settling those by cash. We’ve settled 650,000 and we’ve got, we estimate, between 10,000 and 12,000 to go. Of the repairs, between 15,000 to 100,000 estimated, we have, through the Fletcher’s EQR project management office, completed as of this week—I haven’t seen the last numbers—my estimate is 29,000 repaired. We’ve eased the opt-out provision, so if people want to manage their own repairs, we’ve made it easier for them to do so. Three and a half thousand have opted out to date, and opt-outs are continuing at the rate of about 40 per week, and we’ve changed those provisions. I won’t go into that now, but if people wish to ask some questions about that, they obviously will do so.

All of the repairs over $50,000—so the larger repairs for which we are responsible—will be complete by this time next year. And of the repairs we are undertaking we have earmarked at least 100—we’re running ahead of that—per month for the vulnerable, the elderly. And we obviously have to make some judgment calls about that, on the advice of a number of social agencies.

Apportionment: of the repairs which belong to the private insurers—20,000 to 25,000—almost all will have to be apportioned across events. We have apportioned to date 12,645, I think was the last number that I had seen, and with those we have apportioned we have paid what in our judgment is the EQC liability to the homeowner or the mortgage holder and have passed the file over to the private insurer.

A quick word on TC3, which is obviously of concern to, certainly, a number of people at this committee. We have responsibility for about probably approaching half the repairs in TC3. There are around about 27,000 homes that require repair in TC3, of which around about 10,000 will require enhanced foundation—you know, specialised foundation—repairs. The bulk of those, of course, will fall to the private insurers because those will, in the main, will be over-cap. For us we have completed 1,734 repairs in TC3, and we have just over 1,400 repairs in TC3 which are under way, either from scoping to under the hammer. Also, of that 12,640-odd apportionments we have completed and passed over to private insurers, about 4,500 of those are in TC3. So, in our view, there is no obstacle to the private insurers proceeding with those repairs.

Final comment on land, and I’m sure the committee will want to spend some time on land, I take an opportunity to address maybe some misapprehensions. We have around 80,000 land claims that are outstanding. In almost all cases EQC’s land settlements are not a prerequisite for repair or rebuild of houses. Where, in those few instances, a private insurer might say that the land repair needs attention before they can proceed with a rebuild, we have offered a fast-track process for the insurer for us to address that at the same time or prior to their doing the rebuild. There has been a low uptake on that, but that option is still available. And in TC3 the constraints for major repairs, which are obviously repairs requiring foundations, are: one, drilling to provide information to give to the engineers to design the foundation, and then the design of the foundation
to a stage which will enable it to get a consent—the other two. The insurers may want a contribution for whatever EQC’s land settlement is towards the cost of enhanced foundations. In our judgment, our liability is to the homeowner directly, or to the homeowner’s mortgage holder, so that is a discussion which in our view is to be held between the insurer and the homeowner.

And in land damage, of the 80,000 outstanding land claims, about two-thirds of those are straightforward, and that ranges from what you would call, perhaps, weekend work with a barrow, shingle, and rake and spade to somewhat heavier work requiring a digger and a bit of levelling, and the remainder are the more complex and unusual ones often related to crust thinning and future susceptibility to future events. And those raise some very difficult technical and legal issues, which we’ve been working through very carefully, both to ensure (a) we comply with the Act and (b) to minimise the risk of litigation or reversal of our decisions at a later date.

Dalziel How many in that category did you say, sorry?

Wintringham Of that? Well, if there’s about 80,000, you’d say around about two-thirds are the easy ones, and about one-third are the more difficult ones.

And for the settlement of the land claims: the communication programme begins in January and very soon after that the settlements will begin. Our intention is to cash settle, but we will provide support for the elderly and vulnerable who may not know what to do with the cash, and we will be moving from east to west, and that will be a process which will take the best part of 2 years to complete.

Final comment: I’m going to take this opportunity in public to thank Ian and his management team for what they have achieved over the last 2 years. I think they’ve done an extremely good job. We haven’t always got it right first time, but I would like to acknowledge the thanks to our people, a number of whom, particularly in Christchurch, like the customers we are dealing with, are under some stress.

Goldsmith Thank you very much. Right, if we have a quick summary from Roger.

Sutton Sure. Perhaps to lead off where Michael finished, around the land issue. This event has been characterised by very serious land damage. In terms of the land zoning, nearly 8,000 properties we zoned them red, where they get a Government offer. So far nearly 6,400 people or householders have signed an agreement to sell us their property. We’ve taken possession of 5,173 properties, so we eventually settled just over 5,000 properties, which is pretty extraordinary when you consider the scale of what we’ve been facing. So in many ways the land zoning is nearly complete.

We’ve done the Port Hills land zoning, which proved to be extremely difficult and contentious for a lot of people that live in those areas. There’s an appeal process under way. I think something like 140 householders appealed their land zoning, and about half of them wanted to be green who are red, and about half wanted to be the other way as well. So it’s just one of the issues which is really actually hard. For someone with a young family
who’s had rocks near their house, they go “I just want to go. I don’t believe you. I should be green.” An older couple I was talking to the other day at the supermarket who’ve had rocks bounce over their house, and they’re red and they want to be green. So people just have quite difference sorts of appetites for risk there. But I think the Port Hills decisions have been extremely challenging and very difficult to make—the number of variables there, the level of uncertainty, and the different perspectives from people as well.

Moving through on to insurance. I think insurance—sometimes, when I’m talking at a public meeting, I talk about how there are battles and there are wars, and I think the battles people face with getting things done, whether it be with their own insurer or with EQC, are important, and we want to work through those. But the real important war is making sure we actually make sure we keep cover for New Zealand in the long term, and they understand the risks they face when they insure earthquakes in New Zealand, and that they continue to offer us cover, because that underpins so many aspects of the economy we live in.

So we’ve been very pleased with that, and, you know, Ian with his discussions with the reinsurers, he’s got a nod now. He been able to get reinsurance, and I think all of the reinsurers also now wish to fill their reinsurance programmes as well. So I think that’s almost been one of the silent successes that’s actually been extremely important. You look at many major natural disasters around the world, you see massive changes in insurance cover for people. And while people are seeing higher premiums than they’ve seen before, the fact that we’ve kept cover, I think, has been great.

We are stuck without reinsurance, because, from the reinsurance, everything else really follows. Without the reinsurance, if you like, the insurance companies can’t really act. So we are now seeing many bold statements about offering new policies to people across the city. Less new policies are being offered in TC3 land, but I am very confident that will come, and that’s a real focus with us—working with all the professionals so they can understand what TC3 really means and what the risks are.

In terms of cover coming back, I was talking to one of those sort of property developer types who, he’s not a builder of $50 million buildings, he’s the sort of guy who builds $4 million buildings, and he’s just completed a building on Moorhouse Ave, which, in fact, IRD and I think the Department of Conservation are going to be tenants in for a period of time, and he was very concerned whether he’s going to get any insurance cover. He’s got insurance cover. He originally had his contract works insurance out of London with Lloyds, and this is cover out of NZI, and he thinks he’s paying a premium very similar to what he was paying before, which he’s very surprised by. And he also says that “It’s given me such a boost, I’m going to go up and buy some more land and do some more buildings now.”

So, you know, I think the whole momentum of some of these things is really starting to build up, which is great. I’m not saying that there aren’t people who have got terrible, terrible struggles, but unless we actually see
some of these guys, the guys who’ve got money to spend, spending money, it’s hard to see the recovery getting up to the speed we want it to get to.

In terms of the mums and dads and their insurance, I mean, we’re seeing—the easiest stat to give you is Southern Response. They’d have about a third of the market. They have a publicly declared intention to get through 1,000 rebuilds or major repairs next year, and they’ve done 99 percent of their assessments. So things are starting to move there.

I’ve just been at a meeting the other evening with a group of elderly people in Parklands. They spoke about their seeing much, much more action happening there, and there is a sense that things are starting to move for those sorts of people.

In terms of, if you like, the overall strategy, we put out a recovery strategy that was launched and gazetted in May. The central city recovery plan—that’s also, obviously, came into effect on 31 July and that was, we think, very true to the 106,000 ideas that came from the city council’s Share an Idea process. The next part of that, and Warwick can talk more about this, is the transport plan, which is currently out for submission as well. So maybe I’m starting to just take up some of your stuff, Warwick. Do you want to speak just a bit about the CBD issues?

Isaacs

Thank you. Good morning. In the central city, as Roger has just said, the recovery plan was launched at the end of July to overwhelming support from the residents of Christchurch and also the wider public of New Zealand. In there we identified a number of anchor projects, the first of which were the Avon River precinct, metro sports facility, the convention centre. And so far we’ve established project teams with the city council, working very closely with the city on those things. So, on those key first projects, we’ve had expressions of interest in the marketplace, which have closed now, for the convention centre. We’re about to appoint design, quantity surveying, and project management firms for the Avon River precinct and the top of the eastern frame, where there’ll be a very large children’s playground and family playground there. So the central city is going very well.

I might move to infrastructure. So far there’s been $380 million spent on repairs and rebuilds to date. There are currently 90 projects, with a value of $228 million, currently under construction. There’s a further 178 projects in design, with a value of approximately $1.1 billion. So infrastructure repair and rebuild is certainly moving at pace.

Roger touched upon the central city transportation plan. That’s out for consultation at the moment. That was a joint effort between CERA, NZTA, the city council, and ECAN, and that team worked very, very well to deliver a very good draft. So far we’ve had in excess of 20,000 engagements with that through social media, and our own website’s had in excess of 1,600 individual unique views on that. So we’re very happy with that, and consultation on that closes 1 February next year.
The land acquisition in the central city—that’s going well. We’ve now got contracts on three pieces of land, which doesn’t seem a great number, but we’ve also got 15 in advanced stage of negotiation and 116 other properties which I’d expect to have negotiations completed in the new year. That’s out of 761 properties that we wish to acquire in total.

You may want to talk a little about demolitions—just to let you know that in the central city we expect the main programme of demolition to be completed by the middle of next year. Obviously, with some of the properties we’re buying for some lengthy projects, we do need to demolish some of the remaining buildings on those sites. They’ll take a little longer.

In the Port Hills, as you might imagine, some of the issues up there are quite complex around the removal of residential properties, given there’s weight restrictions on a number of roads and it’s hard to get heavy equipment up there, so we’re working very closely with the insurance companies and their project management offices on how best to deal with those properties. So that’s just a quick update.

Sutton So just as to my organisation for the next year, the focus is very much on making sure we get the residential rebuild happening more quickly, working with players there, working with communities to make that happen. The anchor projects, working with the city council to get those under way, bringing more pro-investment into the city, but it’s also very much about people. At the end of the day, we need to continue work with community organisations, continue to communicate with them. I don’t know how many hundreds of public meetings we’ve had in the last year, but make sure we’re out there working with these communities to make sure we can really get this rebuild happening.

Goldsmith Very good. Thank you very much for that. There’s a huge amount to cover there, so we’ve got some questions.

Cosgrove To EQC, in respect of the monopoly provider, Fletcher’s, a simple question: 2-odd years down the track are you still convinced you are getting value for money, and if the answer is yes, how have you convinced yourself of that, given the total monopoly position for EQC work for Fletcher’s?

Wintringham The answer is yes, and I’ll ask Ian or Bruce to elaborate. But the test is the cost, quality, and timeliness and safety of the Fletcher-managed repairs compared to our own assessments of the cost and the nature of the repairs to be done. So this is not handing over to Fletcher’s saying “Here’s a job to be done, you do it.” We do the assessment, and then we ask Fletcher’s to do that on our behalf, and a lot of the management of that contract is concerned with matters of timeliness, with the quality of the work that is being done, but also the relationship between the cost of Fletcher’s, including their overhead—there’s the actual cost of construction and the cost of their project management—compared with our own estimates, and on the basis of that assessment I have no reason to doubt that we are getting satisfactory value for money.
Cosgrove  Could I ask you—slightly hypothetical—but if you had two providers, for instance, in a normal competitive market, you don’t, in any way, shape, or form, feel that that competitive market tension may deliver, in its rawest form, better price? And, encompassed with that, have you done any external benchmarking, over and above your own internal assessment process, or any reviews at all of the monopoly, to provide a regime to test your thinking?

Wintringham I’m going to ask Ian to pick up, but just as an introductory comment, the answer is yes, we have considered two. At the stage when we did, our view was that the transaction and administrative costs of running two PMOs, as well as the fact that both would be seeking labour from the same labour pool, meant that the advantages would probably be marginal, and, given we had an awful lot of other things to do at the same time—but do you want to elaborate on that, Ian?

Simpson If I can. Just to start off with, I’m reacting slightly to the phrase “monopoly”. Fletcher’s are a monopoly PMO if you’d like to call it that, because we’re the only game in town at the moment. There are lots of PMOs working across country for the private insurers; they just haven’t geared up yet. So Fletcher’s were selected by us through a procurement process where other firms had the right to take part in that process.

Clayton But, with respect, you only had one provider of sorts.

Simpson That’s right, but the constraint isn’t the PMO resource; the constraint is the actual labour resource that’s fixing the houses, and that goes out to well over—is it 3,000 contractors we’ve got…

Witness We’ve got 1,500 contractors and about 70,000 tradespeople.

Simpson So 70,000 tradespeople living and working in Canterbury providing the resource. Having two PMOs would fight over that same resource, and in our view would increase the cost rather than decrease. We know we’re getting value for money. We regularly, on a monthly basis, test our assessed cost to the actual repair cost. Last time we did it we’d fixed about 26,000 homes. There was an increase between our assessment and the final repair cost of about 15 percent.

Cosgrove Was that an internal assessment?

Simpson They were our claims assessment, when we first assessed the damage, right through to the final bill for fixing the damage.

Cosgrove That’s all internal. My question was do you benchmark that externally?

Simpson When you say it’s internal, it’s the EQC assessed cost versus the repair that was put in place during the Fletcher’s process. So we set rates on those repair costs—we’re delivering against set rates. For that 15 percent, if you take out damage from subsequent earthquakes, that explains most of the 15 percent. There’s only a 1 percent difference between EQC’s assessed cost of value and the actual final repair cost that’s delivered by the contractor. So we’re gaining the performance we need in terms of pace, and we feel we’re getting value for money in terms of final repair.
Cosgrove  My other part of the question is are you looking at any, or have you done any, analysis or review, over and above the sort of mark-to-market issues, but global analysis or review of that monopoly position?

Simpson  No, we’ve worked with the trades associations across the country in helping us set those rates. As you are aware, there’s been some media interest in whether those rates are too low. So in terms of what we’re paying, we’re comfortable, having spoken to the national organisations, that we are at a reasonable rate for the work that’s done.

Smith  Are you aware, given that your duty is to try and as efficiently as possible get these houses repaired quickly and at fair cost to, ultimately, a public entity, that the private insurers operating in Christchurch have also all chosen a single PMO model, and doesn’t that suggest to you that they have come to the same conclusion as EQC that that’s the best model to meet the objective of quick fix at least possible cost?

Simpson  That’s our view. That’s the way it works. Because when the private insurance sector does kick off it will be early 2013—that’s what they’re saying—that’s our next big risk, that we will be competing for that same pool of resource. So it’s bad enough that it’s between organisations. If you had it within the organisation, that would just double the problem.

Cosgrove  For CERA: in terms of red zoned land, I know that at least one local authority—and this is red zoned land—where the deal’s been done and people have moved away and are waiting with bated breath for a decision on what will happen to that red zoned land, and in at least one case are being hampered in terms of their horizontal infrastructure repairs because they may have to have a road, Roger, as you know, through a red zone to get to a green zone or whatever. When are they likely to get a determination on that? Because presumably nothing stands in the way of making a decision—you own it, it’s been abandoned, you know what’s coming next.

Sutton  Yeah, but if local authorities want to talk to us now about infrastructure they want to keep going with the red zone, we’re happy to have those conversations. In terms of the long-term use of that land, we have done very little work on that so far. I mean, it’s still just early days, we’ve still got people living in there, and I think, to some extent, for us to say to have to declare what’s going to happen to that land—yes, it’s going to take a lot of thought before we make those decisions, Clayton.

Cosgrove  Do you have—and I’m not talking about where people are living. I’m talking about where you own it; they’ve gone. In some of those areas the environment’s deteriorated, as you are aware. Some of the houses have been subject to arson. It’s not a particularly pleasant place to live if you’re on the cusp of it. In terms of clean-up, house removal, even as basic as keeping the grass down, what’s the regime? Because in some of those areas where I’ve driven through it looks like, sort of, OK Corral stuff.

Sutton  We employ—I don’t have the number on top of my head—in the order of 30 or 40 people, something like that, on that sort of tidy-up work within the red zone. We’ve got community liaison people who work with those
communities trying to make sure they can respond to issues as they are raised by people.

Cosgrove Can I just ask you, in terms of community engagement, would you accept that both yourself and the Minister, if you like, are the public face of the organisation, and probably have the highest-profile role in terms of the public face of CERA?

Sutton I accept that I have a very public face in Christchurch, yes.

Cosgrove And have you been hampered at any point with your engagement with stakeholders? Can you identify any areas that you’ve been hampered in, in engagement with stakeholders?

Sutton I work—I mean, the key stakeholders, we actually work very happily together.

Cosgrove Happily together?

Sutton Tonight there’s a monthly dinner of all the chief executives of the local authorities that I attend. I meet weekly with EQC to talk about issues.

Cosgrove Community?

Sutton Community—I’ve done a lot of community meetings. I’m not sure there’s actually any public servant in the country that’s attended more community meetings in the last 10 years than I’ve attended in the last year, Clayton. I think we are pretty available in that way. I haven’t heard of any criticism around that.

Cosgrove Sure, I appreciate it. Could I ask you if the following public comments have hampered your efforts—and I’m not questioning your efforts to engage with the community: one, on 2 February where the Minister called the Mayor of Christchurch “a clown”; on 12 September of this year, where the Minister described that he is “sick and tired” of TC3 residents “carping and moaning”; and, finally, on the 3rd of this month, where he described the Christchurch Press, after an article with respect of scrutiny as being “the enemy of the recovery”. Now, given that TC3 residents, the media, the mayor, the council are key stakeholders, particularly the TC3 earthquake victims, that you and your organisation have to interact with, do you in any way feel that those sorts of responses—one, do you agree with them, and secondly, have they made life difficult to engage positively with stakeholders?

Sutton No.

Cosgrove No?

Sutton No, they haven’t made my life more difficult. I mean, I remember some of the days when there’d been some quite political comments made by people I work for, but people I don’t work for—I’ve attended public meetings at night, going “Gee, I wonder what’s going to happen tonight.”, and actually the public meetings run as per normal. So I think people understand that politicians of every colour are going to make statements from time to time about their political foes and I don’t let that get in the way. My relationship,
professionally, is largely, if you like, with the officials from other organisations, and I don’t see those sorts of things as getting in the way of those relationships.

Cosgrove So does your department stand by the comments of your Minister?

Sutton I don’t think that’s actually for me, actually, Clayton. I think you know that’s not for me.

Bennett Thank you to Michael and Roger. Your contribution to Christchurch, I think, and New Zealand has been invaluable. So thank you very much for your work. The numbers that you talk about are staggering for other parts of the country. We don’t realise the work that you’re actually doing, to that extent, so well done and thank you.

I guess when you see those kinds of numbers a light bulb or two could go off that you think that there are opportunities for people to perhaps game the system or take advantage of it. I’m just wondering what processes you’ve set up, or are intending to set up, that would enable you to keep a finger on what’s happening on the ground, so that there isn’t that advantage taken over the rebuild, and that it is commercially fair but at the same time done in a manner which, you know, you don’t have a situation where, 10 years down the track, where people say “Well, this could’ve happened or did happen.” So are you open to those kinds of needs and what’s your plan around that?

Wintringham One, I don’t think we should kid ourselves. Our liability for Canterbury recovery is at the moment estimated somewhere between $12 billion and $12.5 billion, and, when those sums of money are involved, international experience says that there are opportunities for fraud and some people try and take advantage of those opportunities. So let’s acknowledge that from the start.

For us, what we’re doing, fraud—two areas of risk. One is in the nature of the claims that people make, maybe claiming for damage which is not earthquake damage or claiming for contents more than once, for example, and, second, international experience shows that in the area where, as between the manager of a contract and the contractor, you’ve got to be really careful about collusion there.

So what are we doing? On the first we’ve got a—you chip in, by the way, if I get it wrong. As far as the—we have a claims review team of currently, I think, seven investigators, run by a rather scary ex-policeman, former armed offenders squad and with a PhD, I think, in criminology as well, and with a gleam in her eye. And we have, over the course of the last year, with that team, we’ve introduced a number of metrics to determine and to throw up where unusual claims, or unusual patterns, and, if you’ll forgive me, I don’t want to talk about what those might be in public. And as a result of that—and the numbers are pretty small—but we’ve got, I think, of the order of $4 million that we’ve held up, and I’m not saying all of that is fraudulent, but a proportion is likely to be. My last numbers, I think, were 11, I think, we’ve handed over to the police for prosecution. I think we’ve had four successful
prosecutions. I’m anticipating that that may well continue and I think publicity around that’s quite salutary, and I have some very strong personal views about people who take criminal advantage of the distress of other people in these circumstances.

Now, as far as contractors are concerned, do you want to make a comment about that, Ian?

Simpson First of all—there are 12 investigators in the team, just to be really clear about that. In terms of contractors, it’s actually a really difficult line to draw. So a lot of the 1,500 contractors we are dealing with were managing two or three jobs a week and are now handling a far higher volume, and their back offices aren’t necessarily up to the job to give us the accurate information we need. So we have had a number of cases where we’ve been billed for work that clearly wasn’t done, and we’ve got to make the judgment. So we’ve been billed for demolishing two chimneys when the house obviously only has one chimney. And we’ve got to try and make a decision about whether that’s a book-keeping invoicing area or whether it’s actually an attempt at fraud. So we draw, and have drawn, I have to say, a relatively generous line around that. We haven’t paid the bill but we’ve gone back and said “Look, I think you’ve made a mistake.” That’s why some of the numbers are relatively low so far there.

Also, in terms of the inherent process, we feel it does need collusion to get significant fraud through the system, so we have a number of different people touching the claims, so our assessor up front, then the contractor has to come in and give a quote. If that quote’s different to our assessment, then a third person, a quantity surveyor, will describe the difference to us. So, inherently, those people have to start colluding together before we start getting significant fraud.

And the only other point I’ve made is that we have been approached, as with all the other major players in Canterbury, by the Serious Fraud Office, to start collaborating information to try and build a broader risk register, so we can pick up triggers from a number of different parts of the recovery process.

Wintringham We’ve signed up effectively to a “whole-of-Government approach” to this, which is probably is a lead-in for you, Roger.

Sutton Yes, so we’re working with the SFO around this. I mean, the amount of money to be spent, the $30 billion or $40 billion, that’s pretty much the same as Christchurch’s annual GDP. So within Christchurch’s GDP you find people making dishonest practices, in any case, so making sure we minimise and we eliminate, to the greatest extent possible, is right up there. In fact, in terms of Ian’s example of tradesmen, at my own house, the person who replaced broken windows in my house invoiced me for 46 square metres of glass, not 4.6 square metres of glass. Then I never paid the bill, and it took him a year to come back and say “Look, I’m now taking you off to the cleaners,” because I’d never paid my bill, and I think that was just pure incompetence because he’s just got so much stuff going on.
Within my own organisation we had to start up from ground zero. We started off with Ministry of Social Development control systems, accounting systems and so on to try and manage stuff, and they’ve been good, but, of course, the Ministry of Social Development don’t tend to demolish 17-storey buildings and do those sorts of things. So you know I always say, in some ways, in terms of organisations, there’s good systems and bad people, and then there’s bad systems and good people, and I think I started off with bad systems but good people, and I think now I’m getting average quality and good-quality systems but with good people. So, again, I continue to work hard at making sure everything we do does actually keep a good trace of what transactions are going on and making sure probity is always maintained. But my colleague Warwick, do you want to raise anything?

Issacs Well, I think for us, Roger, you talked about demolition. From day one, we appointed individual expert advisers, independent of CERA. Every single invoice that we get for demolition is checked by an independent quantity surveyor and they have discussions with the contractors, and we either get a recommendation to pay or not. Around the land acquisition side of the central city and other areas, as you can imagine, people could, perhaps, attempt some dishonesty. We have four firms independent of CERA and independent of each other which peer review the numbers that they are involved with there. Around the anchor projects, which are $100 million projects and in excess of that, we have a number of different, again, external experts on probity and procurement processes to ensure that we try and minimise our involvement in any of that sort of thing as much as possible.

Goldsmith I’ve just got a question along those lines. Other than fraud, I mean, there’s a line where you’re constantly drawing as to work being done on houses where you’re improving the actual quality of the house. I mean, you’ve got crummy old house and you’ve got a couple of cracks in the wall because of the earthquake and then you get the whole thing redone as beautiful as new. So how do you manage that in terms of being reasonable but not overly generous and blowing the budget?

Wintringham Yes, that’s a conundrum that we face regularly, and I’ve just been recently down and seeing one house that falls squarely into that category, where, in effect, our repairs will be making up for 40 years of no maintenance, in a way. Do you want to make a comment, Bruce?

Emerson I think that’s right. It is difficult, so our ethos is we’ll put back what was there before, and it has to meet the building code, so there is some element of improvement. That’s accepted, I think, broadly, but actually we just try and give people exactly everything they’re entitled to but nothing more than that. The issue we do face is pre-existing damage, and, particularly, you know, who around the table has looked at their concrete slab foundation since they moved into the house? Because there are shrinkage cracks, there’s all sorts of stuff down there. And in having that conversation about whether, or even having clear evidence about whether, it was there before or after, again, we have some techniques that we use around mould and dirt
and paint trails and other pieces that were in the crack, but that’s a difficult conversation. So that’s where a lot of the issues come from.

One thing, if it gives you some comfort, is that we are audited to death, not just by the OAG, which is very welcome, but also by our international reinsurers. So a professional claims review team from Lloyds have been through. We’ve had two of the world’s largest reinsurers come through and review the files as well, and so far we’ve had a clean bill of health on that front. So we try to feel that we’re playing it right down the middle in terms of that.

Dalziel This seems to be a major area of dispute between EQC and individual claimants, and certainly in terms of the issues that are coming through my office, the EQC land claims, over-cap decisions, waiting for the joint review and apportionment, they are the top four issues for EQC. But the other one is the reclassification of something that’s already been put in a scope of works by EQC and signed off as earthquake damage now being re-evaluated as historic damage. I wonder whether that has been a decision that EQC has made to go back and re-review those or whether it’s been picked up in either the joint review process or an apportionment process, and I just actually ask the question whether it is appropriate under the circumstances to change your mind about something after you’ve already signed up to the decision?

Simpson I think the issue is that our assessments post-February and even more post-June were better than the assessments post-September in terms of we have people with more experience and more track record of actually doing the work. So I don’t know the exact number but there are some cases where we’ve had to go back and say “Well, actually, I’m sorry but we got it wrong the first time around”. And you’re right. Sometimes the joint review with the insurer does lead to some different information coming through. It’s in no way a policy. It’s not as if we’ve gone out to try and find these cases. They come up in the course of having to do another assessment post another earthquake.

Dalziel Isn’t this causing major stress to people who thought they had an agreement about what was going to happen, and now these people spend all of their time fighting EQC over the reassessment of the claim and not only the apportionment issue between the insurer and that, because at the end of the day that doesn’t matter to them if the work gets done, but it does matter if all of a sudden work that’s been agreed with, earthquake damage is suddenly historic damage, it’s causing huge stress.

Simpson I think the important thing is that we get the home repaired to the relevant current standards as quickly as we possibly can. So that’s why we’re pushing hard on the apportionment programme to have that finished by May next year—even if there are 20,000 claims we have to apportion, and we’re working hard with the insurers to find more efficient ways of doing that joint review process. So I do recognise it has been stressful for a number of people, but as I said before we also just need to make sure we play it
absolutely straight. So we have to act on the best evidence we’ve got at the time.

Wintringham  Would you mind just giving me, I mean not now, but just two or three examples of that? Because obviously I’m not right close to the claims administration.

Dalziel Is this the issue that’s tied up with the complaint—this is Ruth Dyson’s issue—that she’s made about one of the assessors that you’ve been using?

Wintringham The engineer?

Dalziel The engineer.

Wintringham Graeme Robinson, is it?

Dalziel Graeme Robinson, yes. That’s what it comes from, isn’t it?

Simpson That’s one part of it. So, in general, we’ve completed a number of assessments through the programme, and those assessments, as I said, have improved in terms of quality of the assessment through time.

In terms of the engineering work that we do, that tends to be, as you can imagine, if we need engineering resources, those are the more difficult cases.

Dalziel Because I understand that that’s going to a review panel. That’s not the mediation is it? That’s separate.

Simpson Again, a general comment. When there is a dispute from the customer or from the insurer, we do have a number of complaint processes, then the mediation process. So all our complaints will go through that process. A number of complaints—eight—have gone to the Institute of Professional Engineers in New Zealand about some work that has been on the engineering front, and we’re working with them through that complaint process. They’ve agreed with us that the most efficient way to work with them through that process is for us to have an independent engineer just review those examples that were brought to their attention.

Dalziel And Ruth just wanted to know if the review panel that you set up to investigate, to investigate complaints about him, had as a member of the panel an assessor who worked alongside him on the assessments that are now being reviewed?

Simpson So I did have a conversation with her around this. I wouldn’t call it a review panel. I think in an early communication we’ve misnamed that. We had some peer review internally about the work that was being done and so I wouldn’t call that an independent review. It’s not an elaborate review we’re doing now.

Wintringham What was the outcome of that?

Simpson In terms of?

Wintringham In terms of the decisions that the engineer made. Sorry, it’s not my job to cross-examine you in front of the committee. But the question was hanging.

Dalziel I’m sure Ruth would be very grateful.
Simpson I don’t have a specific on that case. But when new information is brought forward, again we’ll always act on the best information we’ve got. So we’ll take the engineer’s report, any of the reports that become available, and when that new information comes up we have a change of opinion in some cases, and in many cases we are supporting and actually backing up the work that was done originally. These are, as you know, some very difficult cases where it does make a big difference to the outcome of the house, and in many cases there is already a dispute in place before the more senior members of the organisation go in to look at the example.

Dalziel For somebody with historic damage, for example—so the argument is now that you’ve agreed that it is earthquake damage. You’ve subsequently said “No, it’s actually historic damage, so we’re not going to pay for that to be fixed.” Where does the claimant go in that situation to get it independently assessed?

Simpson If they think the assessment is wrong, they can pay to have an engineer.

Dalziel But why do they have to pay for that? Where is the process that just lets somebody independent look at the two sides and sort it out?

Simpson On that, we are working. In terms of repair strategy, we’re going to be working with the Ministry of Business, Innovation and Employment on an independent sort of role to sort of sit down between us and the insurer if there is a dispute in that case.

Dalziel Yes, but some people are in dispute now.

Emson The joint review process includes engineers from both the insurer and the EQC. So often there is a separate engineer or a second engineer involved. A good number of those cases end up in that situation where it has changed in terms of the view by either the insurer or EQC. I have a number of examples where we’ve gone back and reviewed cases undertaken, and indeed in one case just north of the city, six homes, and each of them had come back with some minor amendments to the qualification, but we fully supported using an independent engineering service in reviewing those houses. The others your talking about is by self-selection—working with the most distraught and most difficult cases; the ones where we are in dispute, so, inevitably, they become difficult conversations.

Simpson It might pay to come to the table if you’re going to talk, so we can get it on the microphone.

Dalziel The ones that I’m talking about in this instance, which is not the Graeme Robinson one, they don’t involve the insurer. They’re all EQC. They’re well under the cap.

Emson In that case, yes, the option is an independent engineer, but in most cases before we get there we will offer a second assessment, so give the opportunity for the customer to see it happen again, using a different assessor team to run across that work. So we’re providing every opportunity we can. Look, as Ian said before, the difficulty is—and in my own home, the situation is I didn’t know what the damage was before it was affected by the earthquake, and lots of it is around foundations and lots of the homes...
are on piles, and when you pull the floorboards up, which none of us do, you’ll find pile damage of piles that were put down 30-40 years ago have deteriorated. Now all of a sudden we find our floors squeak and bend and buckle a bit. We all assert that’s from earthquake damage, but when you pull the structural piece apart, clearly it is not, and we are trying to be as balanced and as fair in this process as we can.

Dalziel  I think for the people I’m talking about they already had it signed off by EQC that the damage was earthquake damage. Subsequently, EQC have backed away from that. People are in the middle of getting their repairs done, and all of a sudden the rules change and they’re very, very distressed about it.

Emson  And that is extremely stressful, and, unfortunately, a lot of the earlier assessments were done without, perhaps, the attention that we’re now able to provide with more experience, and those are the circumstances we need to work through, one by one.

Dalziel  Well, under the Judicature Amendment Act, a normal process if somebody is paid something by mistake or a commitment is made by mistake and a person’s acted on reliance on it, then usually if it would cause hardship to the person there is a way around that, and I just ask EQC to look at that.

Cosgrove  I may have asked you this last time, but in terms of repairs, why is it that EQC doesn’t look at when they do an assessment bracing, because I’ve had it put to me from one of your ex-staff who’s an engineer that—and I’m not an engineer, so forgive the analogy, but he put it to me it’s a bit like an old-fashioned beer crate. You get on top of it, you jig around a bit, the thing stays up, but all the nails are loose. The advice I have, and having seen it first-hand, is that you don’t, even where there is a bracing plan, but where there’s not a bracing plan there’s no invasive test, in the same way as you don’t take carpet up to look at whether the foundations are cracked, which is slightly odd, unless the person pays for it.

And what’s been put to me is you may find a situation a little bit like leaky buildings, if you like, where an assessment has been done, the place has been fixed up superficially, but the beer crate or the frame is loose but standing, and if another event happened, by then it’s so weakened that it may be, I wouldn’t say catastrophic, but it may engender extremely expensive repairs next time around. So, given that, why don’t you do a bracing check when you’re assessing houses?

Wintringham  This has exhausted my area of expertise.

Cosgrove  Mine too.

Simpson  I’ll start, and maybe hand to Bruce in a second. As I think we said, you did ask this question last time, and as we said last time if you think about the time it would add to start ripping panels off walls of every house we had to assess, we’re adding years and hundreds of millions, if not billions, of dollars to the overall cost of the programme, and the second piece is we’ve done some work with BRANZ around that very issue, so Bruce if you could maybe talk about that.
Cosgrove: Could I just make a comment on that. I accept your point, but, equally, you could make an argument that if you don’t check, the greater cost may well be down the track rather than—and, again, it’s a bit like the refusal to lift people’s carpet up from their foundations and see if there’s a crack. One assessor said to me “Well, there’s a piece of highly technical equipment that EQC doesn’t use that you can check it with and that’s called a wee steel ruler, where you run it down where a perceived crack is, between the skirting board and the carpet to see.” It’s a highly technical piece of equipment, but EQC doesn’t do that.

Emson: The challenge we’ve faced before, in terms of should we be pulling wall linings off and checking bracing—we’re guided by our process that involves the loss adjusters, firstly from an insurance perspective and then the quantity surveyors—

Cosgrove: This is all pre-insurance. This is just EQC—nothing to do with insurance at this point.

Emson: I understand that, but we’ve got loss adjusters in our business that do the assessment for the damage. Before we start the repairs, quantity surveyors and experts in the building industry work for the Fletcher’s organisation and with the contractor. So both the contractor and the QS is looking at the job before we sign it off and approve it. They are guided by both BRANZ and industry norms. So we are aware of the challenge but are working within the constraints or the guidelines of industry standards as we operate today. And I believe Fletcher’s and the major construction companies were part of that design standard, through BRANZ, and that’s what we’re being led by.

Cosgrove: With respect, this is pre-Fletcher’s being involved. This is the guys coming around for the first assessment for an event, where they go through your house and look at everything, and then they write a report and give it you and the system flows. But what’s missing from that, at any check of under-floor foundation, if you’ve got a solid and any bracing check. So the thing I’m worried about is if there’s a future event and some poor Joe is sitting there and there’s a future event and they’re impacted on greatly, and then we get into a situation possibly of trying to prove what was what—again, a bit like my colleague’s comment about historical damage.

Emson: I obviously didn’t answer clearly. The assessment done by our people at the initial level is the first assessment. Before work starts we go through a process of re-assessing, then a quantity surveyor and a contractor are involved in assessing the home for the damage.

Cosgrove: Even if it’s under cap, because then you give them a cheque?

Emson: Yes, for every job.

Cosgrove: But hang on, if it’s under cap and you give the person a cheque and they—sorry, not under cap, under the EQR ceiling and they go away and get their repairs done, there’s no second assessment at all is there?

Simpson: But if you’re talking about enough damage to cause bracing issues, the visible damage will not be under $15,000. You’re going to have major work. Even if we class it as cosmetic, we’d typically be looking at $30,000 for
cosmetic work. The average job is $35,000, so I can’t see a situation where you’re going to have significant bracing issues and yet we’re not already going in through the Fletcher’s programme to have it resolved.

Emson If it be homes under $15,000 with structural damage that we’ve acknowledged will not be cashed out, only those with the cosmetic damage get a cheque. Everything else is under the repair programme.

Barry My first question is about EQC. I think you’ve done an outstanding job and are to be congratulated, you and your team. So well done. As far as EQC is concerned, though, I want to talk to you about the managing of complaints. I understand from briefings from you that you’ve had something like 443 official complaints that have gone through to the Ombudsman. Can you outline the nature of the complaints and how you are processing and dealing with those, please.

Wintringham Right. There’s two things. One is complaints, and the other is Ombudsman inquiries, and they are often related because a person who is not satisfied with the resolution of a complaint may ask for their file under the Ombudsman, so we perhaps chip in with the detail.

In terms of complaints, I think we divide. There are complaints which are related to some aspect of the repair of people’s houses under the EQR process, and there are some complaints related to and, you know, Ms Dalziel has pointed out examples of people, for instance, who disagree with their assessment or with either the assessment itself or something to do with the nature and process of that assessment.

Let me pick up the Fletcher’s complaints first. My recollection, correct me if I’m wrong, is that of the complaints related to Fletcher’s, I think there are something like 2,100 that have been recorded—2,100 that have been recorded—and that’s across all customer engagement, and that includes, you know, emergency repairs, heating installations, as well as the repair and rebuild—

Barry And can I just put that in a context, and that is you’ve had 100,000 settlements through or repairs through Fletcher’s?

Wintringham Well, yeah, but 29,000 rebuilds. What’s the numbers of the—you’re helping me out here.

Simpson It’s 1.6 percent of all the customer contact that we’ve—

Barry Sure. It’s a small proportion—sure.

Wintringham 1.6 percent. I’m not being smart about it, but we’ve actually had over 3,000 compliments as well, but that’s never picked up. Let’s put that to one side.

Emson Noted for the record.

Wintringham Yes, noted for the record.

Barry Let the record reflect.

Wintringham Of the complaints about the construction process, there are some complaints which we will not be able to deal with, and those complaints
may be—and I do not want to trivialise them, because they’re obviously of concern to people—but the complaint from the neighbour who complained to us about the colour of the house, the colour that we were painting the house next door under the repair, which was chosen by the homeowner. And obviously that is of concern to the neighbour, but it’s outside our, you know, outside our control. Or the person who was concerned that the tradesman was using Dulux rather than Resene paint. There are those. But, you know, some of those we will not be able to deal with.

Barry They wouldn’t go through the Ombudsman, probably, those sorts of complaints.

Wintringham Probably not. And then the other complaints about the quality of the construction—my understanding, and I’ll ask Ian or Bruce to confirm if I get it wrong, is that the bulk of those are to do with, well, there are some to do with behaviours of the tradespeople who are in there, and there are personality clashes, but the bulk of the complaints about the work itself are to do with the finishing, often painting, and that’s not unusual, because has anybody here had a repair or renovation done that they’re entirely satisfied with?

??? Normal practice.

Wintringham But, nevertheless, it’s important, so we have established—what is it—a painting guru? Yes, to go and do the inspections and provide the separate opinion on that. As far as more general complaints about assessment goes, have you got the numbers of that? We could talk about OIAs if you want.

Simpson OIAs we could talk about. In terms of general assessment complaints?

Wintringham General assessment complaints? Numbers?

Simpson I don’t have that in front of me.

Wintringham No. We may have to give you those, because they are related to OIAs. We have an issue with Official Information Act requests. I mean, no ifs or buts, we do not have the infrastructure of a Government department to deal with them, and people who are understandably frustrated and distressed will seek under the Official Information Act information about their claim. We will respond to that as we can, as a result of which we have at times had to take people off claims processing to deal with those, but now we are building the team to deal with it. You’ve got some numbers there about the number of complaints gone to the Ombudsman. My understanding is that our business is still, yes, it’s less than 5 percent of the Ombudsman’s business. So while it’s a matter of concern to us, we need to get on to that so that it doesn’t become a large part of the Ombudsman’s business. Do you want to add anything?

Dalziel Could I just ask a quick supplementary on that because it is relevant. Have you thought about automatically sending out the scope of works to people? Because I actually think a significant number of your complaints would evaporate if you just did that automatically.

Wintringham Yep. Yes. Yeah, we have thought about that.
Dalziel: Have you thought about it? Why don’t you do it?

Wintringham: Yeah.

Dalziel: I mean, electronically it would cost you nothing.

Emson: One of the problems, Lianne—sorry, Ms Dalziel, as you’ll appreciate, we have difficulty identifying the customer. So every customer—in my own case, I have nine or 10 claims, multiple events, three categories by complaint, and we have had awful difficulty identifying the customer and building a common database that says, actually, the address that’s 123 Smith Street is this person. We’ve got lots of issues that we’re facing there. We’ve gone through a process of rationalising that, which will allow us now to send out uncosted scopes of works—

Dalziel: Yep.

Emson: —to customers as they complain.

Dalziel: Automatically, or do they have to ask for them? Because what I’m saying is that if you leave it so that they have to ask, you will end up with complaints.

Emson: So my reaction is that there’s nothing automatic in our system. It’s all manual, but as a matter of course, that’s what we’re trying to get to.

If I can just come back to, if I can, on the complaints. One of the processes, particularly the EQR exercises, we take every complaint, whether it’s whether or not the builder’s wearing a T-shirt versus a vest, down to, yes, there’s serious issues with the work. One of the things we do offer that perhaps causes some of the confusion is a complaint is lodged, and the customer has that opportunity right up to the point where the tradesperson leaves the home, and then there’s a 90-day period. And during that 90-day period we go back to the customer again, before we make the final payment to the tradesperson through Fletcher’s, to ensure the customer is satisfied with the work. But through that process, if a complaint is lodged at all, we register it as a complaint. So we take in everything, and then there’s a filtration process, from those that are a difference of opinion through to substantive complaints. So there’s a lot of focus on ensuring customers’ complaints can be dealt with.

Barry: And do you have a mechanism to publicise that or to acknowledge that, yes, while there have been 2,100 recorded complaints and 3,000 compliments, the resolution is also recorded in some form?

Emson: We should publicise it, but—

Barry: Mightn’t be a bad idea.

Simpson: It’s reported internally.

Wintringham: No, it’s not reported externally.

Barry: Sure.

Goldsmith: All right. Now, we’ve got a fresh line of questioning from Eugenie Sage.
Sage: Thank you. Good morning. On the central city plan, and to CERA. Did CERA receive any request from the Christchurch City Council to designate Hagley Oval as an anchor project in the central city plan and blueprint?

Sutton: I’ve got some notes in my bag about what that whole legal position is, and I couldn’t tell you what those notes are because I was going to read them flying up here but I didn’t because I—yeah. I’m sorry. Can I get back to you on that?

Sage: Yes, and the follow-up, then. If there was no such request, why was it designated? Yep, that’s fine.

Going on to heritage, then. CERA’s draft recovery strategy provided for a built heritage recovery plan, which, and I quote “enables innovative and sympathetic restoration and rebuilding contributing to a quality urban environment”. There’s no clear mention of a built heritage recovery plan in the final strategy, which was released by the Minister in March/April. Why was it dropped?

Isaacs: There is a recovery strategy. Sorry, there’s a—the Ministry of Culture and Heritage is leading the work around the heritage plan. I can’t answer why it wasn’t—I’m not sure why it was dropped out of the strategy. I’m not sure why it’s not specifically mentioned, as you say, in the strategy.

Sage: So, Mr Isaacs, are you saying that it is the Ministry of Culture and Heritage’s responsibility to complete the plan and not CERA’s, even though it was in CERA’s strategy?

Isaacs: CERA has asked the ministry to do that work, and we are part of the team, as is the city council, on that, but they are the lead agency on that at the moment.

Sage: Well, whose responsibility is it for finishing it?

Isaacs: Well, we’re—I mean, we are, you know, we coordinate the recovery, but it is for them to actually lead that bit of work and see it to its completion.

Sage: When will it be completed, then?

Isaacs: I think—I’ll go back to them and get an answer to you.

Sage: And I hope it’s clearer than some of the written answers for questions that have been coming through.

Just going again to some of the projects, the anchor projects in the central city blueprint, in preparing a blueprint did CERA consider or begin to explore any public-private partnerships for the construction and operation of any of these central city anchor projects?

Emson: I mean, I think the answer is—well, Warwick?

Isaacs: Can I just clarify the question you’re asking. During the process of the development of the plan, no.

Sage: Or subsequently?

Isaacs: Subsequently, yes, but not during its development. But, certainly, subsequently we have. And that was a part of what I talked about before—
the expression of interest around the convention centre to explore the potential, including PPP.

Sutton 

So, yeah, we are looking for players there who would have done that sort of thing before, who know how to make it a really successful place, who know how to do that sort of thing, who’ve got real know-how and also therefore have got the incentives to build something which is energy-efficient and has all those other good things in there as well if they’re going to be the long-term player in there.

Sage 

So you’ve mentioned the convention centre. What about the performing arts centre?

Isaacs 

So, again, through the convention centre process, we did actually identify that it was a performing arts area. Also, even, I think, we talked about the library, the central city library, being adjacent to the convention centre. Any participants in the marketplace that wanted to put forward some proposal where the private sector may have a role other than just building it, we were open to those expressions.

Sage 

So are you saying that some of the facilities like the library, like the performing arts space, which was in the town hall, which the city council used to own and operate, would potentially be operated by a private sector interest?

Isaacs 

We did put that to the market. Also, that would include the music centre, Court Theatre, who don’t want to own their own buildings. They want to be tenants. So we did put that out to the market and say if there was any interest there, then not only CERA, but the city council and those organisations, would be interested in hearing from those people.

Sage 

Is that one of the reasons why CERA doesn’t believe that the town hall should be repaired and restored, to free up the area—that whole concept for a public-private partnership?

Sutton 

I don’t think we’ve said that, have we?

Sage 

Well, there certainly hasn’t been a clear—your Minister has certainly not endorsed the repair of the town hall.

Sutton 

I’m not our Minister.

Sage 

So what is CERA’s position on the town hall, then?

Sutton 

We don’t have a position on it.

Sage 

Just one final one, then. And so in relation to the convention centre, has any consideration or has any exploration been done on an arrangement similar to the financing of a new convention centre in Auckland involving Skycity?

Isaacs 

The short answer is no. Again, we put it to the wider—through a very public process. Now, I’m not sure whether that particular party has been part of the responses back to us or not, but the short answer is no, we did not go out of our way to explore that type of arrangement.
Sage But you wouldn’t exclude it if they come back to you on it?

Isaacs We would have to consider those, as we would consider any others.

Smith I have two questions, one for EQC and one for CERA. But, firstly, I do want to acknowledge that your two organisations, to have received a clean audit report, with the scale of challenges that you have had over the financial year that’s in review, is a pretty extraordinary achievement. When I look at the time pressures, the billions of dollars that you are collectively responsible for, the technical challenges, the sorts of strong emotions, it’s a pretty good report that we’ve had through from audit.

My first question is with respect to EQC. It’s a pretty extraordinary organisation that we have in New Zealand around managing earthquake risk, and, effectively, your pot has been completely cleaned out with the Christchurch earthquake. Earthquakes aren’t kind in coming in regular 30-year intervals. We had the experience of the Murchison earthquake in 1928 and Napier just 3 years later. It’s effectively a random event. Touch wood it doesn’t happen, but there is a risk that somewhere else in New Zealand we could get a major risk event, with your pot empty, and New Zealanders are relying on you to provide that cover. What have you been able to secure in terms of reinsurance cover so that—God help us we don’t—if we get a massive 7.5 or 8 earthquake in this city with a sort of $20 billion to $25 billion bill, what level of reinsurance have you been able to secure for the medium term until EQC has been able to recover its reserves up to the sort of pre-Christchurch earthquake point?

Wintringham Yep. You negotiated it on our behalf, Ian, so do you know the exact numbers? Yep? Good.

Simpson So we actually managed to increase our cover in the last renewal, the cover that kicked in from 1 June this year, so prior to that point, we, the EQC, took the first $1.5 billion of claim costs, and then we had reinsurance cover up to $4 billion, and then it was back on to our balance sheet. That cover, thankfully, given the sequence, we’ve had reinstated for a second event. So while that is $2.5 billion of cover, our claim is almost $5 billion for the Canterbury sequence.

When we renewed last year, we were able to add an extra $1 billion layer to the top of that cover, but because of pricing constraints we didn’t see as much value at the bottom range, so we lifted the bottom of the programme from $1.5 billion up to $1.75 billion. So we’ve added to the scale of the programme.

In terms of the medium term, one change that the market has requested from us, that we’ve complied with, is we’ve moved to an annual programme. Historically, we had a rolling 3-year programme to try to take some of the volatility out of the premiums, given the uncertainty, largely the seismic risk in Canterbury, but around the country. They’ve pulled that back, so we’re now, this year, moving to an annual cycle. So we need to maintain that ongoing transparency with the international markets, just to
2011/12 FINANCIAL REVIEW OF CERA AND EQC

let them know how we’re progressing and the contractors in terms of doing the business

Smith So, just to be clear, at the current regime for EQC you’ve got a $1.7 billion excess?

Wintringham Yes.

Smith And you don’t have $1.75 billion in the tin?

Wintringham No.

Smith And so, effectively, the Crown is covering a liability—

Wintringham Yes.

Smith —of up to $1.75 billion in the event of an earthquake, and what I’m hearing is that, and you’ve got $5 billion of reinsurance cover over and above that. Is that correct?

Wintringham No.

Smith Well, you’ve said 4, and you’ve added a further 1.

Simpson Sorry. The top is $5 billion, but you take off 1.75 at the bottom. So the absolute cover is just over—

Smith 3.25.

Simpson 3.25.

Wintringham Yes. So to go back—so before, we covered the first $1.5, then there was $2.5 billion of reinsurance, which took us up to 4, and then after that we—which then reinstates, but if it’s for the same event, then we get back into our own funds, and, ultimately, the Government guarantee. Now we’ve got, in the event of another major event the Government carries the first 1.75, the reinsurers carry the next 3.5 because we’ve gone up from 1.5 to—

Simpson 1.75.

Wintringham Yeah, but the reinsurance cover itself has gone up after our 1.75 excess.

Simpson Yep, up to $5 billion.

Wintringham So that’s 3.25. I’m sorry. So 1.75 we carry, and now we’ve got 3.25 from the reinsurers, but that’s on an annual basis, but our judgment is that, in the absence of another major event, we will be able to renew that on an annual basis at certainly no worse pricing than currently, because I think the price that we are paying for that, for our cover at the moment, reflects the uncertainty of the Christchurch events. The longer we go on without another one, the memory of the market fades.

Smith Can I be clear—pre–Christchurch earthquake we effectively had that which was in the National Disaster Fund plus your reinsurance, and from the answer that you’ve given me, the level of cover that we currently have is in effect less (a) because the National Disaster Fund has been cleaned out—

Wintringham Yes.

Smith —and so there is an inherent element of risk for the Crown—
Wintringham: Yes.

Smith: —which is significantly above what it was pre-Christchurch—

Wintringham: Yes.

Smith: —in terms of a significant event. If I look at worst-case scenarios of a one-in-500-year event in Wellington, which could potentially have as much as a $25 billion liability, you’re indicating that, sorry, the Crown, by my rough numbers, is likely to be carrying a liability of up to 20.

Wintringham: Yep, but this is not a decision which the board and management of EQC decided to take alone. We took that decision after sounding out from the Government and the Government’s advisers about the degree of fiscal risk that the Government was prepared to take, and there is a significant cost in terms of our reinsurance. I mean, we are now paying, what, 100?

Simpson: 140.

Wintringham: Yeah, we are now paying $114 million per annum for our insurance premiums. I suppose the other part is, it depends when the next event occurs, because with the increase in the EQC premium, obviously a part of that increase was to ensure the beginning of the rebuild of the Natural Disaster Fund.

Goldsmith: Just a quick follow-up and then David’s got one, but just remind us—the cover you had prior to Christchurch, I have $15 billion in my head. The fund and the reinsurance you had prior—

Simpson: Prior to Christchurch we had $6 billion in the Natural Disaster Fund, and the reinsurance cover we’ve just talked about, which for a single event adds $2.5 billion. Plus, we should add, in terms of the Crown risk, since 1993 we’ve been paying the Crown $10 million a year for the Crown guarantee. So that, in effect, was State-provided reinsurance. That’s the way we looked at it. That’s the ultimate. Could I also just clarify if I could, Dr Smith, in terms of the Wellington event, we need to compare like with like, so EQC’s residential portfolio, while the whole Crown cost may be 25, we’re looking at a 50th percentile cost of about $7 billion.

Smith: So the worst-case scenario for Wellington for EQC is more like a $7 billion bill?

Simpson: Well, that’s the 50th percentile. That’s the mid-point. If you get up to the 95th percentile, I think you’re looking at $11 billion or $12 billion.

Parker: If the cost of the reinsurance has risen, has that doubled? Fifty percent more, is it?

Wintringham: We paid just under. For the 2.5 in excess of 1.5, we paid around about $38 million to $39 million, so for the—

Goldsmith: Prior to Christchurch earthquake?

Wintringham: Yeah, this is prior to Christchurch. There are portions which rolled over bit by bit, but the simple explanation is we paid about $38 million, $39 million. It always hovered under 40, and now we are paying $114 million for a
slightly larger amount of reinsurance, but at a slightly higher attachment point.

Simpson: Sorry, I did mumble my answer. It’s 140, rather than 114.

Wintringham: Thank you.

Parker: 140!

Wintringham: 140.

???: That’s tripling.

Simpson: Roughly triple.

Wintringham: Yeah, I took your advice there.

???: Thought we’d done well!

Parker: What’s the effect of that on a householder’s EQC premium?

Simpson: Our levy is set by regulation, and there’s no direct actuarial link between our costs.

Parker: OK. So what have levies gone from, to?

Simpson: They were $69 per year including GST, and they’ve trebled to $207 including GST.

Parker: And for that the householder gets a level of earthquake cover which is limited by an upper amount, and in respect of the risk over and above that, they pay via their private insurance. And just remind me what the level is it’s capped at?

Simpson: The EQC cover is $20,000 for contents, $100,000 for the building and land area, capped by area rather than value.

Parker: OK. So just to keep it simple, we exclude land—$100,000 roughly for the building—and in terms of the cost increase in respect of their insurance-related costs over and above their $100,000, presumably that’s about tripled in the private sector as well?

Simpson: Not sure. It maybe doubled in terms of private—it’s depending around the country, but maybe doubled in terms of the—

Sutton: Of late I’d say, yeah, I mean, the anecdotal stuff I hear is that people’s premiums commercially are up significantly, although it depends a lot on what you’ve got. If you’ve got a brick and masonry building, you know, in Wellington that’s unreinforced, you’re going to pay a much, much higher premium there than you did previously. If you’re building a modern building—the example I have, modern buildings in Christchurch are paying 30 percent or 40 percent more than they did pre-quake, but then they’re probably paying half of what they were having to pay, say, soon after one of these quakes.

Parker: OK. So, sorry, I’m just trying to get this in rough numbers. So for earthquake cover now for someone who’s got, you know, a house that might be worth, say, $400,000, the earthquake component of their premium will be probably around $600 a year. Would that be roughly right?
Sutton  Well, the EQC bit is about $200, and you’re paying for a—I mean, I think I pay about $800 a year to insure my house.

Parker   In total, including that?

Sutton   Including the EQC.

Parker   The reason I ask is that one of the reinsurers came to see me and said New Zealand has the highest level of earthquake cover in the world and that they thought that going forward, unless the Government was willing to step in and provide a level of the cover, and, as Nick Smith’s already illustrated, they already do, they were contemplating more, they didn’t think that the levels of earthquake cover that we have going forward will be affordable for a lot of people. Do you have a view on that?

Wintringham Yes. Affordability of insurance, speaking from our perspective, depends to a very large extent on the ability of the insurer to lay off that risk with reinsurers. So the nub of the question is the willingness of reinsurers to take on the risk and the price at which reinsurers will do so. So at the moment we’re seeing—this is from our perspective; I can’t speak for the private insurers—this is only residential, with those numbers we’re seeing a significant step up in pricing. It may be famous last words, but my judgment is that that’s a peak, and we will start pulling back from that, and we are not seeing any evidence—all our lines were fully subscribed, in fact oversubscribed, last time.

Simpson   That’s right.

Parker   So I understand—I understand the insurance is available at a price. My question was do you think there are going to be increasing numbers of New Zealanders who under-insure because they can’t afford full insurance? Are you seeing any pattern around that?

Sutton   Yeah, look, the first comment I’d make is that New Zealand’s level of insurance is really high. So we’ve found out in the red zone about 99 percent of people actually were covered—you know, quite an extraordinary number. And I think that’s very, very high internationally. And that all the buildings have earthquake cover is probably unique. I think the insurance companies are thinking about how they cap some of their cover at the moment. So a lot of people have had uncapped policies, so if you’ve got a house with lovely rimu panelling and all this other sort of stuff and it’s going to cost this much money to go and fix it, the insurance company has been obliged to do it. So those uncapped policies, we’re seeing insurers moving towards saying “Well, we’ll rebuild your house. We will give you a new house, but we’re going to cap the rebuild price at”—make up a number—“$200 a square foot.” or something like that. So I think they’re looking to try and cap their cover because they’ve just been surprised at the amount they’ve had to spend fixing a lot of people’s houses.

Parker   So assuming that flows through, my question still is are you worried about there being a trend? And given the increasing cost of insurance, do you think there is any likelihood that some people are going to say “Hey, I can’t afford it.” and they’re going to either not insure, under-insure?
Simpson At the margin that will be a risk, but I think actually the market will respond with different products that actually still provide a reasonable level of cover, but maybe not the gold-plated policies that we’ve seen—

Sutton I think that is something for us to consider, do we have have policies which cover us against broken glass and what I’d call trivial, without being too rude, but don’t actually cover you for the really catastrophic event, and I think we as a society, people, need to think carefully about what they want to be covered for. Do they want to be covered for trivia or things that really matter?

Parker The big risks that they can’t afford.

Sutton Right.

Parker Can I just suggest that I think that’s an area that you people need to monitor very clearly because we’ve seen in respect of the proportion that is uninsured, it actually falls on to the Crown again, or we have people who suffer a terrible consequence, which just, you know, leaves them relatively poor for the rest of their lives. So I would encourage you to be monitoring whether that’s the case, because the answer may well be then, your answer, that we have to encourage people to insure against major events rather than trivia.

Wintringham This is one of the major considerations of the review of the EQC Act, which is currently under way, which starts off with what is the reasonable expectation that a society should have of the risk which people cover themselves, and what would be the Government’s role, and then how do you give effect to that through the scheme?

Parker Will that include what would be the effect on your cost and the ministry’s cost of having an excess? Because at the moment there’s virtually no excess in the EQC portion of it, and that must drive some behaviours.

Wintringham Oh, yes, all of that is absolutely right. It’s on the table for discussion. It’s the nature of the cover, the excesses, relations with the private insurers, who does what, what the cost of it is. Those who have responsibility for the review, one of their primary considerations is maintaining an effective insurance market in New Zealand, because that obviously underpins economic and social activity.

Bennett Nick Smith touched on the risk in Wellington. Probably the more likely risk may actually be the central North Island at the moment because you cover volcanoes as well, don’t you?

Wintringham Yep.

Bennett Have you perceived what risk that might be if you did have something there at the moment, and whether that would then be a problem for you?

Wintringham Yeah, well, I’ll give the chief executive a chance to collect his thoughts while I—yep, the answer is yes. Certainly, prior to Canterbury we were in, I think, the mid-stages of modelling what events under our cover would trigger, what, more than 80,000 or thereabouts claims?
Simpson: Yep.

Wintringham: And there are, well, you know, there are a definable number. And it still comes back to that the probable maximum loss for our cover, it still remains the Wellington fault because it’s a combination of the geophysical or natural risk with the proximity and nature of the built environment. And it’s still Wellington. And to go back to your comment earlier, Dr Smith, we are prone to earthquakes, but with the great prescience of the people who established the EQC scheme in the mid-1940s—Earthquake and War Damage as it was then, of course—between then and Canterbury, we have had no major earthquake in the built environment. You know, Te Anau, Edgecumbe, Inangahua. God bless the people who live there, but it’s not in the centre of a major city. So we’re riding on the back of that.

Dalziel: I have a number of questions, but I’ll just focus in on the residential red zone and CBD. I thought that the Minister may have softened his stance a little bit in the House yesterday with an answer to a question on people wanting to stay after 30 April. In his reply he said that it would be assessed on a case by case basis. But then he went on to say “But I would have to say it is unlikely.” Have you offered any advice on this and what was that advice? He talked about the cost of maintenance of access and infrastructure to homes, but that’s paid for by the council rather than CERA or the Government. So what’s the council’s position on it? And there will be people who won’t accept the offer, so they’ll still be there anyway. So it’s a really important question, because there are some people who are just weeks away—of 30 April—from having their house ready to move in to. So you’re going to require them to move twice when just allowing them to stay for a matter of weeks after that deadline would actually allow them to have a much easier transition to their new life.

Sutton: This is something I get stopped in the supermarket by people, I get phone calls from people, about this issue, and the elderly people want to talk to me about this issue—in particular, the sort of cases you talk about Ms Dalziel. So it’s something we are talking to our Minister about, but at the end of the day it is very much a political decision about what happens there, but we’ll continue to answer the Minister’s questions as he asks our views on these issues as we collect information. But we are trying to talk to those people to try to understand what their needs are, what the hold-ups are going to be, and how many of them there are. We are talking to people about that.

Dalziel: But have you provided advice recommending that it be extended on a case by case basis?

Sutton: No, I don’t think we have actually provided any written advice—no.

Dalziel: So he hasn’t asked you to provide any advice on extending the deadline for some people, even on a case by case basis?

Sutton: No, no, he hasn’t, but we are working on some advice at the moment.

Dalziel: And bare sections and commercial land in the residential red zone, why 50 percent of the most recent rating valuation for the land?
Sutton  The simple answer to that is the fact that the residential land that had a
building on it had EQC cover, so it was insured to that extent—

Dalziel  That’s not a reason why you’ve made an offer for a voluntary settlement of
their land, which would normally be subject to a compensation claim. So
you’re treating commercial buildings in the residential areas differently from
the way you’re treating commercial buildings in the centre of town.

Sutton  If these buildings had been taken for a road or something or other under—

Dalziel  They would have market value at the time.

Sutton  Yes, so they may have market value at the time, and you could argue market
value at the time is much, much less than RV, because—

Dalziel  No, no, market value at the point at which the designation would be
required. So the Government can’t extend out the time and then say
“Actually, your land’s not worth anything now because it’s got a motorway
coming up to the door.” I mean, there’s lots of court cases on that.

Sutton  I guess my advice is that if we had said “Look, today we’re going to offer to
take your land for this motorway.,” and that land had been decimated by
this earthquake event, then that land would be worth much less than RV,
though.

Dalziel  But if you’d done it at the time— You know, if it was related—

Sutton  Like I said, if we paid them the value before the earthquake—

Dalziel  The market value.

Sutton  —but the key thing is it’s before the earthquake. My advice is that the
relevant number is post the earthquake.

Dalziel  Yeah, but hang on, you’ve given 100 percent of the land value—the rating
valuation, not the market value, but the rating valuation—for the land for
everyone else in the red zone, but not the business owners. Why on earth
are the business owners being treated so poorly?

Sutton  Well, the business owners’ land isn’t actually insured.

Dalziel  That’s not the point. This is a voluntary offer that you’re making for people
to settle the land.

Sutton  But that’s also the point as well—that it’s actually a voluntary offer as well.

Dalziel  But then you’re extending the time—

Goldsmith  I think, Ms Dalziel, you’re just not letting him answer the question.

Sutton  It is still a voluntary offer. Decisions haven’t been made whether the offer is
going to be compulsory or what’s going to happen to those people. It may
be some of those landowners decide to stay, and it may be the Government
and the local body decides to allow them to remain as well—we haven’t
made those decisions yet.

Dalziel  But if they’ve got no damage to their property?
Goldsmith: We'll just have one final question, because we've done our time, and then we'll move on to the next thing.

Dalziel: And there are a lot of business owners in the centre of town too—or building owners, property owners—who are being, basically, screwed in terms of the amount they are being offered as well. So it's been pretty hard on business in that regard, so if you're in the residential red zone, you're only going to get 50 percent of the rating valuation for your land. But even in the CBD you're not even guaranteed the rating valuation for your land either. Some people are losing a lot of money. I saw one business owner saying that he was prepared to accept half the rating valuation of his land, but he owns extensive properties in the centre of town where the CBD, the frame, will increase the value of the land significantly. So what are you doing for those poor property owners?

Sutton: At the end of the day I guess I also work for the taxpayer, and I have to pay them what I think is fair value. I think if the Government actually had done nothing, if the Government, after this earthquake, had said “Look, we’re not going to take any active role in the CBD. We’re just going to stand back and do nothing.” Then I think the land prices—if the land price had been $100 before the event and the Government had said “We’re going to do nothing.”, then the land price would have maybe been less $20.

Dalziel: The alternative wasn't nothing.

Sutton: Well, in other countries, that has been the alternative—

Dalziel: But it was never going to be the alternative here. How do you answer a business owner, a constituent of mine—

Sutton: I guess in answer to that—

Dalziel: —who owns a building and they have been offered insufficient money to set up their business somewhere else?

Sutton: I guess at the moment a lot of those business owners we're seeing are talking to us about taking the money, because they see the money we're offering them is actually going to allow them to buy a business elsewhere in the city at a price they think will actually work for them.

Goldsmith: OK. All right, well, thank you very much. We've had a good session—an hour and a half. Thank you very much for coming in, and we appreciate all your efforts. Thank you very much.

conclusion of evidence
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Capital and Coast District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
# 2011/12 Financial Review of the Charities Commission

Report of the Social Services Committee

## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation</td>
<td>2</td>
</tr>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>The Commission’s Performance</td>
<td>2</td>
</tr>
<tr>
<td>Transition to the Department of Internal Affairs</td>
<td>3</td>
</tr>
<tr>
<td>Trust and Confidence</td>
<td>3</td>
</tr>
<tr>
<td>Appendix</td>
<td>4</td>
</tr>
</tbody>
</table>
Charities Commission

Recommendation

The Social Services Committee has conducted the financial review of the 2011/12 performance and current operations of the Charities Commission, and recommends that the House take note of its report.

Introduction

The Charities Commission was an autonomous Crown entity established under the Charities Act 2005 to register, support, and monitor charitable organisations in New Zealand. Its functions included compiling and maintaining the Charities Register, monitoring the eligibility of registered charitable entities for registration, educating and assisting charities on governance and management, and taking action against non-compliance with the Act.

The commission was disestablished on 1 July 2012 and its functions transferred to the Department of Internal Affairs, except for the charities registration function, which is now carried out by an independent board with support from the department.

In 2011/12 the commission’s total revenue was $5,729,199 and its total expenditure $6,107,744, leaving a deficit of $378,545. The Office of the Auditor-General assessed but did not grade the commission’s environment, systems, and controls, as it was about to be disestablished.

The commission’s performance

Two assessments against output performance measures—the proposed six-monthly quality audits of complaints received and actioned, and of investigations carried out during the year—were not completed in 2011/12. We recommend that the department assess the relevance of and need for these measures.

The commission did not meet its target for deciding applications for registration, deciding only 10.3 percent of applications within the required time, compared with 99.5 percent in 2010/11. We note that a number of staff from the registration team left at the time the transition was announced, which affected the pace of registrations. However, we are pleased to hear that by December 2012 the backlog had been eliminated and the 70 percent target for completing applications on time is now being met.

Some projects planned for the compliance and education teams were deferred until replacement staff could also be appointed, and we note that a proposed review of the Charities Act has been put on hold. We expect that the department will be providing an update on the review and the deferred compliance and education projects in its next annual report.

The Office of the Auditor-General also found a number of transactions that were not strictly in line with the commission’s policies. Issues included the adequacy of supporting documentation and the appropriateness of farewell gifts and staff benefits. We recommend that transferred staff members be made aware of the department’s requirements, which may differ from those of the former commission.
Transition to the Department of Internal Affairs

The total cost to the former commission of the transition was $304,451, including $209,482 in compensation and other benefits relating to cessation. The costs to the department of the transition related primarily to systems. These costs will be considered in the 2012/13 financial review of the department. The department expects savings from the transition of $283,000 for 2012/13, and $566,000 for 2013/14.

At disestablishment, the commission had 40 staff who were to move to the department. Most of them accepted permanent positions in the department.

Staff turnover was a problem during the year preceding the disestablishment. However the department said it endeavoured to keep the registration, compliance, and education teams intact for transfer to the department. The commission’s turnover of permanent staff during this period was 35 percent, particularly affecting the registration team. Eight new registration analysts were needed for a team of ten, which contributed directly to the commission’s not meeting the registration completion target. However, the department reports that staff morale has improved recently with the recruitment of the new charities leadership team and staff to fill vacancies, and there has been less turnover since September 2012.

The charities group was placed in the department’s service delivery and operations branch with the community operations group. It uses the existing compliance framework and shares compliance strategies to target organisations being investigated. The department also intends to share resourcing between the charities and community operations groups, where regional advisers from the community operations group will take up an education role for community organisations.

The department intends to measure the benefits of the transfer through analysis of internal workflow reports, and assessment of the number of collaborative initiatives in the sector and “the range of options available for reaching into the sector.” It intends to report against the measures through its annual report and reports against the department’s performance standards. We recommend the department clarify its performance measures, and look forward to receiving the results at the next review.

Trust and confidence

The department acknowledged that the public’s trust in charities has lessened over the previous two years, as evidenced by a 2012 survey undertaken by the former commission. In response, the department has focused on maintaining the integrity of the Charities Register, addressing complaints, and providing extra staff to meet the registration application completions target. Through their newsletter, the department has also provided the charities sector with information about public perceptions and actions that might assist in increasing public confidence.

The department also asserted that the survey results were influenced by negative media about the practices of organisations that were fundraising on behalf of charities, and noted that the same survey had revealed public awareness of the commission had increased. We expect that a further survey conducted prior to the next financial review would be enough to gauge if that assertion was correct, and if the actions undertaken by the department were sufficient to restore confidence in the sector.
Appendix

Approach to this financial review

We met on 20 February and 10 April 2013 to consider the financial review of the Charities Commission. We heard evidence from the Department of Internal Affairs and received advice from the Office of the Auditor-General.

Committee members

Peseta Sam Lotu-Iiga (Chairperson)
Jacinda Ardern
Hon Phil Heatley
Melissa Lee
Jan Logie
Le’aufa’amulia Asenati Lole-Taylor
Alfred Ngaro
Dr Rajen Prasad
Mike Sabin
Phil Twyford
Hon Michael Woodhouse

Denise Roche replaced Jan Logie for this item of business.

Evidence and advice received

Office of the Auditor-General, Briefing on the Charities Commission, dated 20 February 2013.

Department of Internal Affairs, Responses to written questions, dated 15 February and 13 March 2013.
2011/ 12 financial review of the Commerce Commission
Report of the Commerce Committee

Contents
Recommendation 2
Introduction 2
Budget and resources 2
Telecommunications 3
Christchurch rebuild 3
Credit Contracts and Consumer Finance Act 4
Work under the Fair Trading Act 4
Plain English initiative 4
Appendix A 5
Appendix B 6
Commerce Commission

Recommendation

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of the Commerce Commission and recommends that the House take note of its report.

Introduction

The Commerce Commission is an independent Crown entity under the Crown Entities Act 2004, and a body corporate under Section 8 of the Commerce Act 1986. The Minister responsible for the commission is the Minister of Commerce, and it is monitored by the Ministry of Business, Innovation and Employment. The chief executive is Brent Alderton, and the chair is Dr Mark Berry.

The Commerce Commission’s income for 2011/12 was $42.18 million, and its expenditure for the period was $35.3 million, resulting in a surplus of $6.9 million rather than the budgeted loss of $2.3 million.

The commission’s purpose is to make markets more competitive, consumers better informed, and regulation better targeted and more effective. It also works to limit anti-competitive behaviour.

Budget and resources

We asked how the commission had achieved a net surplus in 2011/12 while undertaking its advocacy and litigation work. It told us that the surplus resulted partly from funding for some work that did not eventuate.

We noted the commission’s increasing workload, and that although it had occasionally received additional one-off funding for extra work, its baseline funding remained static. We asked whether further resources might be needed. The commission said that over the last three or four years it had changed its structure and the way it funds its work. To manage its budget it projects funding and spending several years ahead and tries to manage its resources flexibly. The commission believed that its work was respected by the business community, and said it was not afraid to tackle major litigation, in which it achieved a high degree of success. It did not believe that there was a risk of increasing the incidence of lengthy litigation initiated by other parties.

We asked whether the commission believed it was adequately resourced for its likely workload, including any inquiries, and whether it might initiate more inquiries if it had more funding. It pointed out that time-limited funding for undertaking inquiries under part 4 of the Commerce Act had expired, and it was now working with the Ministry of Business, Innovation and Employment to assess the level of continuing funding needed for this work. The commission said it was adequately resourced, and in the past year it had been able to undertake all of the major competition, consumer, and regulatory work before it. It had not asked the Government for additional funding.

The commission said it had done no work regarding The Hobbit movies or the Skycity convention centre.
**Telecommunications**

We observed that the Prime Minister had stated that he would not rule out using legislation to overturn the commission’s draft determination on the wholesale price of copper. The Government had also announced that a review of the telecommunications industry would be brought forward. We asked whether the commission considered the actions of the Government to be inappropriate political interference, and whether it felt political pressure. It told us it believed the process between the commission and the Government was working as was intended, and it expected to be consulted during the review. It was not consulted about the terms of reference for the review, but did not expect the review to prevent it doing its work.

The commission said it did not think the review being brought forward was related to competition issues regarding Chorus, but thought the review would raise any such matters. It agreed that the heart of the issue was the orderly transition from copper networks to new fibre technology; it did not believe that copper was in competition with fibre, as both were owned by Chorus.

Some of us expressed concern about the ability of the Commerce Commission to perform its statutory role, and that the telecommunications review announced recently by the Government hamstrings the work of the commission in determining wholesale copper prices until that review is completed. We asked whether this made the Commerce Commission a toothless tiger.

**4G network**

We asked whether the commission considered Vodafone’s newly announced 4G mobile data network to be competing with the fibre network for business. It said that mobile networks were a partial competitor with fibre, but there were many things mobile networks did not have the capacity to do. It had no plans to regulate competition in this area.

**Second trans-Tasman network cable**

We noted that a number of telecommunications companies had recently announced a joint project to lay a second trans-Tasman network cable, and that there were potential competition issues. Concern had been about wholesale prices for telecommunications companies that were not part of the venture, and Telecom New Zealand’s involvement with both the new cable and the existing cable. The commission told us that it had begun to examine these issues.

**Christchurch rebuild**

We asked whether the commission was doing anything to educate businesses in Christchurch about competition issues. It told us that it had a team dedicated to the Christchurch rebuild, which was working on an advocacy programme targeting the industries, such as construction, that it believed would benefit most from help understanding Fair Trading Act and Commerce Act issues, including prohibitions on anti-competitive behaviour. We raised the question of Fletcher Building’s monopoly in project management of home repairs in the Christchurch rebuild in respect of Earthquake Commission mandated repairs. The commission explained that it did not in fact consider the arrangement a monopoly situation. The Earthquake Commission had awarded the contract to Fletcher Construction in a competitive tender process; home owners are free to opt out of the Fletcher-run programme.
The commission had assessed a number of complaints under the Commerce Act and Fair Trading Act about the project management role performed by Fletcher, and had found no issues under either Act. It had no active investigation or inquiry into the matter.

Some of us are very concerned that the Commerce Commission has not considered it appropriate to proactively monitor the activities of Fletcher Building in respect of its monopoly position in relation to Earthquake Commission earthquake repairs. Some of us are of the view that, given Fletcher Building has a legally mandated monopoly, the Commerce Commission should be active in monitoring the company’s performance.

**Credit Contracts and Consumer Finance Act**

We acknowledged the good work the commission was doing on the issues covered by the Credit Contracts and Consumer Finance Act 2003, and noted that the commission had increased the resources being spent on these issues. We asked how this work was going and was likely to progress in future. During the 2011/12 year the commission completed 49 investigations, with four court proceedings resulting in judgments, 13 warnings being issued, and 13 compliance advice letters being sent. The remaining 19 investigations resulted in no further action. Three of the court proceedings resulted in fines and refunds to consumers.

**Lower-tier lenders**

The commission’s main focus under the Credit Contracts and Consumer Finance Act has been on lower-tier lenders targeting vulnerable consumers. It told us that lower-tier lenders were often difficult to identify, and premises were frequently no longer occupied when the commission went to visit. The commission’s process involved identification, audit, and re-checking to ensure that changes were made and compliance with advice was enduring. It told us its work with such lenders had so far resulted mainly in its issuing advice on compliance.

**Work under the Fair Trading Act**

We were impressed that the commission had completed more than 460 investigations into alleged breaches of the Fair Trading Act 1986. We asked whether the commission had prepared for changes to the Fair Trading Act under the Consumer Law Reform Bill. It told us that it welcomed the reforms under the bill and believed they were an important addition to consumer protection law. It had begun preparatory work and intended to undertake public consultation over its approach to various issues raised by the legislation.

**Plain English initiative**

The commission told us that one of its key initiatives was its plain English programme, and it had put much effort into using plain English in its documents and communications. It believed that the way it communicated and explained its work and the law was important for its success. It was a finalist in awards organised by the Plain English Trust.
Appendix A

Approach to this financial review

We met on 21 February and 21 March 2013 to consider the financial review of the Commerce Commission. We heard evidence from the Commerce Commission and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received

Commerce Commission, Responses to written questions, received 24 January and 12 March 2013


Organisation briefing paper, prepared by committee staff, dated 7 February 2013.
Corrected transcript of hearing of evidence on 28 February 2013

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Julie Anne Genter
Peseta Sam Lotu-Iiga
Mark Mitchell
Dr Jian Yang

Witnesses
Dr Mark Berry, Chairman
Dr Stephen Gale, Telecommunications Commissioner
Brent Alderton, Chief Executive
Kate Morrison, General Manager

Young Welcome to the Committee. Look, we’ll just go round the table and introduce ourselves, and then if you could do that for your team, that’d be great, thanks, Dr Berry.

Berry Right, well, I’ll introduce our team here. We also have in the audience here with us Sue Begg, the deputy chair, and certain other officials from the commission who would be able to answer questions as we go through, depending on where the questions may head today.

Young Thank you very much. Well, if you’d like to give us your introduction, and then we’ll come to questions.

Berry We’ve got an introductory statement to give highlights last year and so we’ll go through that as quickly as we can and then leave it to questions. Thank you for this opportunity to meet with you again this year to outline our achievements over the last year. I’ll deal first with some immediate issues. Shortly, investors in the failed financial offering of credit sales will receive letters advising them of the share of the $60 million that we achieved in a landmark settlement, which we announced just before Christmas last year. Our investigation determined that the five companies who developed and sold the credit sales notes had likely breached the Fair Trading Act—in particular, by misleading about the safety of the investment. These investors have bought notes believing their capital was 100 percent guaranteed. The word in the prospectus was “capital-protected”. The notes are now worthless. The commission expects that eligible investors who accept the
offer will receive around $850 for every $1,000 invested. Without our intervention they would have achieved only 2 percent of their investment now. With the benefit of this 85 percent top-up, it brings them up to 87 percent compensation in total. We believe that this outcome could not have been guaranteed from litigation, and these investors are receiving their payments in the course of this year. Bear in mind that many of these investors are older than 70 years of age. We took that into account in the settlement. This case has some important lessons for the financial industry, and shortly we will be releasing our investor closure report, which will set out what we believe to be lessons for the financial sector going forward, which we hope won’t be repeated.

Another significant financial product investigation on our books at the moment is the complicated interest rate swaps farmers bought into back in 2005 and onwards. We have today announced that we are now progressing this matter to a full investigation.

Another issue that continues to be raised with us that I’ll touch on briefly is credit card surcharging. Now, some of the commentary on this is actually inaccurate. There is an expectation that the commission can in some way regulate surcharge pricing in the way that this is done in Australia. In Australia there are discrete regulatory powers conferred upon the Reserve Bank of Australia. We do not have those powers. We have an ongoing role in terms of looking at the compliance with the Fair Trading Act in relation to credit card surcharges, and we are currently investigating the Air New Zealand matter, which is in the public domain.

I’d like to touch briefly on some highlights for the 2011-12 year. In litigation we have received some important judgments that clarify the application of the Commerce Act to overseas companies and their conduct within the cartel arena within New Zealand. The appellate court in two cases—Visy, and Kuehne + Nagel—has endorsed that we have jurisdiction to proceed and to take those cases to trial. The Visy Board inquiry relates to our allegation of cartel conduct in relation to cardboard packaging. Kuehne + Nagel is the last outstanding defendant in the freight forwarding cartel prosecution.

In the long-running air cargo case last year we achieved a further $11.3 million in court-endorsed penalties. The commission has, to date, recovered more than $25 million in penalties, and $1.6 million towards our costs. Three further airlines have since admitted cartel breaches, and we are waiting for the court to deliberate on penalty judgments in those matters.

Another important judgment last year was the Court of Appeal’s decision in the “data tails” case. The court endorsed what is a record penalty of $12 million against Telecom in that case.

We have continued to enforce the Credit Contracts and Consumer Finance Act, with a view to establishing precedent on its provisions. In August last year we received a judgment on the limitation issue, which was adverse to us in terms of restricting considerably the class of affected consumers and how we could seek compensation for them. We have since settled the
proceeding in relation to those claims that are still valid within the limitation time, and affected investors are to be paid out $200,000 compensation. We have been in discussions with the ministry as to the need to clarify the law relating to this limitation provision. It really provides an unrealistic hurdle for us. This case flushed it out. We’re now talking to the ministry about getting the law changed so that that kind of eventuality won’t happen again.

Another longstanding case in the litigation basket was the prosecution of Vodafone, which over the last 2 years has brought penalties amounting to $1.5 million for various misleading deceptive campaigns under the Fair Trading Act. Telecommunications remains our largest area of complaint under that Act, and we continue to be vigorous in our pursuit of matters there. That is a record penalty for that legislation.

In the regulated utility area under Part 4 of the Commerce Act we have continued to make significant progress in terms of our challenges faced under that work stream. All of the process challenges to our input methodologies are now complete. That was the first judicial challenge mounted against us. The second major judicial challenge against us related to whether or not we were obligated to do a starting price adjustment input methodology. We did not do such a methodology, because we believed that we were not required to do so, and the Supreme Court confirmed late last year that our position was correct on that.

Finally, in the litigation basket under the Part 4 regulation work stream, now that that earlier litigation is out of the way, we have now been able to progress to the merits reviews or appeals of all of our input methodology decisions. Those hearings commenced in September last year, and there have been various tranches of hearings, which were completed on 15 February this year, so that litigation is now behind us, and we await the court’s decision.

Advocacy has been an important area of our activities again in the last year. We have a need to expand our focus on advocacy, because compliance with the Act naturally brings benefits to New Zealand consumers. You know, if we’re doing things right by the Act, then consumers are informed and they comply with the law.

Our low-level inquiry unit continues to nip issues in the bud, achieving great results, and I’ve been reporting back on that for the last 2 years. I’ll give just one more example. Protector Insurance failed to disclose a cancellation fee. We looked at that under our low-level investigation unit. Protector saw the problem, refunded 840 policyholders more than $44,000. You know, our cost of doing that intervention was a mere $850.

Our advocacy team continues to interface with businesses to be active in advising about compliance with the Act. We have two particular advocacy initiatives—one is the construction sector, with particular regard to the Christchurch rebuild, and we are also beginning to roll out our advocacy in the health sector. I should also add that we have a DVD on compliance with the Fair Trading Act, and we’ve worked with secondary schools to get that piloted into the schools, with some considerable success.
Our fair trading staff have been very active in dealing with a tide of complaints relating to the growing trend of internet-based traders, some of whom sail fairly close to the wind. We have been providing these companies with compliance advice. In most cases it’s good to see that websites concerned have taken note of this, and we have actually started to see a drop-off of complaints around these website advertising problems.

Under the Credit Contracts and Consumer Finance Act we achieved our first ever banning order, and that indefinitely prevents one Trevor Allan Ludlow from involvement in the consumer finance industry in the future. We also took another test case under the Credit Contracts and Consumer Finance Act last year, which was heard by the High Court on our views about an unreasonable fee case, and we await the judgment in that case.

Finally, under the credit contracts regime, we have inspected further lower-tier lenders in Auckland, Wellington, Waikato, and the Bay of Plenty, and so we have done extensive reviews of their conduct. We’ve really made an effort to get to meet and see all of those traders that we know are involved in that kind of finance.

In terms of merger activity, again, in the current environment there’s not been a great deal. We undertook just eight decided merger applications in 2011-12. There are some signs that merger activity is starting to pick up. In the current financial year we have already decided six mergers, and we currently have a further four on our books. We also received three applications for authorisation—two of these for restrictive trade practices. And it’s been some years before that we have received those kinds of applications. Finally on the merger trade practice front, we completed our first major investigation for some time under our section 47 merger provision, and that was in relation to the Sky-TVNZ joint venture relating to Igloo, where we found that there was no likelihood of substantial lessening of competition.

I’ll turn very briefly to our regulatory work streams. As I’ve mentioned already we’ve continued to roll out our significant regulatory instruments over the last year. Achievements beyond what I’ve already mentioned include in 2011-12 setting the individual price quality regulation path for Transpower. We have also had to defer the setting of the electricity lines business default price quality path as a result of the litigation, but once the Supreme Court cleared us in the starting price adjustment case, that meant that we could then get on and do our ruling on the default price quality path for the electricity companies, and that we did on 30 November last year. Today we have just announced the gas default price quality path rulings.

In the airport sector we have been working closely with the three airports in relation to their information disclosure regime, and we have now advanced into our processes of doing reports to the Minister under our section 56G. We are now required each time the airports do a price reset to report to the Ministers of Transport and Communication as to whether or not this information disclosure regime is achieving the goals of Part 4 of the Act. As you’ll know, we’ve reported on Wellington, and on Tuesday this week we
held our hearing with Auckland International Airport. As you’ll know in the case of the Wellington Airport, we found that the regime is not limiting Wellington Airport’s ability to make excessive profits.

In dairy our focus during 2011-12 was on preparing for changes under the Dairy Industry Restructuring Act, and we’ve already undertaken the dry run review last year. We’ve already undertaken the first statutory review, and we are now currently positioned to move forward to do the second statutory review, which is scheduled to be completed by September this year.

So those, in a nutshell, are the key points that we have achieved in the areas that I oversee, and with your indulgence if I can hand now to Dr Gale to give a brief outline on the telecommunications branch.

Young Thank you. That would be good—thanks.

Gale Good morning.

Young Good afternoon.

Gale The telecommunications team had a busy year up to July and since then, including a change of commissioner from Ross Patterson to myself. The annual telco monitoring report released just last year showed some interesting trends. The broadband connections have increased from 27 percent to 63 percent of all lines over the 5 years to June 2011. Voice and toll revenues are down, but internet revenue is increasing. The fixed line retail market is showing falling revenue for most services, but only internet revenue is increasing. The new voice over IP internet-type services are starting to provide increased competition for traditional voice services, and we expect that trend to accelerate with the roll-out of ultra-fast broadband.

Mobile connections now have shown little growth since 2008. While New Zealand may be nearing a saturation point for mobile phones, there has been a strong growth in the use of mobile devices for internet access, and this is likely to continue. Mobile data doubled in the year to 2011 with unit prices dropping from about 20 cents to about 12 cents a megabyte. 2degrees has established a presence in the market, acquiring 14 percent by connections by the end of 2011, and up to about 20 percent last year. The commission has restarted its monitoring of broadband quality. Consumers are particularly interested in the quality of their service relative to price, reporting that this is a key reason for switching providers. Internet service providers have supported the testing and have changed their service levels as a result. More recently and in the medium term, the commission is in the process of finalising the first determination under the new telecommunications development levy.

Young Look, we are running out of time for the presentation, Dr Gale. We’d like to get to questions as soon as we possibly can. Could you just wrap up, if you don’t mind, sir.

Gale OK. Well, shall I jump to the big items of the last recent period? In December last year we reset the price for Chorus’s local loop copper network, and we set that price by international benchmarking. The benchmark price was $23.52 per line per month—a considerable drop from
the value it had been in 2007—and that’s the price that feeds into most wholesale prices for phones and broadband. We’ve since had five applications for that price to be reviewed again using an engineering model. This will be a substantial piece of work which will take about 2 years to complete.

In December we also released the draft decision for the price of wholesale broadband access, also known as UBA: unbundled bitstreaming access. This draft decision was a result of a legislative change in 2011 at the time of the separation of Telecom into Telecom and Chorus. The legislation required a move away from an essentially unregulated price—so-called retail minus—to a cost-based price. The draft price was again set by international benchmarking, and the change in pricing principle resulted in a drop of price from $21 to $8.93 per line per month. And it’s in response to these pricing decisions that the Government has decided to bring forward its review—the review that’s provided with the Act.

Clark Mr Berry, thanks for your presentation. I’ve got a line of questioning really around budget and resource, which goes toward the kind of nature of your work and the increasing workload, I think, that your organisation bears. I mean, the Government has asked Government departments to produce more with less, and I think, you know, your audit and so on, from what I can understand of it, says you’re doing the basics well, though you are facing an increasing workload. So what I’m wondering is, you know, a little bit around what kind of resourcing you might need to tackle more of the stuff you’re getting. In the last few years you’ve had additional one-off funding to your budget a couple of times, but, actually, your baseline funding has remained static, which to me indicates that your organisation’s likely to be increasingly stretched over time. I mean, that stands to reason. The skills that you’re employing have gone up in price and the workload is going up at the same time. Can you tell me a little about what you would be able to achieve if you had a little bit more resource?

Berry Look, I’d prefer to pass that question to my chief executive. He is the expert in-house in terms of funding, finance, and where we go on those kinds of issues.

Alderton Just make a couple of points to start, if I might. The first is that the commission over the past 3 or 4 years has made a number of changes both in terms of its structure and the way it goes about its work to try and position itself well to live within the funding that we’ve got. And we also project out 3 or 4 years to look at how we’re likely to be able to live within the funding that we currently have. As it currently stands, there’s no particular pinch point in the funding that we have as we look out over the medium term. We try to use the resources that we do have pretty flexibly, and, as Mark said, the merger activity, for example, has been down over the last couple of years. That means that we can use the people that might work in mergers activity to work on fair trading.

Clark Sure, sure. There’s always going to be trade-offs within. I’m asking about the overall budget, because, you know, with respect, people I talk to in
larger businesses, you know, people I’ve known for a long time—and this sounds unkind—but they treat the Commerce Commission increasingly with a bit of contempt. And my sense is that they think the Commerce Commission is—

Lotu-Iiga  Who?

Clark  —becoming a bit of a joke, you know, because it’s under-resourced. In their view, it’s a toothless tiger, you know. You guys do do some really good work, and I want that up front. And when you do dig in, you dig in well. But sometimes the Government’s going over the top of you, talking about re-legislating to get around the recommendations you’ve made. We can see clearly that you’re facing increasing difficulty keeping up with the work, and then you’ve got a Government that’s giving a nod and a wink to say look—

Lotu-Iiga  Is there a question here?

Clark  —big businesses here—

Young  What is the question, please?

Clark  There is a question. Look, I didn’t get a satisfactory answer out of the initial question, so I’m just giving a bit of context, Mr Lotu-Iiga—chair. So—

Mitchell  On what they’re doing, how they’re planning?

Cosgrove  Point of order. Last time I checked, there was only one chair, not three, so it’s up to the chair to rule, not you two.

Clark  Thank you. So my question is, you know, with that as context and a wider perception that you are a bit of a toothless tiger, what kinds of things could you rip into or would you want to rip into?

Berry  Can I just start by responding to the suggestion—

Lotu-Iiga  Have you read this?

Berry  I think the commission has actually migrated into a pretty serious entity that is respected by the big-business community.

Clark  Respected, yes.

Berry  You know, we are not scared to take the big cases. We have just achieved a record penalty against Telecom. We have achieved the largest out-of-court settlement involving credit sales, a product promoted by Forsyth Barr and Crédit Agricole. I mean, we are at the frontline of major litigation, and we are achieving a high degree of success in terms of our cases. I’m not aware that we’ve not gone into the territory of any major matter that we should have looked at.

Clark  Look, there’s an increasing risk of future litigation. That’s signalled, right—and that is because people are willing to take you on. They see that if they stretch out a process, you’re not going to get anywhere with them. That’s the message that’s sent—

Berry  I don’t agree with that.

Clark  Sorry, can I finish? Can I finish? Can I finish my question?
Berry: Sure.

Clark: There’s a—

Young: Just come to your question. Come to your question.

Clark: Yep. Well, I just need to say there’s a nod and a wink going on with the Skycity stuff, The Hobbit, and so on, right from the Prime Minister saying big business can change the rules—

Mitchell: Point of order.

Clark: —according to—

Mitchell: Point of order. This is wasting the committee’s time. This is an emotive statement. It’s an emotive statement.

Clark: It is not. With respect I just think this is a serious issue and this is a serious committee that needs to ask the question.

Young: Ask the question.

Clark: Yeah, I’m getting to the point, all right? One more sentence.

Young: Sorry, David. Point of order—please direct them to me.

Mitchell: I feel that the member’s making an emotive statement that is wasting the committee’s time.

Young: I will ask the member to come to his question. Thank you.

Clark: OK. I’ve been asked to come to the question. I’m happy to come to the question, which is there seems to be a nod and a wink that big business can get around the rules, and that is creating future litigation risks. I put that to you. Do you agree with that?

Berry: No.

Lotu-Iiga: Just for the benefit of my colleague here, I’m reading page 47 of your annual report, which shows a net surplus for the commission. Thank you for being here this morning, and also compliment you on the work that you do, because I haven’t heard these allegations that have been made about businesses saying that you don’t do your work. In fact, if anything, I’ve heard that, you know, you are doing your work so well that, you know—

Clark: Business loves you.

Lotu-Iiga: Excuse me, you’ve had your chance. You know, businesses are aware of the work that you’re doing in advocacy as well as in the litigation space, so, I mean, if the question is around whether you are stretched, how is it that a net surplus has been made in the last, you know, in the financial year that’s under review?

Alderton: Yeah, I mean—is that the question?

Lotu-Iiga: Yeah, that’s the question. Yeah.

Alderton: The paragraph under that table on page 47 sets out the reasons, and you’re quite right. We did achieve a surplus in 2011-12, but some of that was because work didn’t come in the door—some of the merger activity. Some
of it was, like, the assessment of Transpower’s capital expenditure proposals, which didn’t actually arrive, but we were funded for that anyway. That funding is carried over to 2012-13. So there’s a number of reasons why there’s surplus there.

**Lotu-Iiga**

So, in a supplementary on my colleague, did any of your work involve *The Hobbit*, Skycity, or any of the companies that he’s referred to in his previous question? Did any of your work—

**Alderton**

Not that I’m aware of. No.

**Lotu-Iiga**

No? OK.

**Cosgrove**

I suppose the nub of the issue is do you feel, firstly, that you have adequate monetary resources to cater for future a workload—not just that which has come to you but also any and all self-initiated inquiries you may choose to initiate? And by that I mean, to put it bluntly, if you had more money, would you self-initiate more? But do you feel you’ve got sufficient funds and, from that, also have you asked the Government for increase in funding, and what’s been the response?

**Young**

Just some context—if you don’t mind, Clayton, this is a financial review looking at the past financial year and present operations. That may be an estimates question looking forward, but I’ll let you answer this question.

**Cosgrove**

No, no, hang on. I’m prepared to table an English dictionary. I did ask have you—that’s past tense—asked for more money, and do you feel that you have adequate funds? So I think those questions were in order, and I think the gentlemen can answer for themselves.

**Berry**

Look, I mean, I'll answer the broader aspect of the question—

**Cosgrove**

I’d like a specific answer, not a broad answer.

**Berry**

—first—

**Young**

Let him answer.

**Cosgrove**

I asked a specific question—

**Young**

So let him answer.

**Berry**

In the past year we have been able to undertake all of the major investigatory work that has been before us. I mean, we are adequately resourced to do the competition, consumer, and regulatory work that we have. The one increase in our funding was when we took on new and further responsibilities in dairy. And so we have worked within the current budget in the last financial year, and I don’t see anything in our operation being undermined as a result of having inadequate resources. We are well-resourced to litigate, and we do, and we have undertaken the major trade practice inquiries and all of the other prosecution and regulatory functions we have. To answer specifically the second part of your question, we have not asked the Government for any further funding.

**Berry**

In the past year we have been able to undertake all of the major investigatory work that has been before us. We are adequately resourced to
do the competition, consumer, and regulatory work that we have. The one increase in our funding was when we took on numerous and further responsibilities in dairy. So we have worked within the current budget in the last financial year, and I don’t see anything in our operation being undermined as a result of having inadequate resources. We are well resourced to litigate and we do, and we have undertaken the major trade practice inquiries and all of the other prosecution and regulatory functions we have. To answer specifically the second part of your question, we have not asked the Government for any further funding.

Bakshi Thank you very much for your presentation and thanks for what you are doing for the consumers. My question is regarding the Fair Trading Act. Your report says that in the past year you have taken almost 460 investigations, and you were able to control a lot of problems before they become real problems. I would like to have your comment on that.

Second, is that with the new provisions in the Fair Trading Act and the new Consumer Law Reform Bill, have you taken work to implement those things? There are two parts of my question.

Berry I’ll answer the second part first about the proposed reforms and I might invite our general manager, Kate Morrison, to speak on the second, given she’s at the forefront of doing the work and interfacing with consumers.

We welcome the reforms that have come about under the revisions to the Fair Trading Act and we are currently doing preparation work to gear up. We will be consulting with the public over our proposed approach on various issues. As we have been reflecting on it, it seems that particularly the new unfair contract terms provision will have real bite, as will the substantiated claims provision.

Interestingly, we are currently hosting the chairman of the Australian Competition and Consumer Commission, Rod Sims. He was with us yesterday and with us this afternoon, and he’s been telling us about how effective that provision has been for the Australian Competition and Consumer Commission, so this afternoon we’re getting to learn from them how they’ve been going down these cases, down the path. But, you know, there have been some unfair contract cases that we would have pursued under the new provisions if they were there, and I think it will certainly give more teeth to consumer law. I think they are an important addition to the basket.

Morrison In relation to the number of cases—the 460-odd that you refer to—I’m (inaudible) a format, amalgamates all of our cases, so, by way of example, that would include, in this financial year, an examination, an investigation, of the nature of credit sales, under the Fair Trading Act, which took 2 years and a significant amount of resource, and an inquiry under the low-level inquiry unit, which may take less than an hour (inaudible). So I can’t really incorporate those into what I might characterise as complex against those simple ones, but the record is of all the investigations we undertook.
Curran In the context of my colleague David Clark’s comments with regards to the Commerce Commission being a toothless tiger, in December the—as you have referenced—commission released a draft determination on the wholesale rate of prices of copper, known as the Unbundled Bitstream Access (UBA). Also in December, the Prime Minister in the House, as well as outside the House, would not rule out using legislation to bypass that decision. And just 2 weeks ago, the Minister of Communications and Information Technology announced a wide-ranging review of the telecommunications industry, which she said was to engender investor confidence in the sector, but which the vast majority of the sector says is destabilising the industry at a critical point.

My question is, do you view the Government’s intervention by announcing that review and by the comments of the Prime Minister as being political interference in the normal work of the Commerce Commission as determined by statute and the Telecommunications Act, as you referenced, and will you be allowing it to derail your wholesale price final determination later this year?

Gale No, I don’t think it’s inappropriate political interference. It seems to me that’s how the process is supposed to work. The commission’s job is to implement legislation and we do that to make sure that we interpret legislation properly. We use a consultative process with all the parties, and in this instance our work has raised matters that the Government has chosen to sweep into the review that’s provided for in the Act.

Curran How can you undergo your process in that current context?

Gale Oh, the continuation of the UBA process? We’ll consult with industry very shortly about whether we’ll change the timetable for that. But the process has now become more complicated with the application for an engineering calculation for the copper local loop.

Curran So do you welcome the review that the Minister has announced? Do you think it’s going to add to the work of your current determination in reaching a final conclusion?

Gale The review’s primarily the ministry’s responsibility, the Minister’s responsibility, and the review’s wide ranging and it’s specified quite closely in the Act. It also specifies that the commissioner will be consulted, so we expect to be involved to that degree.

Curran The review is certainly in the Act, but it was due to be completed by the end of 2016 and it’s been brought forward, at a period, which is a critical period, for the determination of copper versus fibre pricing. There’s no doubt that it’s created a lot of public commentary, including by your predecessor in this particular role. You are saying to the committee today that you do not consider that to be political interference and the commission welcomes that review being brought forward?

Gale I’m saying that I think that’s how the process is intended to work. I think, as I said before, the process is intended to work that we implement the legislation as it stands. In this instance it appears that the Government’s
decided that these settings are not consistent with an orderly migration to the fibre network, so I was chosen to start the review early to ensure that outcome.

Curran  Does the commission have a view on whether the review being brought forward by—a year or 2 years, whatever it is—2 years is actually intended to suit and, I guess, to prop up the bottom line of one particular company, being Chorus. In that case, does the commission have concerns around the competition issues that your draft determination is aimed at dealing with?

Gale  I don’t think it’s related to competition issues, so much. This is the UFB project.

Curran  So are you concerned about the favouring of one company by this review being brought forward?

Gale  I think that what’ll come out of the review—the prices and the commercial arrangements for the rest of the roll-out of the fibre—will flow out of that review, and so, at the moment, I think all options are on the table. I don’t know what will come out. I’m not concerned about the fact of the review. It’s not—

Curran  You’re not concerned at all?

Gale  Well, the review’s the Minister’s prerogative.

Curran  Can I ask—do you view that copper is a competitor to fibre; and, if so, why?

Gale  No, I don’t think copper is a competitor to fibre in the normal way in which one would talk about competition, because this is copper and fibre that are both owned by Chorus. Normally when you think of networks competing they are owned by separate people. So this is more about a migration policy that will be swept up into this review and the TSO review—the telecommunications service obligation review.

Curran  So at the heart of this issue is the migration from copper to fibre—yes?

Gale  Yeah, that’s what’s signalled in the Minister’s release.

Curran  So would it be the Commerce Commission’s view that this is the political issue that the Government has to determine how that takes place?

Gale  Yes.

Curran  Yes. And would you consider that that is the ultimate purpose of this review?

Gale  I think the Minister’s press release says that the purpose of it is, amongst other things, incorporated in the whole scope of the review. One element is the orderly transition to the new technology.

Curran  Do you—I’m sorry, I’d like to continue. I asked at the beginning whether this was political interference and you said no. Would you consider that it’s political pressure?

Gale  No, because I think our processes will continue. The pricing of the copper local loop will continue over the next 2 years, and the pricing of the UBA
will continue over some timetable. So it doesn’t exert pressure on the result, because the result can’t stray from the legislative principles.

Curran  Can you define what political pressure would look like?

Gale    Well, political pressure would look like me giving an advance warning to the Government—

Lotu-Iiga Point of order. Sorry, I don’t think he’s here to answer what political pressure looks like; he’s working for the Commerce Commission.

Cosgrove I’ll speak to that. Point one—the gentleman was in the middle of answering, so he is willing to answer. And, secondly, with any entity before us it’s quite appropriate to ask what they would define as political pressure or pressure from an individual or whatever, because that may well have an influence on their activities. So, of course, it’s in order.

Young     OK, alright. There has been a line of questions around this and now you’re asking for definitions on what political pressure is, so I think that you’re moving out of scope. If you could bring your questions back into scope—to the operations—that would be appreciated. Thank you.

Cosgrove With respect, I beg to differ with you. If I was to ask hypothetically had individual A or B brought pressure at a private sector capacity to this organisation, that would be in order, and it would also be in order to ask what they would view as inappropriate pressure, given the responsibilities they have under the Act. It’s completely in order. That question’s been asked of all sorts of entities, and probably over the last 50 years, and the gentleman was willing to answer, so why don’t we just get on with it.

Young     Thank you for your comments. What I said before was that there’d been a number of questions along this line, which have been answered. We are getting to the point where it’s starting to become repetitive.

Curran    OK, well I’ve got another one.

Cosgrove Can we let the gentleman finish his answer, out of courtesy? He was about to—he was halfway through his answer.

Gale     I would regard political pressure as being told by the department or by the Minister to distort the answer that comes out of the legislation as to any of these prices.

Curran    OK. So can I ask then what role do you see for the commission, given this review that’s been announced in parallel with a determination that you are under review are undertaking; will you be able to function in the short term or does this effectively hamstring you until that review is completed, and doesn’t it make the work that you are undertaking appear as if the commission is a toothless tiger?

Gale     It won’t hamstring our operations. The—

Curran    Given the Prime Minister has said he will overrule this legislation if he doesn’t like the answer.
Gale Well, it’s feeding into a review. The work that we’re continuing to do will feed into the review.

Curran But if that’s not political pressure, I don’t know what is.

Lotu-Iiga Are you telling him?

Young Don’t lead the witness, thank you.

Mitchell Can I ask a question about the Christchurch rebuild and whether or not the commission is doing anything in terms of educating businesses down there, sort of, around competition?

Berry The answer is yes. Look, I just wonder if I can ask Kate Morrison, our general manager, to talk about that. But we have been dedicating resources to talking to the CERA, insurance, and so on.

Morrison So very briefly, for the committee—it falls into this financial year, but we have a great advocacy programme specifically in Christchurch. We’re doing that in cooperation in some cases with other agencies, and we have actively targeted the business community that we feel most needs to hear both Fair Trading Act and Commerce Act messages, specifically groups like the construction sector and, for example, the CERA. We’ll be reporting on that programme at the end of this year.

Mitchell Just on that, what agencies are you, sort of, engaging with around that?

Morrison Well, it’ll expand as we go forward, but I guess the (inaudible) talking with the Serious Fraud Office in relation to their initiatives.

Cosgrove Yes, just on that Canterbury rebuild issue, have you or do you have the jurisdiction, or have you considered looking into the monopoly position that Fletcher Building has in respect to the project management of repairs—I think the level has moved but I think you’re aware of what I’m talking about—the rebuild repairs, because you’ll be aware that there is only one entity that is in charge of managing those? Do you have any concerns? Have you looked at that? Are you intending to look at it? If not, why not?

Berry Can I just defer to—

Cosgrove Maybe come up to the table. That might help.

Morrison As part of our advocacy programme I mentioned that we’re talking with construction sector participants, insurance sector participants, but we don’t have any open investigations that would relate to that issue.

Cosgrove I suppose my question was—because they have an absolute monopoly, right; or given a monopoly by this Government, and there have been concerns around that, some valid, some invalid—have you considered looking at any of those arrangements in a competition, or lack of it, sense? Do you have any concerns about it? Should you give it any thought, perhaps?

Morrison We’re not looking at them in the context of monopoly business, but we are, as I said, talking with sector participants about the prohibitions on anti-
competitive behaviour and that includes in relation to construction sector activity.

Cosgrove And you don’t consider that an entity that—I think the project management thing is quite good, apart from the fact that there’s only one player in it. You don’t think that monopoly position is something you should focus on, given it is a monopoly position? Why wouldn’t you make some inquiries or look at that, to ensure it’s operating appropriately?

Morrison If, as a result of our advocacy, as a result of our conversations with particular sectors, including construction, we have a particular concern, we would obviously take that forward.

Cosgrove So you’re relying on third parties to bring concerns to you. Why wouldn’t you self-initiate and just make some inquiries, given that it is a unique scheme of arrangement for obviously unique circumstances? But it is an absolute monopoly. Why wouldn’t you self-initiate and proactively look at that and focus on it, to ensure that the safeguards are being met?

Morrison We have been proactive. I think that’s an important part of what we’ve stated—

Cosgrove With Fletcher Building and that scheme of arrangement?

Morrison I don’t think that we have anything particularly, in an investigation context, that—

Cosgrove You have no concerns about it.

Young The term “absolute monopoly”, is that a fair definition of project management?

Berry I was going to say that we have a monopoly provision in the Act which sets a very high bar and it would be unlikely that Fletcher Building would fall within that. But, the kind of things that we would be focusing upon is collusive conduct, and that kind of coordination between competitors.

Young Sorry, could you say that again. There was too much chatter.

Berry We have a monopolisation provision in the Act that requires an exceedingly high level of market power, and it’s difficult to predict that any one building company would in fact trigger the monopolisation provision. Where we would have to be vigilant is whether or not there is any kind of anti-competitive collusion between companies operating in that kind of market. It’s the more general substantial lessening of competition provisions.

Cosgrove That’s an interesting answer. Could I put it to you—how do you reconcile that answer with the fact that the Minister in charge, when he set up the scheme of arrangement for project management for repairs in respect of the earthquake, set it up with one provider—OK—that obviously subcontracts out. That’s not the issue. One project manager—that’s a monopoly, where you have one project manager. So I do not understand the answer to your question. I do not understand also, given that that is an absolute monopoly, why you wouldn’t, because it is unique, take an interest, if not to simply satisfy yourselves, that it was operating appropriately, within the law? It is a
unique set of arrangements, yet you seem disinclined to take much interest in it at all.

Morrison Sorry, it might be that I need to revert to the committee with further information, but we’re certainly not disinterested. We’ve got a specific advocacy programme in Christchurch because we are concerned that the rebuild is successful, that consumers and businesses benefit from a competitive environment, and, in relation to that, are we sitting around waiting for somebody to do something? The vast majority of our investigations are in fact instigated by virtue of the complaints system.

Cosgrove I’m sorry. I accept what you’re saying, but with respect, my proposition is rather simple. A scheme of arrangement creating an absolute majority has been set up by a Government, for very good reason in some respects. Some of us are sceptical about the fact that it is a monopoly, but given that it is a monopoly, given that it is unprecedented, I would have thought, and I wonder why you have not proactively—I’m not talking about advocacy or any of the other activities you’re involved in. I’m talking about you guys as a commission saying: “We need to have a close look at this, and just keep an eye on it.”, to assure—and there’s a lot of anecdotal evidence that there are difficulties, but that’s by the by—yourselves that this one company is acting appropriately, in the same way as I would put that proposition to you if it was A B C Company, or whatever. One company has been given a monopoly and is making a hell of a lot of money over this, and you guys seem disinclined to specifically make any inquiries in that respect. If I’m wrong, could you tell me what actions—

Lotu-Iiga You’re wrong.

Cosgrove Well, if I’m wrong, what actions specifically and what inquiries specifically have you undertaken in respect directly of that entity and its arrangements?

Morrison To successfully answer that, fully answer that, I’d like to submit—

Cosgrove Thank you. That’s fine.

Lotu-Iiga She said that the previous—

Cosgrove I would like some detail on it—

Lotu-Iiga I haven’t had a go yet.

Cosgrove Just on that. Just one moment. I assume therefore you can confirm for us that you have taken any actions?

Lotu-Iiga She is going to present that information. She’s said it twice.

Cosgrove I’m not asking for specifics. She must know whether there are some actions taken, or not. She can come back to us with some detail.

Lotu-Iiga She’s coming back to us.

?? That there’s an inquiry going on is surely significant—

Clark That’s a fair—

Lotu-Iiga Moving along. I just want to move to the Credit Contracts and Consumer Finance Act, a subject I’ve raised with you in past reviews, and just first to
acknowledge the first conviction that you’ve got of Trevor Ludlow. I think
the work in this area is very good.

And also, since we had these discussions, I think 2 or 3 years ago, around
loans sharks and the prosecution of such, or at least the investigation of
these types of operators in the market, and I know you did some work with
the Financial Markets Authority in South Auckland. Can you give us an idea
about how that went and what you found, and then also looking forward,
whether—and I note—[Interruption] Excuse me. You’ve had a go. I’m sorry
about the unruly behaviour. We’re just trying to ask some questions.

Cosgrove Oh, get a life. Come on. Man up.

Lotu-Iiga You’ve had a chance. I’ve noted the increase in resources that have been
going towards monitoring these. It is, a, where have you got with this, and,
how this is going to progress in the future. Have you got a firm
undertaking from the commission that these resources are going to be
available going forward, given it’s a problem area, certainly in my
community?

Morrison So in relation to the lower tier lender approach, we have sought to identify
lenders who would not necessarily prevail on the financial services market
as lenders of note. We identify them in a number of ways. It can be an
internet search, it can be looking at classifieds in local newspapers, but they,
by nature, are quite difficult to discover. In some cases, when we go to visit
those businesses they no longer exist or operate, and that has happened in
two of the cities that we have visited. We most recently conducted visits to
lower tier lenders in Porirua, here in Wellington, and we in effect consider
and check levels of compliance with CCCF, particularly as to disclosures
and fees.

Lotu-Iiga What about—

Morrison The plan—the next step is to continue with those lower tier lender checks,
which is the first identification, and then, if you like, a programme of what I
would classify as audit, and then in the forward planning for this year we
have a programme of going back to recheck those businesses to make sure
that the changes we think have been brought about by those visits and that
compliance advice that we’ve offered is enduring.

Lotu-Iiga So are they financial service providers, as defined in the legislation? I mean,
you’re talking to them. Have there been prosecutions? Give us a feel for
where you’ve been with these companies. I mean, how many are we dealing
with here? By all means comes back with further information, if you have
to.

Morrison I will. The predominant outcome at this stage has been compliance advice,
which you would expect. We did identify what I would call more egregious
practices, but in both instances for those visits the lender had closed down
before our visit, so we took no further action in relation to those. In terms
of prosecutions, they are well set out in the report.

Curran Thank you. Back to the telecommunications part of the conversation. Can I
ask quickly, have you been consulted on the terms of reference for the
review? Have you seen the review terms of reference and will you be submitting to the review?

Gale Yeah, the terms of reference—we haven’t seen any preparatory material for the scoping report for the review. The format of the review set down in the Act and the consultation requirements and the coverage—

Curran But have you been consulted about it?

Gale No.

Curran So you haven’t had any contact with the ministry around those terms of reference?

Gale No.

Curran No, and will you be submitting?

Gale Yes, the ministry is required to consult with the commissioner, and we will submit.

Curran Great. A couple of other questions. We’ve just had an announcement today by Vodafone of 4G in the market place, which is a big announcement. Do you consider that 4G, or LTE, to be a competitor to fibre, and are you considering regulating Vodafone’s newly launched LTE network?

Gale There’s been no discussions about regulating the LTE.

Curran Have you done any thinking about it?

Gale I guess our understanding is that LTE will be a partial competitor to fixed fibre, but there will be lots of things that the mobile networks will not be able to do, won’t have the capacity to do.

Curran So are you planning on doing a piece of work around that?

Gale On regulating LTE? Not at the moment. There’s no plans at the moment.

Curran But you think you consider it to be a partial competitor.

Gale Yes.

Curran Thanks. Another announcement last week was around the three telcos announcing a new trans-Tasman cable development—another big development in the external infrastructure for New Zealand—but there were competition issues raised during that with the ownership of and involvement of Telecom of both cables. Do you have concerns around that, and are you looking at it, and are you also looking at the competition issues around wholesaling for other networks that aren’t part of that venture; and, if so, have you got any statement that you would like to make to the committee on that?

Gale OK, to keep the lines clear, my job is the telco commissioner and compared to the rest of the commission, can I refer that to Dr Berry, just because the competition issues, if they arise in any contracts related to the sale of wholesale international traffic would come under the Commerce Act, not under the Telco Act.
Berry  So the short answer is that we have commenced looking at this. I mean, we’ve only just found out about this in the last week. Again, these are matters that take a bit of time to work through. But we do have this under scrutiny, under the Commerce Act, to see if there are any issues that we are concerned about.

Curran  Do you see it as being an issue at a base infrastructure level to have one company with substantial interests in both of those, both sets—

Berry  Look, naturally, we will be taking that into account, and we will go through our normal investigation process, looking to see if there are any competition issues that need to be addressed at this stage.

Curran  Thank you.

Cosgrove  Thanks. I know we’re almost out of time, and I know this might upset some colleagues, and I don’t want to labour the issue, but I want to have another crack. Acknowledging the fact that you are going to come back to us with some detailed information, or your colleague is, I’d just like a simple answer to a question, and that is, you must know this: whether you have undertaken any actions, any inquiries, any research—I’m not interested in detail; you’ve said you’ll come back to us—in respect of the monopoly position that Fletcher Building has, as I outlined to you in previous questions, in respect of the Canterbury earthquake. With respect, if you can’t answer that question, then it does say something about the organisation. You must know whether you’ve engaged any actions or inquiries—given that you’re going to come back to us with the detail; I’m not asking for detail. So could you give us a simple answer to that, please, or your colleague, perhaps? It’s a simple yes or no, basically.

Morrison  Um—

Cosgrove  Do you want to come forward?

Morrison  I will need to submit to the committee on the specific question. What I can confirm is that I’m not aware of an existing investigation on the matter. I’m not aware of an existing monopoly-type inquiry on the matter. But I am aware, and do manage a team, that has specifically worked in relation to the Christchurch rebuild, including—I can only state—all arrangements in relation to that, to promote compliance with the rules, including anti-competitive conduct and (inaudible)

Cosgrove  In specific relation to Fletcher Building?

Morrison  I’ve asked (inaudible) to submit to the committee—

Cosgrove  The only thing I’ll say is, given anything, I would have expected you to know what actions you’ve taken—not necessarily the detail.

Morrison  Well, look, I’m confirming that there isn’t an investigation or a monopoly inquiry in relation to that. But, look, we have considered arrangements in Christchurch. I just—in order to be clear with you, I need to gather information.
Just a quick supp on that is that you’ve already stated that you are ruling out a programme of education around fair trading and competition and the rebuild in Christchurch, which is under way now. Would Fletcher Building be excluded from that, or do you think that it will be included in that programme?

We wouldn’t exclude any particular company.

I’m happy to leave it. I think Clayton’s asked the substance of the question, and I know we’re pushed for time.

Yes. Your presentation had five strategic business programmes to achieve better delivery. I noticed here that the intelligence unit played a key role in your work. How about other programmes? Could you give me an elaboration on the other programmes listed here—basically, a few other programmes.

Sure, I mean, there are programmes listed under each of these headings, so: “Simplify our business”, “Understand our value”, “Better connect”, and so on. I guess one of the ones that may be most visible to the commission has been our plain English programme. So the way we communicate and talk about what we do, the way we explain our job, the law, and that sort of thing obviously has a big impact on our success, and we have put a lot of effort into trying to make our documents and our communications plain English, and actually have been a finalist in the plain English awards. So for us the way we communicate about what we do has been a big area of focus.

How about the survey? You have a survey programme. It’s called the “new employees’ survey” —

We did an engagement survey for the first time last year. We are planning to roll that out, in fact, in the next couple of weeks within the commission, and it’s really about employee engagement. There’s a very strong link between employee engagement and productivity. And, of course, we want as highly engaged a workforce as we can, so it’s important for us to monitor that.

Well, I think we’ve had our time with you. Thank you very much, Dr Berry, Dr Gale, and your team. We appreciate your being here today and your answers. Thank you. All the best for next year, and congratulations on, I think, some remarkable results.

**Conclusion of evidence**
2011/12 financial review of the Counties Manukau District Health Board

Report of the Health Committee

Contents

Recommendation 2
Introduction 2
Financial and service performance 2
Diabetes and cardiovascular services 2
Maternity services 3
Building and facilities redevelopment 3
Innovation 3
Staff retention 4
Localities model 4
Physician Assistants 4
Mental health services 4
Dementia care 4
Population-based funding 5
Oral health 5
Appendix 6
Counties Manukau District Health Board

Recommendation
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Counties Manukau District Health Board, and recommends that the House take note of its report.

Introduction
The estimated population of 500,800 living in the Counties Manukau region is diverse, with complex health needs. It includes a high proportion of Māori, Pacific, and Asian people, and has a high level of socio-economic deprivation.

Financial and service performance
In 2011/12, its total revenue was $1,352.493 million, and its total expenditure was $1,347.084 million, resulting in a surplus of $5.409 million.

The Office of the Auditor-General (OAG) issued a modified audit opinion on the financial statements and statement of service performance of the DHB. The opinion was modified because the OAG disagreed with the DHB’s accounting treatment of certain funding in the comparative information from the 2010/11 financial statements. We were told this does not have a material significance.

We were interested to hear that the DHB believes it should record a liability for revenue it has received from the Ministry of Health but not yet spent, even when there are no contractual obligations it needs to meet to keep these funds. The OAG advised us that this is recognised as a liability at balance date for “income in advance”, and this treatment is inconsistent with generally accepted accounting practice.

The OAG also recommended that the DHB improve its asset management, and determine what infrastructure assets need to be accounted for. We expect these recommendations to be implemented.

In 2011/12, phase two of the Thriving in Difficult Times programme realised a saving of $26.5 million, and combined with savings from the previous financial year represents a total saving of $49.5 million. Thriving in Difficult Times aims to reduce wastage and increase efficiency, without compromising service quality and patient safety. We are pleased with the DHB’s commitment to financial sustainability.

Diabetes and cardiovascular services
The Ministry of Health has estimated on the basis of the region’s diabetes prevalence as at 31 December 2011 that 31,023 people in its population will have the disease, representing an 11.8 percent increase on the previous year. We asked what the DHB is doing to address this disturbing matter. We heard that it is working with other Northern region DHBs and its primary care partners to improve health systems and the clinical management of long-term conditions such as diabetes and cardiovascular disease.

The DHB told us of the difficulty of ensuring patients manage their insulin effectively, particularly among the difficult-to-reach population. It has created dedicated teams to work
with patients individually to manage their condition as well as possible, tailoring services to meet the community’s need. We recognise the importance of simplifying access to services and giving patients the information and support they need to manage their condition effectively.

We agree with the DHB that it is important to address the growth in type-two diabetes in the Indian and Asian communities —indeed in the entire community. We note that the number of Indian people with diabetes has increased by approximately 500 per year in the last two years.

We understand that the DHB is evolving the prevention and treatment strategy for diabetes. We will watch with great interest as to the type of management it considers optimal and how effective the strategy is.

**Maternity services**

We are aware that the DHB has higher rates of fetal and neonatal deaths than elsewhere in New Zealand, and these rates are highest in Pacific and Māori people. In response the DHB commissioned an *External Review of Maternity Care in the Counties Manukau District*, which was released in November 2012. The review set out risk factors for perinatal and infant mortality, and recommended improvements, including access to good care as early as possible in pregnancy.

The DHB explained that a large proportion of their population does not interact continuously with the health profession, waiting for a crisis before seeking medical help. We note that health literacy is a contributing factor. For pregnant women this means not engaging with the health sector until they go into labour. The DHB is working with local midwives to promote early engagement with the health sector in the community.

We heard that the DHB is investing additional funds in midwifery, and a senior project team has been set up to bring care to disengaged communities. The DHB also plans soon to set midwifery access targets to measure progress. We are impressed with the comprehensive approach the DHB is taking in this area, and look forward to seeing the recommendations of the report being implemented.

**Building and facilities redevelopment**

*Towards 20/20* is a long-term programme for the building and refurbishment of facilities and services, including the development of the Middlemore Clinical Services Block and facilities at Manukau Health Park. The programme is designed to deliver integrated interdisciplinary care. The total value of the projects is estimated to be at least $623.9 million.

**Innovation**

In June 2011, the DHB opened *Ko Awatea*, a centre for health-system innovation and improvement. It is designed to improve value for money and to help keep pace with the demand for more and better health services within tight financial constraints. It is a collaborative venture with the Auckland University of Technology, the Manukau Institute of Technology, and the University of Auckland. *Ko Awatea* aims to draw together local and international knowledge to improve value, quality, and sustainability in health systems and patient care. It combines three centres of excellence, focused respectively on leadership capability, quality, and research, knowledge, and information management.
Staff retention
We are impressed with the DHB’s innovation drive and asked if it has helped recruit and retain staff. The DHB agreed and said it is enjoying an empowered workforce sourced from the local community. Ko Awatea can be credited with generating excitement amongst staff and changing the culture. We recognise that an innovative environment is fundamental to recruiting and retaining clinical staff of a high calibre. We congratulate the DHB on its efforts in this area.

Localities model
The DHB has introduced a Locality Clinical Partnership model to deliver health services in partnership with primary care providers in the places where patients live rather than in a central location. The first partnership was formed in Franklin in July 2012, three more are expected to be operating by December 2013.

We heard that each locality has a five-year business plan. The model involves the empowerment of nurses, and working closely with pharmacists. Services are designed to fit the needs of local patients, on the basis of a comprehensive assessment of the health profile of the community. We look forward to seeing the model in action.

Physician Assistants
We were interested in the recent Physician Assistants pilot launched at the DHB, which allocates an assistant to a surgeon or physician and works under their constant supervision. The Physician Assistants are highly skilled health professionals, usually with a nursing or paramedical background, who have undertaken intensive post-graduate medical training. The Physician Assistants complete tasks such as patient histories, physical examinations, ordering and interpreting tests, educating and advising patients, treatment plans, and discharging patients from hospital. It was explained that this frees up the time of junior doctors, and addresses health workforce shortages.

We were told that the pilot was very successful and the DHB is considering implementing a Physician Assistants programme permanently to help meet future needs around managing diabetes and cardiovascular disease, and address workforce shortages. We will monitor this situation with interest.

Mental health services
We asked the DHB about waiting times for mental health services. The DHB said it is meeting its overall access targets for waiting times, and is above the national average, recording an improvement from the previous financial year. We note that the DHB has not reached the target for those in the 0–19 age group and is working with Child, Youth and Family to improve its performance in this area. The DHB assured us that it is working to make more beds available in supported-living facilities for patients with high and complex needs.

Dementia care
We note that the proportion of people aged over 65 is projected to increase, with consequent pressures on health services. We asked about planning for dementia care services. The DHB said it is expanding services and developing more residential facilities in preparation for the expected increase in demand.
Population-based funding

We recognise that the DHB has one of the most challenging populations in New Zealand, and asked if it felt that the current population-based funding formula was working. The DHB told us that the formula has proved vital for them, as population growth has been reflected in the funding they receive. Nevertheless they recognise the need for innovation to thrive during these difficult financial times.

Oral health

We are pleased with the recent investment in a mobile dental clinic, which has had a positive effect on oral clinic attendance by pre-schoolers and teenagers. The DHB said they are committed to more investment in equipment and facilities.
Appendix

Approach to this financial review
We met on 20 March and 27 March 2013 to consider the financial review of the Counties Manukau District Health Board. We heard evidence from the Counties Manukau District Health Board and received advice from the Office of the Auditor-General.

Committee members
Dr Paul Hutchison (Chairperson)
Shane Ardern
Dr Jackie Blue
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Scott Simpson
Barbara Stewart
Louisa Wall
Dr Jian Yang

Evidence and advice received
Counties Manukau District Health Board, responses to questions, received 15 and 26 March 2013.

Office of the Auditor-General, Briefing on Counties Manukau District Health Board, dated 20 March 2013.

Organisation briefing paper, prepared by committee staff, dated 14 January 2013.
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Crown Health Financing Agency, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2011/12 financial review of the Electoral Commission
Report of the Justice and Electoral Committee

Contents
Recommendation 2
Introduction 2
Transfer of Chief Registrar’s functions 2
Improving access for overseas voters 3
Security of voter information 3
Late setting of electorate boundaries 3
Contractor for referendum campaign 3
International electoral administration meeting 4
Appendix 5
Electoral Commission

Recommendation

The Justice and Electoral Committee has conducted the financial review of the 2011/12 performance and current operations of the Electoral Commission and recommends that the House take note of its report.

Introduction

The Electoral Commission is a Crown entity established on 1 October 2010 by the Electoral (Administration) Act 2010 to administer the electoral system. From 1 July 2012, the commission took on statutory responsibility for enrolment.

The Electoral Commission is accountable to the Minister of Justice, but is not subject to ministerial direction in discharging its electoral functions, and must act independently.

Financial and service performance management

The 2011/12 financial year was busy for the commission with the general election and MMP referendum held on 26 November 2011. The commission also conducted a review of MMP, presenting its report to the Minister of Justice in October 2012.

The commission’s total revenue for the period 1 July 2011 to 30 June 2012 was $39.093 million, and its total expenditure was $40.349 million, producing a net deficit of $1.256 million. The deficit was largely attributed to the costs of the MMP review, which were additional to the 2011/12 budgeted activity and funded from the commission’s reserves.

The Office of the Auditor-General gave the commission “very good” ratings for its management control environment and financial information systems and controls, and a “good” rating for its service performance information and associated systems and controls. These were improvements on the respective 2010/11 ratings of “good” and “needs improvement”.

Transfer of Chief Registrar’s functions

On 1 July 2012 the commission took on the functions of the Chief Registrar of Electors, undertaken by New Zealand Post Limited through the former Electoral Enrolment Centre. This was the second stage of administrative reform following the creation of the Electoral Commission. The commission told us it had established processes for carrying out these functions, and that things were progressing well.

Online enrolment

We heard that the commission is particularly interested in enabling online enrolment. At the moment voters can update their details on line but cannot complete the entire enrolment process online, as this will require legislative change. The commission hopes the necessary change will be made in time for the 2014 general election.

Māori electoral option

The commission is currently running the Māori electoral option, including a highly praised advertisement campaign, for which we commend it. We understand that the Electoral
Commission has recommended that the Māori option be available on a three-yearly cycle rather than the current five years. The commission told us that it would be a simple administrative exercise for the Māori electoral option to be incorporated into the checking of each voter’s electoral details and their circulation to voters about six months before the election.

**Improveing access for overseas voters**

We heard that in 2011 the number of overseas votes fell by 35 percent. This was suspected of being partly due to difficulty finding and using fax machines. The commission said that regulatory change is about to enable overseas voters to scan and upload their voting papers and their declarations to a secure website, rather than having to fax them. It is hoped that this will increase the number of overseas votes in the next election.

**Security of voter information**

We asked the commission how confident it is that its computer management system and New Zealand’s voting information are secure. We were told that the commission has recently conducted a rigorous review of the security of electoral roll information, involving investigation and testing, and is as confident as it can be about its security. We heard that because the voting process is almost entirely manual, it presents a low cyber risk.

**E-voting**

The commission would like to be in a position to introduce e-voting, probably as an option alongside the current manual processes, to allow people to vote remotely via the internet or telephone. However, e-voting raises security and privacy issues that would need to be resolved. The commission explained that our concept of democracy is based on the principal of the secret ballot, and that no system of electronic voting yet devised can guarantee secrecy.

**Late setting of electorate boundaries**

We queried the late setting of the electorate boundaries and were told that parliamentary electorate boundary reviews take place every five years, based on the results of the census and the Māori electoral option. The postponement of the 2011 census meant that the electorate boundary review scheduled for 2012 was delayed.

Following the timetable that operated in 2002, an example of a boundary review also conducted during the third year of the parliamentary term, the final boundaries will be determined by mid-April 2014 and there will be ample opportunity for public input into the objection and counter-objection process prior to this. Parties and candidates will know the number of electorates in October this year. This is also when the government statistician will provide the certificate of population information, upon which the boundary numbers are determined for the Māori and general seats. The draft boundaries will be announced in November.

**Contractor for referendum campaign**

We asked about the $403,000 that the commission paid to Reputation Matters Ltd over the last two financial years. We were told this was to project manage a public education campaign for the MMP referendum, including the drafting of a comprehensive, plain English description of each of the five voting systems. The commission said this was a
large job, for which it did not have the resources. It is satisfied that the contractor provided high-quality work that delivered value for money.

**International electoral administration meeting**

In late February 2013 the commission hosted the heads of the electoral authorities of the United Kingdom, Australia, and Canada for a meeting on electoral administration and voter motivation. We asked whether the commission had gained any fresh ideas for improving voter participation. The commission said the group had discussed the complexity of the issue and found that the underlying causes of declining participation are common to modern democracies. It is a case of identifying the role of electoral administrators, and encouraging politicians, educators, candidates, parties, tertiary education institutions and other groups across the community to become actively involved in stimulating interest and promoting participation.

We asked about the use overseas of digital platforms to increase participation. The commission said that there is no particular rush around the world to use digital platforms for voting in parliamentary elections. Where they are being used, it is primarily to overcome access constraints, which New Zealand has addressed administratively by offering flexibility in terms of where people can vote. We heard that where e-voting or i-voting has been introduced overseas it has had no discernible impact on voter turnout; the issue is too complex to respond to any single solution.
Appendix

Approach to this financial review
We met on 11 April 2013 to consider the financial review of the Electoral Commission. We heard evidence from the Electoral Commission and received advice from the Office of the Auditor-General.

Committee members
Scott Simpson (Chair)
Dr Jackie Blue
Hon Lianne Dalziel
Julie Anne Genter
Andrew Little
Alfred Ngaro
Denis O’Rourke
Katrina Shanks
Hon Kate Wilkinson

Evidence and advice received
Organisation briefing paper, prepared by committee staff, dated 10 December 2012.
Contents

Recommendation 2
Introduction 2
Comparing and switching electricity retailers 2
Reliability of supply 2
Monitoring by the authority 3
Futures market 3
Financial transmission rights 4
Small-scale generation 4
Appendix A 5
Appendix B 6
Electricity Authority

**Recommendation**

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of the Electricity Authority and recommends that the House take note of its report.

**Introduction**

The Electricity Authority was established as an independent Crown entity on 1 November 2010 under the Electricity Industry Act 2010, following a ministerial review by the Electricity Technical Advisory Group. The authority’s statutory objective is to promote competition, reliability, and efficiency in the electricity industry, for the long-term benefit of consumers. The chairperson is Dr Brent Layton and the chief executive is Carl Hansen. The responsible Minister is the Minister for Energy and Resources.

The authority is primarily funded by appropriations from Vote Energy, but it also collects a levy from electricity generators, purchasers, and line owners to recover its costs. In 2011/12 the authority’s total revenue was $74.195 million and its total expenditure was $73.78 million, resulting in a net surplus of $384,000 (compared with $356,000 in 2010/11).

**Comparing and switching electricity retailers**

Funding for the “What’s My Number” campaign, to promote awareness of the benefits of comparing and switching electricity retailers, will cease in June 2014. We asked if the authority considered it successful. The authority thought that the market had become more aware of switching, and believed the campaign had largely alleviated perceptions that switching is slow and complex. A retail advisory group made up of industry participants is to report to the authority later in 2013 on the campaign’s effect and subsequent measures that might be necessary.

The authority told us that the Australian and American regulators have shown interest in the campaign, considering it to be constructive. The authority is also running a similar campaign for small to medium-sized enterprises.

The authority said that in order to attract and keep customers, retailers are proactively seeking to offer innovative products, particularly systems for monitoring consumers’ own consumption. This is an intended outcome of the campaign, and the authority considers it to be of real value to consumers.

We asked the authority if they thought retailers should disclose to us the cost of their advertising and public relations campaigns for customer switching. It said it does not track companies’ campaigns, being concerned with the effect on the market of switching rather than the means by which it is brought about.

**Reliability of supply**

In 2012 inflows into the South Island hydro storage lakes were the lowest recorded in 81 years. 2008 was also a very dry year, leading to a 2009 ministerial review and policy recommendations, most of which have been implemented. Among them was the provision
of extra reserves in Lake Pukaki representing 550 gigawatt hours’ worth of generation. They were made available in 2011, which lessens the chance of a shortage of supply.

**Customer compensation scheme**

In 2011 the authority amended the Electricity Industry Participation Code 2010 to require all retailers to operate a customer compensation scheme under which if a public conservation campaign was required, retailers would have to pay every household $10.50 a week.

The authority told us that South Island storage in 2012 remained fuller than it had in 2008, the previous driest year, as water was drawn down more slowly and early conservation measures taken. It believed the compensation payment created an incentive for conservation measures by the retailers.

We heard that the authority calculated the $10.50 penalty on the basis of the economic value of scarcity of supply and the resulting unsatisfied demand. It intends to review the amount every three years.

**Stress testing**

Participants in the spot market for wholesale electricity are required to apply a “stress test” to their market position, and report the results to their board and to an independent registrar.

This requirement aims to ensure that participants analyse the risks involved, and disclose the level of risk they have decided to assume. The authority introduced stress testing in May 2012, and believes it will encourage certainty in dry years. The authority explained that if participants want to risk high prices because of short supply, they must make this choice explicitly, and cannot later seek government help on the basis of market failure. The authority is getting good compliance with the regime and believes that only three or four participants are choosing to risk high prices. It does not believe that its role as regulator should extend beyond monitoring the risk participants take, to compelling them to reduce risk.

**Monitoring by the authority**

We asked about the benefits of the authority’s role in monitoring and investigating the market for the electricity sector and consumers. It told us that it has investigated every instance of high or unusual prices or price spikes; some of the investigations had led to proposed rule changes, which is the purpose of its investigative role.

We asked if its investigations had direct benefits to consumers. The authority said that measures to improve competition will result in benefits being passed on to consumers. For example, its wholesale advisory group is examining whether new rules are needed for situations where a generator has no constraint on what it charges and has an incentive to charge higher. It also considers it important that retailers can be confident that they can operate in more remote parts of the transmission grid without being hit by a cost spike because of a line outage. These potential rule changes would improve competition and pass benefits to consumers.

**Futures market**

We asked the authority to what it attributed the rise in futures trading in 2012. It told us that under the Electricity Industry Act 2010, if the industry had not developed sufficiently
by the middle of 2011 it was required to take steps to ensure that it did. Rather than bringing in more regulations it chose to facilitate the market, which encouraged four major generator-retailers to become market makers, who buy and sell futures contracts under certain constraints, to stimulate trading. This arrangement provided a pricing spread and the ability to trade for any other company that wanted to enter the market.

**Financial transmission rights**

Financial transmission rights are financial hedges that help protect energy purchasers or generators from price uncertainty caused by transmission losses and constraints. The authority is to introduce these instruments in May 2013; it believes this will facilitate competition by managing risk. The first financial transmission rights auction will be held on 12 June 2013.

**Small-scale generation**

We asked the authority if it planned to quantify the benefits of small-scale electricity generation, and were told that there is no evidence that the authority needs to go any further than reviewing the part of its rules that concerns the operational requirements for small-scale generators seeking connection. The authority does not see its role as providing protection for distributed generation by small-scale electricity generators, but it facilitates and reduces barriers to entry into the market for them.

We asked the authority if it intends to update its report “Barriers to small-scale distributed generation”, as Meridian has changed its net metering contract rules, which are pertinent to the viability of distributed generation. It assured us that it continues to ensure that barriers to entry into the electricity supply industry are as low as possible.
Appendix A

Approach to this financial review

We met on 7 March and 11 April 2013 to consider the financial review of the Electricity Authority. We heard evidence from the Electricity Authority and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received

Electricity Authority, Responses to written questions, dated 28 January and 18 March 2013.

—— Responses to written questions, appendices, dated 28 January 2013.

—— Responses to written questions, combined consultants’ reports, dated 28 January 2013.

—— Responses to written questions, question 12 supplementary information, dated 28 January 2013.

Office of the Auditor-General, Briefing on the Electricity Authority, dated 7 March 2013.

Organisation briefing paper, prepared by committee staff, dated 21 February 2013.
Corrected transcript of hearing of evidence 7 March 2013

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Gareth Hughes
Peseta Sam Lotu-Iiga
Mark Mitchell
Dr Jian Yang

Witnesses
Carl Hansen, Chief Executive
Dr Brent Layton, Chairperson
Androula Dometakis, General Manager Corporate Services

Young Welcome, Dr Layton, Mr Hansen, and also Ms Dometakis—well, I’ve probably got close enough; apologies if I haven’t. Welcome to the committee. Now, we are looking forward to a 5 to 10-minute presentation from you—probably, the briefer the better—and then we will ask questions. Thank you very much indeed. We have received your PowerPoint presentation as well, thank you. Away you go, sir.

Layton Thank you very much, Mr Chairman. Just a small correction on the material you have. Androula Dometakis is not our general manager, corporate affairs. She is our general manager, corporate services, so she is in charge of the accounting. We don’t actually have a corporate affairs general manager—

Cosgrove Is that slightly less spin?

Layton So we haven’t brought the spin doctor; we’ve brought the accountant instead.

Cosgrove If you let Solid Energy know of your policy, that’d be good.

Layton Ha, ha! So we’ve handed out the slides, and the first slide you have relates to what is our statutory obligation. That’s in section 15 of the Act under which we operate, the Electricity Industry Act 2010, and we are, in terms of the Act, required to promote competition in, reliable supply by, and the efficient operation of the electricity industry for the long-term benefit of consumers. We have set out at some length soon after we were established in November 2010 what we took to be the interpretation of that, and we have worked away at those three limbs. We try and promote the reduction
of barriers to entry for new participants. We try to improve market information, price signals, and standards, and to increase consumers’ and producers’ choices and flexibility in the market place.

Most people think that the market has a relatively small number of players in areas like retail and generation. That’s actually not the case. There are now 15 independent electricity retailers, who operate 22 different brands. There are some major ones, but there are also some smaller ones and some new entrants, and on our second slide we have listed those out. There is, in fact, also another four parties we’re aware of that are contemplating or going through business cases to set up retailing. Some of them will come to fruition, some may not come to fruition, but there certainly is interest, and it shows that there isn’t a barrier to entry into that market now.

Moreover, in generation people think: “Oh, New Zealand has four or five generators.” In fact, we have 13 generators that are connected directly to Transpower’s grid. Some of those are small, but they are direct connects, and we actually have in our register 75 separate companies—this is not 75 plants; this is 75 separate entities—that operate generation and provide the New Zealand electricity. Yes, there are some big ones, but there’s obviously, again, not a barrier to entry into that market.

So I’ll talk a little more later about what we’ve done to promote competition, but in reliability, the ministerial review policy required us to address a number of matters, and, of course, interestingly, in 2012, we got the first big test of that. The issues had arisen in 2008 with the management of the dry year that occurred that year, and that led to the 2009 ministerial review and led to a number of policy recommendations, which we were required to implement, and most of which we have already implemented.

But 2012 turned out to be an even drier year than 2008. It was the lowest of the 80-odd years for which we have hydro inflows in the South Island for the first 6 months of the year. It rained after that, but the first 6 months, which is the critical period—and the chart that we have there just shows how low it was even compared with—those of you who have been around a while will know 1992 was the classic year. It led to: “Do we need a market, a whole public inquiry?” Well, 1992 was actually quite a plentiful year compared with—it’s the first blue one in from the red one on the right-hand side of the chart, but it was still a plentiful year.

Slide 6 shows that what actually happened was that compared with 2008, the generators were much slower—despite lower inflows in the South Island—at drawing down that hydro storage, and it wasn’t until they got into July, by which time you know that, given consumption hours and pattern of rainfall and snow melt, and so forth, you can start to use it, and they really drew down. So after that we did actually have precipitation come through, so the red line in slide 6 is the 2012 track for South Island hydro storage, and the blue line is what had happened in 2008. It just illustrates that there was a slower pattern of drawing that water down and more use earlier on of other sources to conserve that water, because they knew that if they actually did run into a public conservation campaign being required,
they would have to pay every household $10.50 a week. So they had a strong incentive to make sure that they didn’t get there.

The other big feature is that in the last 9 months the futures prices have also fallen, so since that time, since we got through the dry hydro period, and that seems to have been managed much better in 2012 than in 2008, and we’d suggest it certainly looks like—although it’s only one occasion, it certainly looks like—the policy changes have been positive in helping with that. The other big trend just more recently has been the falling off of the futures prices going out over the next 3 or 4 years in the market place. They, in fact, fell at one point to be 26 percent below where they were at the middle of last year—$26 a megawatt, or over 20 percent—but at the beginning of this month they were just 14 percent below that level. What that’s reflecting is concern about whether the demand will be there in the medium to shorter term from places like Pacific Aluminium but also Norske Skog Tasman has shut one of its plants, and in general demand has been relatively soft since about 2008, yet generational capacity has been built up. So those issues show the reliability, really, which was our second leg, which has, in our view, been improving.

Slide No. 8 looks at the volumes that have traded on the futures market. These are important, because they allow a way of new retailers to access generation capacity if they don’t have their own generation. They allow for risk management without having to have both the generation and the retail side. They’re also important as a signal to what do people think are going to be the future prices—so for making decisions about investment and whether new plants are required, and so forth. You need a reasonably active one, and this market is now—from a very slow start we were required under the 2010 Act to facilitate its development. We’ve done a number of things to do that, and it’s now trading about two-thirds of the volume of the physical market, which is a reasonably significant amount of electricity.

The other interesting statistic in 9 to look at is what has happened to the concentration of retailers across the country in each of the regional markets that we have, because—well, you can look across the country and work out what the concentration is. There is an index that is known as the HHI index, which is a measure of that concentration. How that works is that it takes the market share of each participant and it multiplies it by itself—it squares it—and then it adds those market shares up. So if you had only one party, then it would have 100 percent market share, multiply that by itself, and you’d get 10,000. So the top level of concentration is 10,000. If you had a whole lot who were very small, then the market share would be close to zero, the sum of them would be close to zero, and so the statistics’ bottom, lowest figure is zero when you’ve got a very atomistic market.

If you had, say, one dominant player with 80 percent and four players with 5 percent each making up the total of 100, the 80 would go to 6,400 when you squared it and the fives would go to 25—add the four fives, 6,500 is a market that’s heavily dominated. So this index is a good measure of the degree of domination. What we have done there is chart what was the
concentration ratios in January 2004 on the left, what they were in June 2008, which is just before the ministerial review started, and in December 2012—at the end of last year—and you can see there’s been a very significant reduction.

Young Thanks, Dr Layton. Look, we’ll come to questions now, if we can, please?

Layton Yes.

Young So what we’ve seen in 2012, the driest year in 81 years—hardly any New Zealanders heard about that compared to, as you say, 2008. So obviously, as you mentioned, policy has had some effect. I notice that the What’s My Number campaign is due to taper off in 2014, so you feel that at that particular point in time New Zealanders know enough on how to power switch—it’s done its work, there’s a pretty robust competition regime happening in the country—for that campaign to have done its work?

Layton Well, the Act actually has. The funding of that ends in June 2014. We think that the market has become far more aware of the switching and we think that having sort of broken people’s psychological concern—because if you recall way back in about 2000, 2001, when there was a rapid change of retailers, it was very long delays and people came to think it was very complex. We think we’ve got people over that hump, or will have them over that hump. We’re doing not only What’s My Number; we’re doing What’s My Number for small to medium enterprises. We actually do have a retail advisory group, which is one of our advisory groups that’s made up of industry participants, who are actually looking at what has been the effect of it and what might be needed to do when it actually ceases to be active. They’ll report later this year.

Clark One supplementary on that. Am I right in reading that HHI graph with the concentrations from 2004 to 2012 that it’s still, in many areas, over 50 percent? Am I reading that right? So that measure is a technical—so wherever it’s kind of red, does that mean there’s still one participant that has over 50 percent of the monopoly in that area? Is that right?

Layton Not necessarily. The yellow to sort of slight orange is around the 4,000 to 5,000, so it’s not a linear scale that’s sort of half; it’s telling you that you’ve got a degree of concentration change that’s coming through. If you get down to about 2,000 to 4,000 you’re probably in what most people would think is a fairly competitive market. So you do have some areas, and there are particular reasons for them. For example, if you look at the central North Island, to the west of Lake Taupō, what you have there is you have a particular retailer that has a high level, but the reason, when you look, is that they are a local retailer—they’re not one of the big retailers—and they have very sharp prices. If you go up to the Bay of Plenty, especially around Tauranga, what you have is an arrangement where TrustPower—it kept the generation and not the lines, and it provides its consumers with a dividend. So it’s kept concentration there.
Clark There’s a bit of a paradox in there. You’re effectively saying that where there’s the least concentration of players, there’s actually a more competitive market going on?

Layton It can be. We’re saying that you have to look—this is only an indicator and guide, you know, and as you can see there are interesting—if you actually go to the back chart, and I’ll give you the number. It’s chart No. 17 in the appendices. Now, what this is is actually the switching rates—not the HHI, but the switching rates—in each region in 2012, and if you notice that the absolute peak is Ōpunake. That’s the hotbed of switching, and the data at the scale at the side tells you it’s close to 30 percent. Everybody is positive. Everybody actually has some level of positive switching.

Now, the question is why Ōpunake is the hotbed, and the answer is Ōpunake Hydro set up as a little retailer and has captured a lot of the local market. A couple of months ago it announced it’s taking on other shareholders who are going to put in a gas plant to complement the local hydro plant. So you can see, actually, you do get entrants who can make quite substantial gains. From looking at the market overall, that’s what we’re trying to see—is there entry possibilities here, can they make progress, and can they put pressure, therefore, on incumbents to be competitive in their pricing? It’s the instrument we have, and we think it’s a good one.

Young Well, I just want to declare Ōpunake Hydro has previously been owned by my brother—

Layton What!

Young —but it has been recently sold to another energy company.

Layton I didn’t know that, Mr Chairman.

Cosgrove No wonder they want to flog everything off!

Hughes Thanks very much—thanks for the submissions. I guess I just have two quick questions. What do you attribute the rise in futures trading to in 2012? It’s a very large jump. And can you explain your slide in the appendix where you try and refute Geoff Bertram’s index of residential electricity prices?

Layton Well, in terms of slide 8 and the big jump, under the Act we were required, if the industry hadn’t developed sufficiently by the middle of 2011, measures to, in fact, ensure it did happen. And what we did was we decided that rather than bring in regulations about it, we’d facilitate it, and what we facilitated was four major generator-retailers being market makers and having to stand there to sell and buy in each contract with a minimum spread between their sell and their buys. So what one had, therefore, was a guarantee that if you wanted to enter the market, the spread was there, the ability to trade was there, and that actually has been very helpful in establishing the market. They knew that if they didn’t enter it into such a voluntary arrangement with the operator of the exchange that the authority had regulatory powers. So that’s—

Hansen Can I add to it? So I think that was instrumental in getting it going, and then, of course, we had the dry period—January, February, March. There
was quite a lot of trading, really, because people were wanting to manage their risks. And then in the second half of the year, you’ll see that it sort of dove down a bit and then took off again in the second half of the year, so a lot of that is due to, you know, parties reassessing long-term demand risk, and we had Norske Skog cutting back their production. You had other announcements going on. So people are saying: “Right, well, we need to manage our risks around that using the market more.”

Clark Just a quick supp, is it possible to get data on the proportion—the relative vertical integration of companies over time? Because that’s a more interesting question. It’s hard to make sense of the scale of futures trading—what proportion of generation is being traded for any given “gen-tailer” now as compared to before, because it’s still at the margins, as I understand it. Sorry, my question is—

Layton Well, interestingly, it’s about two-thirds of the physical, so, you know, there are people who say: “Well, two-thirds of the physical is a significant amount.”, and on some occasions, actually, it’s more than physical, but on average—

Clark But is it possible to get that data for the committee?

Hansen You were wanting, for each company, the amount that—retail and generation? Yes, we can provide that to the committee.

Young Right, a question from Clare Curran, then we’ll go to—

Hughes Mr Chair, I’d still quite like the second part of my question answered, around the Geoff Bertram slide.

Young Sorry, was there a second part?

Layton Yes, there was.

Young All right, we’ll go back to that.

Layton Very happy to. Slide 12 reproduces Dr Bertram’s slides, and what he’s done is take the year 1986, I think it is, and create an index out of it. So rather than look at the absolute level in New Zealand dollars, he’s created an index. What we have done on slide 13—and this data we’ve got from MBIE, but it’s for all the OECD countries, and it’s adjusted by putting it into New Zealand dollars, and taking into account inflation as well, the actual cents per kilowatt hour. So if you actually look at 1986, you will see that we were very low at that time, and there were two reasons why retail prices were particularly low at that time. One was that the line companies, the local retailers, were politically voted in and they tended to subsidise residences and charge high prices to commercial and industrial firms, and that, of course, has gradually over time disappeared. And the second was that a lot of the capital that had gone into, particularly, New Zealand hydro plants had not actually been earning a return, and the loans on those were being funded out of general revenue—general tax revenue—and so we weren’t actually seeing the true cost of electricity at that time.

And if you go to the next chart, which is 14, that really illustrates that a lot of our hydro power stations were not actually cheap, because what we have
done there is said: “Let’s assume we’ve built them today and adjusted for the cost of what it would cost today to build them.”, and compared them, the various plants, with the current futures price, and you can see that if we built them today none of them would really stack up, from 1952 all the way through to 1988. And some of them are a long way off: Benmore, Aviemore, and Roxburgh are not too far, but Clyde and Tongariro, which are well known, were in fact very expensive power stations to construct, even at the time. So I hope that answers your question.

Curran Customer switching is a key part of your work, and my question really is around the disclosure around what lies beneath that. Do you think it’s appropriate for a retailer to disclose to us the cost of their advertising and public relations campaigns around customer switching?

Layton I don’t think it’s something that really is an issue, because you then have to ask the next question: “How have they done the classifications and what have they put in and what have they put out and what are their purposes and so forth?”. Looking at the result, we’re not interested in switching per se; what we’re interested in is people knowing that they can switch and being willing to switch when there’s value in doing it, because that’s how you discipline providers in a market place: by the threat of losing customers. They have to think about those new entrants, they have to think about those alternative providers. So if you’ve got them all with their pencils as sharp as one another, you may actually see switching decline, because they’ve now actually realised that they shouldn’t get too out of line, because they will lose their customers. So it’s the propensity to switch we’re interested in.

Curran Given that some of the retailers aren’t necessarily providing the same information to the committee for us to make the judgments as to what’s going on behind the scenes, I suppose the next question is around the actual numbers of customers who are switching. Do you think it’s appropriate that the retailers disclose to the committee how many customers have switched in and out?

Layton Well, we actually disclose that information monthly by individual company. So we actually publish that data, and we can provide it to you if you wish. And it tells you which companies are losing, which companies are winning, and where they’re winning and where they’re losing by region. So we provide very full public data about that activity.

Curran So then along with that would come the campaign information, I suppose, that goes beside that. Would you agree?

Layton We don’t track their campaigns.

Curran But do you think that it’s important for the committee to have that information?

Layton Not so much about the campaigns; knowing what the switching is, because some of them will operate in one way. You see some, for example, will get a notice that somebody’s wanting to switch and they don’t hold a campaign,
but, in fact, ring up everybody who’s signalling they want to switch and offer them a deal.

Young And I think also—the comment you made before, Mr Layton, is that when this system is actually working at its optimum less people will be switching, because the pencils are sharp. So it’s hard to draw an indicator of actually how effective it is, because switching could slow down when it becomes even more effective.

Curran That’s not my point. My point is, I guess, the amount of money that’s being spent by the retailers on the campaigns that go alongside the switching—

Young That’s the operational prerogative, though, isn’t it?

Curran To disclose that or not disclose that?

Layton What we are aware of—because we have retailers coming to us to tell us—is that a number of them are working on new and innovative products for consumers where clearly the intention is to slow down switching by providing something of value to consumers, particularly around information about their consumption, which may help them to conserve energy, and so forth. We’ve been going 2 years trying to get competition rolling. We started with a fairly concentrated market, as you can see. One would expect them to go through a whole phase of coming to grips with being in a more competitive market, and one of the real end points of that is innovation and looking for new things that are really of value to consumers.

We’re starting—just starting—to see that appearing now. You will have heard about one or two such as Genesis’ experimental street up in North Shore, but there are others that retailers are looking at. We’ve also had recently much more data being available. There was a long period when if you wanted to know about your consumption in detail, a breakdown of that consumption and how it was made up—that was hard to get, and they all said it was impossible. Now there are two or three retailers who provide that as a matter of course. Again, it’s that competitive pressure.

Bakshi One of the roles of the Electricity Authority is to monitor and investigate the market. Can you please elaborate a little bit on how it has benefited the sector—the electricity sector—or consumers of your (inaudible) investigation?

Layton Certainly, that was a new innovation in the Act that we had to monitor. Our predecessor, the commission, had no monitoring role and we have investigated every instance of high or unusual prices. We have looked at, for example, the high prices that happened in November and December 2010. We had the March 2011 events, we had high reserve prices in the early part of last year. We also had spikes in prices around Timaru and Napier, around Stoke in the South Island. We have investigated all those, and some of them have led to proposed rule changes. One of them, the UTS, led to a decision to rewrite those prices using a rule in the system.

What has been really interesting to us is that since we investigated the reserve prices and that then went off to the Commerce Commission to see whether there had been collusion between two parties. That’s been publicly
announced. We don’t know what that is; that’s their process not ours. We
have not had an instance that has required us to investigate and we have
had at least one chief executive tell us that the instructions in their team are
to keep their noses clean. So investigations and the threat of investigations.

Our role is really to find what rule changes we need to make. For example,
those spikes in Stoke and around Timaru, or in the north of the South
Island and around Timaru, led us to, in fact, look at whether we needed new
rules around the positions that are called net pivotal. And the wholesaler
advisory group is actually pursuing that issue as to whether we need new
rules when a generator gets into a position where it both has no constraint
on what it charges and an incentive to charge higher because of its other
market positions. But we’ve had no instances since then of that then leading
to these spikes in prices. But they have gone on for a long time before there
was investigations in the past.

Bakshi Any benefits directly for consumers of your investigations, or reviews or
recommendations?

Layton Yes, I think certainly dealing with the net pivotal situation and having some
rules around that is important for ensuring that retailers will get into small
areas, in particular where you can get one generator, because of line outages,
short term in a dominant position. And so having that will allow other
retailers to come in there knowing that if that should happen, they are not
really at the mercy of the party. So it does have wider competition
implications, and that’s the reason we pursued it and we are pursuing the
options of rule changes. But Carl may have—

Hansen I’ll just add to that that some of these things that we looked at have been
very important for giving retailers confidence that they can operate in some
of the more distant, more remote parts of the transmission grid, because
then they’ve got confidence they’re not going to be hit by a spike because of
a line outage. And I think for industrial consumers we’ve heard from them
that they’ve got greater confidence these days in the pricing process, so they
can be more confident that when there are high prices it reflects genuine
shortages in the market and it’s valuable for them and for the community
that they cut back their production—cut back their demand—for electricity.
So we’re getting more efficient use of electricity and more efficient
production.

Bakshi Your slide shows that you have got 15 independent retailers and there are
some that are really minor in the market, so do they have any protection of
their marketing into the retail market? Do they have any protection for that?

Hansen Protection? What we’ve been doing to facilitate entry is reducing various
difficulties around the prudential regime. So our focus is on reducing
barriers to entry, as we had in one of our first slides there, and improving
information, but we don’t see a role for the authority to introduce any
protection for small retailers. A lot of those small ones—they’re hardly
visible in terms of numbers—they’re actually very new. Some of them are
only a couple of years old, and they spend their first period of time, having
got some customers, working out their systems, getting things streamlined,
getting to know how to use the hedge market to protect their position. So our focus is on having good market arrangements so people can get their own protection against risk, and having a well-functioning hedge in wholesale markets is key to that. So we think the fact that there are up to four other parties that are serious at looking at entering the market is a very good indicator.

New Zealand is about a quarter of the size of the Texas market, for example. Texas is known as the hottest retail electricity market in the US, and probably in the world. It has about 60 electricity retailers. We’re about a quarter of the size in terms of energy consumed, and we’ve got 15 so far. So I think we’ve seen—when I visited the US last year, New Zealand was seen as really at the forefront and a place to watch, and, in particular, the What’s My Number campaign was something that I know the Australian regulators and others in Washington who I spoke to were very, very interested in. They saw it as a very constructive area for a regulator to have ventured into.

Yang Just regarding that customer compensation scheme, you say that it was implemented prior to winter 2011. I was wondering whether you mean that the scheme was established then, or it actually happened.

Layton The scheme was established, but they never got to the point of requiring a public conservation campaign, so we never actually triggered it.

Yang OK. Then there’s a $10.50 per week—the figure. How did you come up with this figure, and is that the kind of—will you review it and then change it at all?

Layton Yes, the provision is that we will review that every 3 years, which is in the rules. Every 3 years we’ll review the figure. How the $10.50 came up was we look at—if you think of the economics behind what’s going on, what goes on in electricity, unlike most markets, when you get scarcity up to a point prices go up and up and up. But in electricity, when you run out of electricity, they cut people off. So there’s unsatisfied demand. The consequence of that, actually, is to lower demand and lower prices, so there is an advantage to getting to a point where you run a public conservation campaign, not only because you get to cut demand and cut your prices on the rest of the stuff that you may be buying as well. So we worked out what was the economic value of that. It was done initially by the ministerial review, and I confess I did it on the back of an envelope. We suggested about $10, and then the authority, with all of their expertise, which is far greater than mine, came up with $10.50, which made me feel pretty pleased, but it might’ve just been accident.

Young A very cheap calculation, on the back of an envelope, isn’t it?

Layton But the principle was the same that we used to approach this.

Lotu-Iiga Thank you for your presentation and your report. We had you here last year and, you know, you sort of, you hadn’t been operating for a period of time. You set out in your report that the two main weaknesses around the ministerial review about how you came about as an organisation was insufficient appropriate incentives to manage hydro storage, as well as
competition in the various markets. Now, I think you said in your presentation that the asset swaps was part of that legislation that we brought through as a Government, and they’ve been reasonably successful in terms of managing. You’ve also removed the Government’s reserve energy scheme, and now you’ve introduced three other sort of measures, one which my colleague referred, and the stress testing. Can you just—I mean, it was introduced last year. How is that going in terms of, you know, producing the sort of outcomes that you’re after?

Layton The stress test—the objective behind it is to essentially get us in a position, and hence actually politicians in a position, where the parties who are taking on risk positions in the electricity market are aware, and we can say: “You were aware what they were.” One of the issues that’s happened in the past is parties would take on positions that were great if it was not a dry year, but that would then cause trouble for them in a dry year. And then they would scream that the market’s not working, that the world and politicians should bail them out. We think that having the stress test allows us to go back and say “You did know what your position was.”, and what’s more to also show that other people had a wide range of other positions, that you didn’t have to have a position so exposed to such dry years.

Lotu-Iiga Yes, I understand that, but how is it working out in terms of—what are you seeing?

Hansen In terms of it operating, we’re getting very good compliance with it. I believe everybody is filling in and doing the analysis that we need and providing it back to the registry, which does a detailed review of it, and then it comes to us. In terms of the results that are coming through, we’ve done three tests so far, and we’re finding that around three to four parties have very little cover. So what that means is they are very exposed to high electricity prices; they’ve chosen to be very exposed. And that’s their choice. We’re very happy with that. So to give you an idea, I think the total sample size is about 20 to 22. You’re talking about three to four parties that are very much on their own, and then just about everybody else is, I would say, 80 to 150 percent covered.

Lotu-Iiga So all it is is that the scheme exposes these things, doesn’t it? There’s no compulsion, no enforcement.

Hansen That’s right. We take a view that the regulator—us—should not have a view about what risk positions people take. But if they’re going to take risk positions, don’t come back later and argue that the market’s at fault when in fact they’ve got to lie in their own bed that they made.

Layton And, of course, there are parties who would prefer not to be in that position and prefer to have the political leverage. We understand that, but they will complain about it. We think it’s better for—we think Parliament was right to bring into legislation a way to protect us against it because when that happens everybody pays, as I said, bailing out people who take the wins and refuse to take the losses.
I know you didn’t get to your concluding slide in your presentation, but you said there’s still work to be done to bring even more competition. Could you just talk to that quickly?

Well, one that we are just about to bring in is financial transmission rights. What the futures market does is provides energy hedges. But there is another cost that’s significant, and that’s the cost of transport, the transmission costs. And what a financial transmission right does is provides a hedge instrument against that cost. That too will facilitate competition because it means they can manage that transmission risk. We also have despatchable demand that we need to bring in, which will allow, essentially, large consumers to act like negative generators and be able to offer to be disconnected as an alternative to generating. And that will also add to the competition. And we have a range of other measures, but they are the two principal policies that we are still working on. May is meant to be the first time of the FTRs, but we need to wait for Pole 3, and that may delay us for another month. We’re all ready to go.

OK, good. Just the final remark on reliability of supply; we all understood that that was a key part of the reforms. Asset swaps obviously helped. Do you want to make any other comments around—you’ve talked about changes to the code.

Yes. Even last year, 2012, only for about a week did we get within a 1 percent chance of us running out of water. That’s a very—we can do that 100 times in a row and still not strike it. It could even be longer than that. So it was a very low probability, even in that year, of the risk. But since then, of course—and it was part of the ministerial review’s recommendation—the bottom of Pūkaki has become available should we get into a public conservation campaign. That adds an extra 550 gigawatt hours of generation that’s available to us, as a country, in storage, and the significance of that is if we got to a public conservation campaign we’d probably have hydro storage of around 1,000 gigawatt hours. So it’s like giving you another 50 percent on it. So with that situation, while there may be a public conservation campaign to tap it—so the company’s not going to race to do it, they’re going to look at it very carefully before they do it—the country, I think, itself can think there’s another buffer that we’ve managed to get in place as well for security. And you’ll recall 3 or 4 years ago people were saying New Zealand didn’t have a secure supply of electricity, because we’d had so many dry years in a row.

Well, we’ve come a long way since those reforms have been put in place.

My question is about your retail advisory group’s “barriers to small-scale distributed generation” report, which I understand no one from the solar energy association or industry were able to submit to and which the report found, unsurprisingly, that there were no barriers. Will you be updating that report, given those submissions weren’t included and also Meridian has very significantly changed their net metering contract rules?
Layton: It’s not correct that they weren’t able to submit. They were able to submit, but the body that represents them chose not to. However, the committee did receive submissions from other parties—

Hughes: I understand that they’ve made a complaint as well that their submissions weren’t included. But it’s not about that—

Layton: But it’s not correct.

Hansen: They mistook—they actually made a submission on a different item, a different area, and had thought they had submitted.

Hughes: But it seems pretty inflexible if you couldn’t include—

Layton: No, because what we had was the same points were made by other parties and were considered by the retail advisory group. And that group did include parties like DEUN (Domestic Energy Users Network) and the Consumers’ Institute Chief Executive and so forth, who are—I can assure you, I actually have a personal interest in small power stations. I have to declare that I’m exploring having a small hydro in the back garden in Karori, which I think will be fun.

Hughes: Will you be updating your work given the changes in PV prices, given Meridian’s changing their rules, given other people have complained that you didn’t hear what they said?

Hansen: We haven’t got any plans to go back and update that report, but we have ongoing work around what’s called Part 6 of the code, and it’s really around the operational aspects that small-scale DG has to comply with to be connected and so on, and that we see as the most productive area to streamline and make sure that we’ve got the best regime there so that we have all of those small generators competing with the large ones and make sure those barriers to entry are as low as absolutely possible.

Hughes: Are you doing any work on the benefits? Because you only looked at the barriers, but there’s a lot of benefits that no one’s quantified in New Zealand as far as I’m aware.

Hansen: The benefits of small-scale?

Hughes: To distribution, to the lines companies, to renewable generation, to competition.

Hansen: I guess different types of generation and different sizes of generation all bring different benefits of one sort or another that are not necessarily captured in the financials of each company. Our role really is to focus on having a really accessible market so that parties can come and compete. If, for example, a particular generation unit brings value to another party, like to a distributor, then they actually—and what many of them do is they go and contract with the distributor and get some payments from the distributor. That helps to serve the needs of the distributor and supplement what they can earn from the market. So we don’t see any particular barriers there in regard to that, other than the fact that they’d be negotiating with a monopoly lines company. But from our perspective, if those lines companies want to get better value for their customers, then they are quite
well incentivised to do that. And we have actually seen a lot of embedded generation. There is a lot of it around the country. So no real evidence at this stage that we need to go further than reviewing Part 6 of our rules.

Young

Thank you very much, Mr Layton and your team. We appreciate your report to us. Thank you.
2011/12 financial review of the Electricity Corporation of New Zealand Limited

Report of the Commerce Committee

Contents

Recommendation 2
Introduction 2
Progress toward liquidation 2
Conclusion 3
Appendix A 4
Appendix B 5
Electricity Corporation of New Zealand Limited

Recommendation
The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of the Electricity Corporation of New Zealand Limited and recommends that the House take note of its report.

Introduction
The Electricity Corporation of New Zealand (ECNZ) was set up as a company under the State-Owned Enterprises Act in 1987 to own and operate the generation and transmission assets of the Ministry of Energy. Since 1999 ECNZ’s primary objectives have been to manage residual issues arising from its previous and divested business activities. It has not traded for some years, and has been settling liabilities as they fall due, and finalising claims and legal actions.

ECNZ has three directors, and does not have any employees. In the 2011/12 financial year it incurred a net operating loss of $63,000 against a budgeted loss of $79,000.

Progress toward liquidation
ECNZ told us that the only issue holding up the liquidation of the company was the transfer of the remaining 16 out of 61 land titles. It was working with Treasury to resolve this as quickly as possible, and hoped the transfer would be completed by the end of 2013. ECNZ does not have direct ownership of the land in question and receives no revenue from it.

We asked why this matter was unresolved after 14 years, and were told that various issues with the land had complicated the process. Some of the land was without formal title, some had not been formally set apart under the Public Works Act 1981 for the purpose of electricity generation or distribution, and third-party access to some of it had not been formally negotiated or recorded. The Crown had responsibility for resolving these issues, which had proved more complex and time-consuming than expected. We heard also that a Supreme Court case relating to some of the land titles was causing a delay. The case, the “Paki litigation”, was related to the ownership of riverbeds and had a bearing on land around the Whakamaru Dam.

We asked what exactly had to happen for these obligations to be resolved. ECNZ told us that the Crown had to raise the titles, and that Treasury was in charge of this process. Once the titles were received by ECNZ, they could be transferred. ECNZ believed that Treasury was working to expedite this process, which involved negotiation with iwi, former landholders, local authorities, and other Government departments.

We heard that it was not possible to set a formal target date for completion of ECNZ business until the transfers were completed, as the company could not be liquidated before its legal obligations were resolved. A wind-up date of 30 June 2009 had been proposed in 1999, but in October 2008 the shareholding Minister, Hon Trevor Mallard, had advised that shareholding Ministers considered that ECNZ should not take steps to wind up until advised by the Crown that the land transfer process was complete.
We heard that Treasury had asked its lawyers to expedite the process; however, ECNZ could not give us a timeline for completion.

**Obligations and options**

We noted that ECNZ paid $72,000 per year in directors’ fees, and asked whether there was any sanction against the directors if the corporation continued not to resolve its business. ECNZ said the directors were hampered by the legal process. We asked whether the directors would consider waiving their fees for periods in which no progress was made. ECNZ said the directors’ fees were set by the Minister. Asked whether at some point the directors might consider resigning in protest at the length of delays in resolving these matters, ECNZ said that the current recommendation was to continue the process.

We asked whether there was a break clause in the contract that would allow ECNZ to extract itself from the contractual obligations for a fee. It told us that a break clause was typically built into such contracts, but break fees were usually too expensive to warrant such action. ECNZ asserted that it had assessed such options in consultation with the Government.

**Conclusion**

We are frustrated by the lack of progress and hope that ECNZ will continue to work with Treasury to complete the land transfers by the end of this year, as indicated, so the corporation can be wound up.
Appendix A

Approach to this financial review

We met on 31 January and 28 February 2013 to consider the financial review of the Electricity Corporation of New Zealand Limited. We heard evidence from the Electricity Corporation of New Zealand Limited and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received

Electricity Corporation of New Zealand, Responses to written questions, received 20 December 2012

———Responses to additional written questions, received 15 February 2013

Appendix B

**Corrected transcript of hearing of evidence 31 January 2013**

**Members**
- Jonathan Young (Chairperson)
- Kanwaljit Singh Bakshi
- Hon Chester Borrows
- Hon Clayton Cosgrove
- Hon David Cunliffe
- Clare Curran
- Peseta Sam Lotu-Iiga
- Mark Mitchell

**Witnesses**
- Victor Wu, Chairperson
- Jane Meares, Director

Young Welcome to the Commerce Committee, Mr Wu and Ms Meares. Thank you for attending today. You probably haven’t appeared before us for some length of time, and we do understand that matters in terms of the Electricity Corporation are winding up, but we just want to get a report from you. If you would like to give us a verbal report and then give us some time for any questions that we may have, that would be most appreciated. Thank you, Sir.

Wu Basically, ECNZ, as you have mentioned before, is in the throes of winding up. The only issue holding up the liquidation of the company is the transfer of land titles, of which there are about 14 to go. These land titles, the process is very complex and goes back to the old NZED days, the 1970s, where there were various parties involved, and we are working with Treasury to expedite these as fast as possible. We are hoping that these may be completed by the end of this year. The legal process will determine the eventual outcome of that. Other than that, there’s no other reasons for ECNZ not being wound up.

Young Right, thank you very much. We have got some questions.

Cunliffe Just to put it on the record, in public session, what’s the total running budget of ECNZ. What’s the cost of running ECNZ each year?

Wu About $100,000 a year.

Curran How much?

Wu $100,000.

Cosgrove What’s that?
Cunliffe $100,000 a year. When did ECNZ first take on its role of disposing of the residual assets—i.e., when did it cease becoming an operational entity and become a wind-up entity?

Wu In 1999 was when the split was done, and from there on ECNZ went into wind-down mode.

Cunliffe Thank you for assisting my memory, because I did recall this matter coming before the committee the last time I sat on it, which was in that term of 1999 to 2002, and if I can recall correctly the committee was told then that, you know, this was a matter that would be wound down and got off the books as soon as possible, and here we are some 13 to 14 years later costing the taxpayer $100,000 a year, and you’ve got to dispose of some properties and you don’t even know if it will be wound up this year. I mean, what sanctions exist if that KPI is not achieved?

Wu Well, I mean, the wind-up, up until the time that the last bonds were paid, which was about 4 or 5 years ago, then we were just waiting for these transfers to be done.

Cunliffe Waiting, on an ongoing cost to the taxpayer. I mean, waiting doesn’t seem an appropriate activity at that cost, with respect.

Wu But the continuation of ECNZ is beyond the control of the directors. There are legal obligations involved in these transfers.

Cunliffe While all members of the committee would no doubt accept that there are aspects to the legal process which are beyond anybody’s control, and nobody’s alleging negligence on the part of the directors, still the directors have an obligation to discharge the objectives of the entity, which are, in this case, to wind up as properly and as expeditiously as possible. Now, 14 years seems like a bloody long time to be going through that process, and you’re telling the committee you’re not even sure if it’s going to be wound up this year. What exactly is the problem?

Wu OK, it comes down to the legal process, right.

Cunliffe So can you brief us what the legal process is. Sorry, I don’t mean to badger, but I just don’t have that information.

Wu If I can ask my colleague, my legal director, who can explain in more detail the legal issues.

Meares When ECNZ or the assets of ECNZ were transferred to the three baby gentailers in 1999 there were, as Victor has said, a number of assets that needed to be disposed of, from ECNZ’s perspective, including the financial bonds that he’s just mentioned, which, as I understand it, were not repaid until 4 or 5 years ago. Then other than dealing with administrative matters, it’s the land titles which need to be transferred to those three entities which have held up the winding-up.

To some extent we are in the Crown’s hands because ECNZ has—there are matching obligations for the Crown to transfer these land titles to ECNZ and then for ECNZ to transfer them to the other SOEs.
Cunliffe So is there a delay in respect of the Crown’s action around those matching titles? What is the hold-up? Is there some legal dispute that is before the courts?

Meares I think the whole process has been far more complicated than anyone had anticipated at the beginning, and, in addition, there is currently a case before the Supreme Court, which has meant that the Crown has delayed the transfer of some of those land titles to ECNZ.

Cunliffe Can you brief us on who the parties to the case are and what—

Meares It’s called the Paki litigation.

Curran The what litigation?

Meares The Paki litigation.

Cunliffe And why does it impact on this?

Meares Because it’s to do with the ownership of riverbeds. Some of the land titles which need to come to ECNZ touch on that, around the Whakamaru Dam.

Cunliffe Can you help us with the cost structure of the residual ECNZ. Presumably, it is a skeleton organisation if it is simply waiting for the completion of the legal case in the Supreme Court, and it will then hire lawyers to complete the conveyancing activity. Why is it costing $100,000 a year, and are people on fee for service or are they on salary?

Meares Well, I might pass over to Victor to answer that, but my understanding is that the costs are administrative overheads and directors’ fees and legal fees.

Cunliffe So what administrative overheads are there? Are you renting an office? If so, why?

Meares We don’t rent an office, no. We subcontract that to an entity in Wellington.

Cunliffe How much are the directors’ fees?

Wu $72,000.

Cunliffe What do the directors do for $72,000?

Wu Well, they carry out the statutory legal obligations.

Cunliffe There’s not much happening, is there.

Curran How many directors?

Cunliffe How many directors are there?

Wu Three directors.

Cunliffe Three directors. And is there any sanction on the directors if the time line for— I mean, have the directors set a definite time line and KPIs for the final wind-up of this company?

Wu Well, the directors have frequently had dialogue with the Crown in trying to expedite the transfers of these titles. To a certain extent, the directors are hampered by the legal process.
Cunliffe  In the company’s work plan is there a completion date specified that you can go to the Crown and say: “The directors insist that the entity meet its obligations to our strategic plan.”? What is your target date, or don’t you have one?

Wu  Well, recent dialogue with Treasury has indicated that, barring any legal hold-ups under the transfers, the end of this year is when we hope to—

Cunliffe  I understand that, but that isn’t the question. Have the directors set a target—a formal target date—for wind up?

Wu  We can’t set a formal date until we complete these transfers, because we cannot liquidate a company which has legal obligations.

Cunliffe  Correct. I understand that, but there is a catch-22 here. One might argue that your leverage with the Treasury would be enhanced if you could go to them and say: “The directors of ECNZ have set a target for wind-up.” It’s not like we’re expecting this done next week. It’s been 14 years. It’s embarrassing, frankly. And it’s a cost to the taxpayer at a time when money is tight. I think the public would want to know that everything that can be done to stop this dragging on at unnecessary cost to the taxpayer is being done. I think the public will want to know if not, why not? And why have the directors, who have responsibility for achieving that objective, not set a final date?

Cosgrove  Just on that, leading from that, through you, Mr Chair, could you take us through the practical impediments and the practical steps and the practical delays, if you like, with the title transfer? Where are the roadblocks in getting this thing done?

Meares  I think a lot of them have been around the Public Works Act, and making sure that land that was taken for electricity generation purposes way back in the seventies can effectively continue to be used for electricity generation, that the titles can be raised by the Crown and transferred under the SOE Act to ECNZ free of that.

Cosgrove  So does that require legislation?

Meares  No.

Cosgrove  Regulation?

Meares  No.

Cosgrove  So what does it require? A séance? What is it actually required to do it? I understand the point. So, if there’s no parliamentary imperative, then—presumably there’s no ministerial blockage through Cabinet-made regulation—what is the practical roadblock in getting the deal done? Officials talking to each other or what?

Meares  It’s the Crown that’s in charge of that process, so I don’t know that I can speak to it authoritatively. ECNZ’s role is to transfer the titles once titles are raised and received by us.

Cosgrove  So what is the Crown’s practical role? By “the Crown” I take it you mean the Minister?
Meares The land belongs to the Crown, and Treasury is managing that process of raising the titles.

Cosgrove OK. So, in practical terms, does Mr English have to give Treasury a boot up the backside and tell them to do whatever they have to do? So you’re saying the impediment is not with you; it’s with Treasury?

Meares Yes, although my understanding is that they’re actively managing that process, and so are we.

Cosgrove Well, rigor mortis appears to have set in over 14 years. I’m still struggling with—I mean, presumably documents have to be negotiated, papers have to be signed, whatever. You’re a party to this, so you must have a view. If Treasury is holding the show up and you’re waiting on Treasury to do things, what I’d like to know is—and you must have an idea, you must know what they are, because you’re a party to the transaction—what is Treasury holding up? What does Treasury need to do to meet its obligations to you so this can happen? You must know that because you’re the other side of the party.

Meares Treasury’s obligation is to raise the title. As I understand it, that process involves various negotiations with iwi, former landholders, local authorities, and other Government departments, because areas like the Whakamaru Dam traverse all sorts of—there are all sorts of issues surrounding that. There are legal roads that need to be established, operating easements, and so on, and they all have to be documented and the legal process gone through. I’m aware that Treasury employs consultants to do that, and that they’ve been asked to expedite this.

Cosgrove Thank you for that. That now makes it a bit clear. So—and I’d like some feedback to the committee, please, on this—either Treasury is not doing its job and not acting or its contractors aren’t acting efficiently or there is a series of negotiations that are occurring between external parties, which for various reasons are taking a length of time—

Meares Mm, I think it’s the latter.

Young Because you made the comment that this has ended up being a lot more complex than was anticipated. Is that because of the negotiations with the various parties?

Meares I think so, and because of the complexity of the land issues. My understanding is that when ECNZ was established in 1987 someone got a Vivid out and said: “Here’s the area that ECNZ needs for its electricity generation.”

Young I think if you came back to us and gave us a report on where things are at at the moment, that would be helpful.

Cosgrove Just on that, just to add to that. I’d like a briefing paper on the points that she has made, but I’d actually like within that some detail. I’m not asking for disclosure of intricacies of negotiations. I’d actually like to know where the hold-up is, whether it’s Treasury’s internal management—I’m sure you can
liaise with Treasury, and you have a responsibility to—whether it’s a Treasury issue or just a negotiation issue.

Cunliffe To that end, could you please set out for us clearly what the required process steps are, which party is responsible for delivering on each of those process steps, what dates are in your work plan—you must have some sense of—for the completion of those process steps, and therefore what your implied target date is? To the extent that there are factors like Supreme Court judgments that might bear upon that, what is your expectation of time period, and how does that affect the process? You may wish to consult, through the Chair, with the Treasury on that. Otherwise, we might need separate briefings on that.

Lotu-Iiga $100,000 is going out annually. How much, given the value of the land, are we talking about? Is there revenue being generated over those parcels of land that are in question?

Wu No, there’s no revenue. ECNZ’s role is purely a documentary role in respect of these titles.

Lotu-Iiga I’m asking you is it your understanding of the lands that are in question—someone owns it now—is there revenue being generated over that valuable land that we’re talking about?

Meares To the extent that some form part of electricity generation land which needs in due course to be transferred to Mighty River Power or Genesis, then, yes.

Lotu-Iiga So there is revenue being generated. Do you know what that revenue looks like?

Meares No. Not separately for those pieces of land that are still outstanding, no.

Lotu-Iiga OK, but, presumably, you have valuations on those parcels to demonstrate that there is some future value in the parcels of land in question.

Wu No, those titles are little bits of land. ECNZ doesn’t have any direct ownership of that land. We’re only involved because of—

Lotu-Iiga No, I know, then it transfers and then you liquidate—I understand that. I’m just wondering—

Meares To the extent there was a valuation, I imagine it would have been incorporated in the valuations, which would have been included in the sale and purchase agreements in 1999.

Lotu-Iiga OK. So there is, give or take, some revenue that’s being generated off the expenses that are currently being incurred to dispose of the land and wind up or liquidate your company. Have you been involved since 1999?

Wu Yes, I have.

Meares No, I was appointed last year.
Lotu-Iiga  Oh, OK. So from 1999 to 2008, presumably this was a situation where you had a relationship with the Treasury or the Crown. Under the last Government, you had that relationship. Would that be fair?

Wu  Yes, we’ve been involved.

Lotu-Iiga  What was the level of activity or correspondence during that 9-year period under the last Government in which, you know, it could have been wound up within, you know, a few years? That’s the sort of implication we’re getting here today.

Cunliffe  You’ve been here for 5 years. This is getting a bit old. I mean, I’m not being partisan about this—

Lotu-Iiga  I’m asking the questions. You’ve had your turn, please.

Cunliffe  I’ll have another one.

Lotu-Iiga  Thank you. Had your turn.

Wu  We’ve had—

Cosgrove  Come on, it’s a new year, team. Be nice to each other.

Young  Be happy. It’s a new year.

Lotu-Iiga  During that 9 years, I mean, you know, maybe it’s more complex now, but, you know, I suppose the implication is it could have been done within that period.

Wu  We’ve had regular, ongoing annual communications with the Government, Treasury, on this issue. Don’t forget that this is the last of the transfers, right? Back in 1999 there may have been 100, you know, so slowly over a period of time it was whittled down. And those directors have been frustrated themselves in this slow process. But in understanding what the problems are—

Lotu-Iiga  Yeah. Yes.

Wu  —that’s just—

Lotu-Iiga  Oh, no, no, and I just want to tease that out. But, you know, it’s been difficult from 1999 right up until now, and, you know, in the 9 years to 2008 this was difficult, correct? There were complex issues, and you’re working through them during that period in a similar vein, correct?

Wu  Yep.

Lotu-Iliga  Yeah.

Cosgrove  Supplementary—

Lotu-Iiga  Hang on, I’m not finished yet.

Cosgrove  No, supplementary—

Lotu-Iiga  You’ve had a go.

Curran  You’re giving a speech here.

Young  Sorry, excuse me. Order, please.
Lotu-Iiga  You’ve had about 20 questions—
Cosgrove  No, no, I’ve got a supplementary directly to your point.
Lotu-Iiga  Could I just finish and then we’ll go back to—
Young    Well, finish off that, then we’ll go to Clayton, then we’ll go to Kanwal—a new question.
Curran   Excuse me—
Cosgrove A supplementary—
Young    No, no, he asked before you did.
Lotu-Iiga Sorry, all this carry-on—I’ve almost forgotten my question. But, look, so in terms of the financial bonds, I mean, I just want to get clear that there is absolutely no way in terms of the obligations of the organisation that you could have extracted yourself from those obligations. There are no break clauses in contracts that are in place? I just, you know, I suppose the legal—
Wu      That’s right, yes.
Lotu-Iiga —person here—
Wu      Legally—
Meares  Well, I wasn’t around as those bonds wound down, but, in general, in those sort of things there is a break clause that you can take advantage of. But, usually, the financial repercussions are such that it’s just not sensible.
Lotu-Iiga Yeah. No, look, that’s my understanding. So that break fee or contract break fee is substantial, correct?
Meares  In general terms. I don’t know about the specifics of these bonds, but, yes, you would have expected it to be, and that it would have been a better result to let them wind down.
Lotu-Iiga And you’ve balanced that out in terms of the cost of winding it up in the proper way or breaking the contracts and winding it up early—you’ve done that assessment?
Wu      We’ve looked at all issues, right, in consultation with the Government over many years.
Lotu-Iiga Yep, over the 13, 14 years.
Cosgrove Could you come back—you mentioned that 1999, there were a substantial number of these, and you may not know off the top of your head. You quoted 100; you might have been hypothetical. Could you come back—and you now say there’s 14-ish—could you come back in your briefing to us and give us a breakdown of how many were disposed of or dealt with—how many you had for each years since 1999 to date? It sounds like there was a bit of progress over 9 years.
Mitchell Yeah, I just, really, it’s just a supp to Sam’s. I just want to be clear myself. So the 14 titles of land you’re talking about, are most of those currently in use and generating revenue?
Wu  Sorry, what was that?
Mitchell The 14 titles of land that are pending in terms of completing the wind-up of the company, are they currently in use and generating revenue?
Meares As I understand it, they are part of—
Wu Part of the whole complex—
Meares So a lot of them are part of either the Whakamaru Dam or adjacent to the Whakamaru Dam or the Tongariro power scheme.
Mitchell So, basically, the 14 titles are in or around that area that’s being operated by Mighty River Power.
Meares Yeah.
Mitchell OK.
Bakshi You mentioned that there is a case going on in the Supreme Court. So when did that start, and what is the progress on that?
Cosgrove It started today. You’re talking about the SOE case?
Young Yes, today.
Cosgrove They’re in court today, mate.
Young Come on, come on. Hurry up. Move on.
Bakshi We’ll see to that. We’ll see to that.
Cosgrove Call Carruthers. Give him a ring.
Meares ECNZ isn’t a direct party to that, so it’s quite hard for us to comment on that. So I don’t really know when it started, but it would be several years ago as it went through the process and is now before the Supreme Court, and I think there’s a hearing in February.
Curran My question is a practical one. You mentioned before in one of your answers that Treasury had asked for the process to be expedited. Is that in writing?
Meares Well, to the extent that that’s a contract between Treasury and its consultants.
Curran Well, is that a recent ask? Has it been expressed, is my question. Because, I mean, it seems to me that in this protracted situation, nobody is trying to push the thing to come to a conclusion and nobody’s driving the process. But then you made the comment that Treasury had asked for the process to be expedited, so how have they asked for that to happen?
Meares Well, my understanding is that Treasury has asked its lawyers to move things along as fast as it can, and, at the same time, we, the directors, have done a review of—
Curran So was that through verbal conversations or—
Meares Yep. It means you have to ask Treasury, I suppose, what it said to its lawyers. I don’t know. That’s our understanding, however.
Cunliffe Two final questions. The first one is in terms of Whakamaru. There’s a well-known grid constraint, which arguably has led to higher prices north of the constraint. There’s a lot of load around Auckland, and it constrains the amount of fee that can come in from the southern hydros. Is the asset at Whakamaru that’s under some form of dispute here related in any way to that constraint? Because that would have an economic impact, possibly.

Meares I don’t know, I’m afraid.

Cunliffe No idea? OK. At what point—this is to our director—at what point would the directors consider resigning from ECNZ if they felt that they were in the position where they were not able to uphold proper fiduciary responsibilities because of unconscionable delays?

Wu Well, I think over the years, especially in the last 5 years, 6 years, we have had discussions with the Government as to the future of ECNZ, and one of the options was that the Government take over. But for various reasons, right, the current recommendation is that we should see this out because of potential legal issues which might complicate issues.

Cunliffe If there is little or no activity, would directors consider waiving directors’ fees during a waiting period?

Wu Well, we still have our obligations. The directors’ fees are not set by the directors.

Cunliffe I’m not saying they are.

Wu They’re set by the Minister. So we are, you know, carrying out what we are employed to do.

Cunliffe You don’t think there’s any risk to the reputation of the directors for continuing to participate in a process that seems to be without end or explanation?

Wu Oh, I don’t think so. I don’t think they’re extraordinary. They’re just basic fees.

Young And I think, I mean, things are progressing this year. We do hope to see a finalisation of matters by the end of the year, as you’ve mentioned. And we are going to get a report back from you, so I appreciate that. Well, I think we’ve all had a good go at questions. Thanks very much for your answers and your presentation this morning. Good day.

Cosgrove And you’re clear on exactly what we’re asking for feedback on? There’s no—

Young And we’ll send a note to them. Right, thanks very much.

*conclusion of evidence*
2011/12 financial review of the Energy Efficiency and Conservation Authority

Report of the Local Government and Environment Committee

Contents
Recommendation 2
Introduction 2
Warm Up New Zealand 2
Encouraging energy efficiency 2
National Australian Built Environment Rating System 2
Biodiesel and alternative forms of energy 3
Appendix 4
Energy Efficiency and Conservation Authority

Recommendation

The Local Government and Environment Committee has conducted the financial review of the 2011/12 performance and current operations of the Energy Efficiency and Conservation Authority and recommends that the House take note of its report.

Introduction

The Energy Efficiency and Conservation Authority, a Crown entity, is mainly funded from Votes Energy and Environment. The authority’s primary purpose is to implement Government strategies for energy efficiency, conservation, and renewable energy in the private and public sectors. It seeks energy efficiency in businesses, homes, and transport, renewable energy, and monitoring and research.

In 2011/12 the authority’s total revenue was $127.926 million and total expenditure was $123.016 million, resulting in a net surplus of $4.91 million.

Warm Up New Zealand

The authority’s major programme is Warm Up New Zealand: Heat Smart, an insulation and clean heating programme that aims to retrofit 230,000 houses by June 2014. The authority told us that for every dollar invested in the programme by the Government there is an audited return of five dollars.

We are pleased that the number of low-income households receiving funding to participate in the Warm Up programme has increased from 60,000 to 120,000 since the programme began in 2009. We note that retrofitting houses in the private rental market is harder to bring about as it is the landlords, and not the renters (many of whom are on low incomes), who make the decision to insulate.

Encouraging energy efficiency

The authority told us that its main challenge is encouraging energy efficiency on the part of businesses and in the transport sector, which between them consume 70 percent of the energy used in New Zealand each year, with large carbon footprints. We were interested to hear that approximately $1.6 billion could be saved each year through energy efficiencies in these areas, but this potential is particularly difficult to realise because business owners prioritise the survival of their businesses over energy efficiency.

The authority is working with the Ministry of Social Development on a whole-of-Government contract for managing Government-occupied buildings to incorporate energy efficiency measures. This project will also ensure that the business plans and statements of intent produced by Government agencies address their carbon footprints.

National Australian Built Environment Rating System

The authority is introducing into New Zealand the National Australian Built Environment Rating System (NABERS) for measuring and comparing the environmental performance of buildings. We queried the necessity of introducing another environmental rating system that would compete with the Green Star system. The authority said that while the Green
Star System works well for new buildings, it felt that the NABERS system worked better for older existing buildings. We were interested to hear that two Government agencies had already used the NABERS system.

**Biodiesel and alternative forms of energy**

We questioned the authority about its promotion of biodiesel. It considered it had been only “moderately successful” at promoting the use of biodiesel in factories, and noted that the certainty of coal supply was often a determining factor. It said it was considering targeting clusters of factories rather than individual factories in an attempt to make the supply of wood more certain and thus a more attractive option than coal. We note that woody mass, the accumulated mass, above and below ground, of the roots, wood, bark, and leaves of living and dead woody shrubs and trees, could provide up to 43 percent of the wood supply.

The authority co-hosted the screening of a film that explores different forms of energy with the Petroleum Exploration and Production Association New Zealand. The screening was intended to foster debate, and the authority feels that it drew attention to the potential for renewable energy in New Zealand.
Appendix

Approach to this financial review
We met on 28 February and 14 March 2013 to consider the financial review of the Energy Efficiency and Conservation Authority. We heard evidence from the Energy Efficiency and Conservation Authority and received advice from the Office of the Auditor-General.

Committee members
Nicky Wagner (Chairperson)
Maggie Barry
Jacqui Dean
Aaron Gilmore
Paul Goldsmith
Hon Phil Heatley
Gareth Hughes
Raymond Huo
Moana Mackey
Eugenie Sage
Hon Maryan Street
Andrew Williams

Evidence and advice received
Energy Efficiency and Conservation Authority, Responses to questions, received 22 January 2013.

Energy Efficiency and Conservation Authority, Responses to additional questions, received 8 March 2013.


Organisation briefing paper, prepared by committee staff, dated 7 February 2013.
2011/12 financial review of the Environmental Protection Authority

Report of the Local Government and Environment Committee

Contents

Recommendation 2
Introduction 2
Financial and service performance management 2
Hazardous substances 2
Exclusive economic zone 3
Appendix 4
Environmental Protection Authority

**Recommendation**

The Local Government and Environment Committee has conducted the financial review of the 2011/12 performance and current operations of the Environmental Protection Authority and recommends that the House take note of its report.

**Introduction**

The Environmental Protection Authority is a Crown agent responsible for regulatory functions concerning New Zealand's environmental management. The authority was established on 1 July 2011 and incorporates various functions previously discharged by the Environmental Risk Management Authority, the Ministry of Economic Development, and the Ministry for the Environment.

In 2011/12 the authority’s total revenue was $23.9 million and total expenditure was $22.717 million, resulting in a net surplus of $1.183 million.

**Financial and service performance management**

The Office of the Auditor-General issued an unmodified audit opinion on the authority’s financial statements, giving a “very good” rating to its management control environment and “good” to its financial systems and controls. Service performance information and associated systems and controls also received a “good” rating.

**Hazardous substances**

**Compliance**

During the 2011/12 financial year the authority surveyed 400 businesses that use hazardous substances to estimate compliance levels with eight hazardous substance controls. The survey found that only 25 percent of businesses were fully compliant, while 30 percent complied with seven of the eight controls. We would like to see industries using hazardous substances substantially improve their compliance with these important controls.

As the survey was the first undertaken by the authority, it is not yet possible to extrapolate any trends. We encourage the authority to consider making the survey a regular activity as more data on hazardous substance compliance is desirable.

**Monitoring and enforcement**

The hazardous substance compliance survey covered only workplaces, and does not indicate exactly where compliance monitoring and enforcement might be lacking. The authority conceded that it is not altogether clear who is in charge of monitoring and enforcement, but went on to say that the “big three” agencies—the Ministry for the Environment, the Ministry of Business, Innovation and Employment, and the Environmental Protection Authority—are cooperating and that some improvements have been made. We look forward to further improvements in the communication of and compliance with hazardous substances responsibilities.
The authority, like one of its predecessors (the Environmental Risk Management Authority), believes there is too little inspection and enforcement regarding hazardous substances in workplaces. The authority itself draws up hazardous substances regulations, but enforcement is carried out by 87 agencies including the Ministry of Business, Innovation and Employment and local authorities. We acknowledge that this is probably too many.

Fireworks are among the hazardous substances regulated by the authority; enforcement is handled by the Ministry of Business, Innovation and Employment. We are pleased that the authority is working with approved handlers to ensure they are sufficiently trained, but note that more is work needed in this area.

**Exclusive economic zone**

The authority is the consenting authority for activities taking place in the exclusive economic zone and on the continental shelf. We asked whether drilling might become a permitted activity under exclusive economic zone regulations, and were told that the authority did not yet know what regulations would be drawn up. It provides advice to the Ministry for the Environment, who draw up the regulations, about the practical implications of the ministry’s policy in this area.

We also asked who would enforce compliance in the exclusive economic zone and continental shelf. The authority said it was looking at other Government departments, and had heard nothing about the possibility of a third party being used.
Appendix

**Approach to this financial review**

We met on 6 December 2012 and 31 January 2013 to consider the financial review of the Environmental Protection Authority. We heard evidence from the Environmental Protection Authority and received advice from the Office of the Auditor-General.

**Committee members**

Nicky Wagner  
Maggie Barry  
Jacqui Dean  
Paul Goldsmith  
Gareth Hughes  
Raymond Huo  
Nikki Kaye  
Hon Annette King  
Moana Mackey  
Eugenie Sage  
Hon Dr Nick Smith  
Andrew Williams

**Evidence and advice received**

Environmental Protection Authority, Responses to written questions, received 5 December 2012.

Environmental Protection Authority, Responses to additional written questions, received 23 January 2013.

Office of the Auditor-General, Briefing on the Environmental Protection Authority, dated 6 December 2012.

Organisation briefing paper, prepared by committee staff, dated 5 December 2012.
2011/12 financial review of the External Reporting Board

Report of the Commerce Committee

Contents

Recommendation 2
Introduction 2
Standing 2
Different standards for different sectors 3
Under-spending and expenses 3
Appendix A 4
Appendix B 5
External Reporting Board

Recommendation

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of the External Reporting Board and recommends that the House take note of its report.

Introduction

The External Reporting Board is an independent Crown entity, established under section 22 of the Financial Reporting Act 1993, and subject to the Crown Entities Act 2004. The board came into existence on 1 July 2011 when it was reconstituted from the Accounting Standards Review Board following amendments to the Financial Reporting Act 1993. The responsible Minister is the Minister of Commerce.

The board has established two standard-setting boards and delegated authority for them to develop and issue standards. The New Zealand Accounting Standards Board (NZASB) is responsible for setting accounting standards and the New Zealand Auditing and Assurance Standards Board (NZAuASB) for setting auditing and assurance standards.

Kevin Simpkins is the chair of the board, Michele Embling of NZASB, and Neil Cherry of NZAuASB.

The board is funded by Vote Commerce. In 2011/12 the board’s total revenue was $4.463 million and total expenditure was $3.396 million, resulting in a net surplus of $1.067 million.

Standing

We asked the board to give us some indication of its standing in the international community and among its stakeholders. It said it believes its international standing is high; it participates in international forums, and is often invited to contribute to the work of the International Accounting Standards Board. It takes part in the deliberations of the international board’s Asian-Oceania group, and hopes to host a meeting of the group in New Zealand in the near future.

The board meets once a year with the International Federation of Accountants to set national standards, and it generally keeps up to date with international developments.

We heard that the board has a particularly close relationship with the Australian Accounting Standards Board, each country having a member on the other’s board. Australia’s and New Zealand’s reporting standards are largely harmonised, although some work remains to be completed.

Stakeholders

The board believes that its standing with its stakeholders needs more work. Started from a low base, the External Reporting Board has been engaging with stakeholders who will be affected by the board’s activities. The charity sector, for example, has given the board positive feedback on its efforts to listen to their views.
Different standards for different sectors

In June 2012 the NZASB issued a public benefit entities package, which sets out to replace a single set of standards for all entities with differential treatment of different sectors. The board explained that, because transactions take place in various different ways, so the standards need to reflect the type of organisation involved to be effective. It described the new structure consisted of four tiers, targeting four distinct types of entity, which the board believes will cover effectively the range of reporting standards needed.

Under-spending and expenses

We asked the board about its under-expenditure for the year under review, and whether, having set up the new organisation, it was now adequately resourced. The board expects to under-spend again this coming year, but by much less. It will review its spending constantly. The board confirmed that staffing was the biggest expense in the year under review.
Appendix A

Approach to this financial review
We met on 28 March and 17 April 2013 to consider the financial review of the External Reporting Board. We heard evidence from the External Reporting Board and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received
External Reporting Board, Responses to written questions, received 24 January and 9 April 2013

External Reporting Board, Appendices to responses to written questions
—— Output Agreement (Appendix A), received 24 January 2013
—— Half-Year Report (Appendix B), received 24 January 2013
—— NZASB Work Plan (Appendix C), received 24 January 2013
—— Final 2011–12 NZAuASB Work Plan (Appendix D), received 24 January 2013

Corrected transcript of hearing of evidence 28 March 2013

Members
Jonathan Young (Chairperson)
Dr David Clark
Clare Curran
Peseta Sam Lotu-Iiga
Todd McClay
Mark Mitchell
Dr Russel Norman
Dr Jian Yang

Witnesses
Kevin Simpkins, Chair
Tony Dale, Chief Executive

Young Welcome. Sorry about the delay. We just had to cover off a couple of procedural matters. You’re welcome, Mr Simpkins. If you’d like to just introduce your team, that would be great.

Simpkins [Introductions]

Young Now, if you could keep your comments—we like, actually, for you to do a presentation of about 5 to 7 minutes, and that will give us good, adequate time. I’m not sure how long you’ve prepared for, but if it’s longer than that, maybe you’d just be able to give the points—

Simpkins It won’t be.

Young —and that’d be great. Thanks. Away you go, sir.

Simpkins Well, this is the first year of operations of the External Reporting Board, albeit we legally emerged from the former Accounting Standards Review Board. It is a completely different organisation, with significantly broadened responsibilities. So the first year—and, in fact, the first yea—and a half that we’re now talking about—have been very much about getting the organisation established. That involved a significant amount of transition, both as an organisation, from a completely virtual organisation prior to that date to having our own staff and our bases to work from, and processes and procedures, etc., to deal with all those sorts of issues, but also, very importantly a technical transition, because the work that the Accounting Standards Review Board had done previously was only on accounting standards. But our responsibilities extend to auditing and assurance standards, and so there was a very important transition to establish a starting point for auditing standards that had, I guess, statutory backing. So
that was—the transition was a very important part of what we’ve been doing, and we had to work hard on that.

Then we had a task given us by the amendments to the legislation that established us, to put in place a tier structure, which, when read in conjunction with our responsibility for financial reporting strategy, led to us developing a financial reporting framework, a strategic framework, to shape financial reporting for the future. We had two extensive consultation processes on that: one is, we led up to becoming the External Reporting Board, and one subsequent to it. That strategy document, including the tier structure, was required to be submitted to the Minister of Commerce by 31 March, and was done so, and was approved by the Minister within the limited statutory authority the Minister has in that context, bearing in mind our role as an independent Crown entity. That was signed off in early April last year, and so our work is now in implementing that statutory framework, and we’ve been working extensively on that.

If I could just talk very briefly in the final introductory comments around the accounting and then the auditing; in the accounting area we have made a significant change, which is to propose two sets of accounting standards—one to deal with profit-orientated entities and one with public benefit entities—and members who have been involved over some time will recall significant concerns being raised, and the last time I recall appearing before the committee there were a number of concerns raised about those issues, particularly from the public sector perspective. We’ve also been seeking to ensure that accounting requirements imposed by law on entities appropriately reflect the scale of those entities and the resources to comply with those requirements. So I won’t go into it now, but we have a strong tiering structure. It seeks to respond very, very definitely to the idea that reporting is a regulatory impost and has costs, and we need to be satisfied that the benefits, therefore, to users of those reports justify the imposition of those costs.

On the auditing front, which has been a new area for us—the first time auditing standards have had statutory recognition in New Zealand—we did start with a set of auditing standards which were approved on 1 July 2011, but we have been working since then to enhance those standards, to improve their international credibility, and also very strongly working at harmonisation with Australia—the idea being that if we’ve achieved a significant amount in previous years in harmonisation between New Zealand and Australia on the financial reporting, we need to move to ensure that the quality of assurance provided is equally harmonised across the two jurisdictions.

So I think I’ll stop there, Mr Chairman. That’s a snapshot of where we’ve been and what we’ve been doing over, I guess, the 18 months or so we’ve been working.

Young: Great. Thanks very much. You’ve just mentioned about the two different standards-setting boards. Can you tell us—give us a bit of a brief and report on their standing in the international and the stakeholder communities?
Are you referring to the auditing and the accounting standards boards?

Yeah.

Start with the accounting. The New Zealand Accounting Standards Board, which is legally a committee of the External Reporting Board that does the detailed work on the accounting standards within our overall structure, has, in my view, a very, very high standing internationally. We are part of processes internationally and within the Asian-Oceania region and, of course, in direct relationships with Australia. In the Australian context, the chairs of the two respective boards are members of the other’s board, so our Chair, Michele Embling, is a member of the Australian Accounting Standards Board, and vice versa. We participate, and frequently are invited to contribute, at an international level. Each of the last 2 years that we’ve been the External Reporting Board we’ve had senior representatives from the International Accounting Standards Board visit us, hold seminars, and have meetings with us, and they have indicated most recently that they intend to continue to do that. The Asian-Oceania group—we’re actively involved in that grouping, as well, participate in their deliberations and in their meetings, and again we expect and hope to have that group meet here in New Zealand at some point in the near future.

Auditing—it’s a different process internationally. The international auditing body is part of the International Federation of Accountants, but we are part of a group of what’s called national standard setters that meet once a year with that board, and keep in touch with the developments internationally. We have had the chairman of the International Auditing and Assurance Standards Board and the technical director of that board visit New Zealand in October last year and have discussions with us and our stakeholders about some of the significant changes they’re proposing.

As to the view amongst our stakeholders here in New Zealand, that is something we are working on. We felt when we took on the role as the External Reporting Board that it was an area that needed to be improved on here in New Zealand, and so we’ve been actively engaging, particularly with areas of our stakeholder base that will be impacted by activities. So at this particular moment, if I could use one example, the not-for-profit sector, the charities sector, we’ve been engaged in liaising with other agencies in a series of seminars that something approaching 2,000 people have attended and participated in. We are getting quite strong and positive feedback that that’s significantly appreciated—that we’re going and talking about proposals and ideas long before they actually come into formal existence.

So, yes, in the end it’s a matter for the stakeholders to have their view, but we are doing significantly more than has been done in the recent past to engage with those stakeholders, and are determined that we will be—it’s one of the mantras we’ve taken on is that we want to be, and we will be, a listening organisation in developing both accounting and auditing standards.

Thank you. Can you just explain to us laypersons just what are the essential modifications that NZ IFRS has gone through—the, you know, NZ IFRS PBE—public benefit entities?
Simpkins: What we’ve done is in a sense a technical split at the moment, so the answer would be, essentially, “Nothing.”, if it’s “What are the requirements currently being applied in the New Zealand environment by public benefit entities?” However, I think your question is more focused on the changes going forward. What we’ve done in relation to the new body of standards that would apply to public benefit entities in the future is based those on international public sector accounting standards. So that’s, at the heart of it, the significant change. However, because international public sector accounting standards themselves in many instances were based on prior international financial reporting standards and equivalents, that means that there isn’t a complete change—not riding a completely different horse, as it were—but there are significant areas of difference where transactions occur in different ways, or, in fact, the incidence of transactions like non-exchange transactions, taxes, rates, and the like obviously are not an issue in a for-profit standard and are, therefore, not dealt with at all. In the PBE standards, of course, those are important issues, and are being dealt with, and they are dealt with in the international equivalent standards, as well.

Norman: Sorry, just to interrupt you there—so, just to be clear, the PBE standard is the standard that currently applies?

Simpkins: They have been developed and they are out for comment, but they haven’t been finalised and issued, so—

Norman: But, sorry, is there a modified version for NGOs, as well? Because obviously a big Government department is different from an NGO.

Simpkins: Yes, within the tier structure, there are four tiers and then within the PBE set of standards—while they were based on international public sector accounting standards, and you could view that perhaps as the core of the standards, wherever there’s an issue that impacts NGOs—as you refer to them, charities—over non-profit entities, that will be subject to legal requirements to report, or may be subject to legal requirements to report, then we deal with those issues and seek to ensure that the standards as a whole deal with all those entities. We did consider the possibility of a third set—

Norman: Does NZ IFRS have a PBE variant that applies to NGOs?

Simpkins: There is at the level of the third and fourth tiers of reporting, where those tiers are directed—where the standards that apply are kind of one-stop shops designed for that size of entity. But at the top-level tiers, no, it’ll be variations within the one standard, within the one document.

Clark: Thank you for your presentation. My question is around the level and the expectations around these standards. Over time these standards are becoming stricter and stricter and more highly specified. I’m not an accountant either, I confess, and so I’d best explain this in layperson’s terms, but when you said you have a mandate to look at simplifying structures or even going outside some of those NZ IFRS requirements in order to make compliance easier and reporting them in a meaningful form for ordinary laypeople.
Simpkins  I think we have a mandate to do that, and that’s very much what this structure is about. So we have—in the context of for-profit businesses, the bill that I know you’re currently considering would of course deal with a significant part of that issue by deregulating, or perhaps I could say entirely, or almost entirely. The remaining entities that are required to report in the for-profits space, you know, are significant entities, and the cost issues are significantly less for those entities. So our feeling is that for the for-profit area, subject to the passage of the current bill, there are less issues there. We’re more concerned about the public sector and not-for-profit sector, where we think there are significant issues. So that’s why we have four tiers targeted at four different levels of entity with, we think, broadly speaking, different capabilities. That’s been our sort of strategic response to that broader issue. Then it’s about delivering that at the practical, day-to-day level, and we’re committed to do that, as well.

If I could just make one comment in relation to your reference to possible departures from international financial reporting standards, the difficulty we have with that is that—and if we’re essentially there talking about the top tiers, the top-tier entities—if we depart from an international financial reporting standard in one instance, we are out of the international financial reporting standards camp. So when we had, 2 years ago, a significant concern about one international financial reporting standard, it was a very difficult issue for us, because if we modified it—which, within the context of New Zealand we could do legally—we would then be outside the camp and essentially impossible to come back in. That would mean not only for the entities directly affected by that issue but for all New Zealand business who are currently able to assert that they are in compliance with international standards and get the benefits of that. So all those for whom that’s valuable would lose that now in an instant from one decision of ours. So it remains a matter that we would keep on considering, but every time we’ve considered it up till now, we’ve considered that the benefits, the caché almost, of being in that international community for our top-end businesses is worth more than the individual irritations we’ve had.

Clark  I guess I’m thinking about the lower end, the lower tiers, the relaxation around them, the softening. They say that compliance is costly and difficult and that it’s also got that (inaudible) to do with stakeholders.

Simpkins  Well, our tier 3 and 4 standards have been developed as stand-alone standards, so that’s the key thing there. We would accept—and I know my chief executive has been doing some work on the issue around even within tier 1—whether all of the entities that are in that group get all of the benefits of being on the international standard, as it were, and so there are two issues there. The bill also that you’re currently considering would permit the Financial Markets Authority to determine that some entities could be in tier 2, and in our submission to you we expressed significant support for that, which I think will give you a sense of our sympathy for that issue. But, secondly, we ourselves have been thinking about that issue and have been doing some research on who are the other entities that are affected by those requirements. Where that will lead us to we don’t know,
but, again, alerting you to that research maybe will indicate to you that, yes, we still do have some residual concerns about whether the costs are justified for the benefits for all the entities. I don’t want to resile from the view that for the top end of New Zealand entities we’re quite convinced that the benefits significantly outweigh any costs to them, but it’s the others who are in that group that we think should be continued to be thought about.

Lotu-Iiga That research you referred to—when do we expect that to be concluded?

Simpkins It’s been done over the summer period, so within the next couple of months.

Lotu-Iiga Thank you for your presentation, and well done for bringing it all together in a single organisation. You had a little bit of underspend in the financial year, I understand. How’s it going now? You know, you’ve had to hire staff, obviously there’s IT systems to put in place. You can’t always get this sort of matched up to the financial year. In terms of resources, are you going all right?

Simpkins Yes. I think as you’ve seen in our report, we did do, as we approached the end of the first year, a zero-based review, and we still think that our overall appropriation of $4.4 million is right. This year we expect to have an underspend again, but it’ll be significantly less—a couple of hundred thousand—so we won’t use our full appropriation, and we will keep it under on-going review as to what’s needed. But, yeah, in the first year it was substantially about staff, because that’s our biggest expense line.

Lotu-Iiga Look, I know that you reported progress around harmonisation with Australia and a single economic market. You’ve got initiatives across a whole range of different areas in terms of doing business with Australia. Can you just give us an update then on harmonisation in terms of the for-profit organisations there. Are you comfortable with where you’re at? Also, you know, what’s the future in terms of further initiatives in that space?

Simpkins If I could just deal with the structural issues, first of all, we now have cross-appointments across all of our boards, and that allows a communication flow. Relationships obviously are helpful in circumstances when issues arise and one country has a different view to the other on a particular matter. So those relationships, those structures, that were started 7 or 8 years ago I think have served us and benefited the External Reporting Board enormously. On our first day we put them in place in the auditing field, which hadn’t been tackled before.

On the harmonisation of for profits, we have harmonised tier 1 reporting, and from the beginning of December last year harmonised tier 2 reporting. We have tiers 3 and 4 currently, but they are sitting there awaiting—

Dale Temporarily.

Simpkins —temporarily, as Tony says—the passage of the Financial Reporting Bill and then would drop away. So at that point our for-profit space would be entirely harmonised with Australian financial reporting.
Currently, on the public benefits entity side of the equation, we have different approaches. The Australians have concluded they are going to continue for now with one set of standards. Within that set of standards they have significant differences for what they call not-for-profit entities. That’s the identical equivalent to our public benefit entities. The view that we’ve taken is that, bearing in mind our pressures and forces, we needed to move down a different path. All I would say is that Australia is the only country we’re aware of that is intending to seek to deal with all entities within one body of standards, and we have found the pressures were so great that something was going to give and we felt we needed to move in this direction. I recall you would’ve been here when the former Auditor-General published his report that was very critical of us and it was a trigger to our developments. So we keep working on the public benefit entity field with the Australians. We know exactly where one another are at, and at the detail level we also would try to minimise difference, but there’s no getting away from the fact that at this particular moment, we will have a separate set of standards for PBEs. They will continue to have their not-for-profit entities within the one set of standards.

Lotu-Iiga And, you know, that’s a mutually sort of beneficial way of moving towards harmonisation discussions with Australia. I mean, they’re not going to be dealing with PBEs.

Simpkins Not in the short term, but in the longer term I suspect there will be further developments, yes.

Young Well, thank you very much, gentlemen. I appreciate your presentation and your report to us. All the best for your year ahead. Thank you.

Simpkins Thank you.

conclusion of evidence
2011/12 financial review of the Families Commission

Report of the Social Services Committee

Contents

Recommendation 2
Introduction 2
Unusual expenditure 2
Transition to new role and functions 3
White Ribbon campaign 3
Appendix 5
Families Commission

Recommendation

The Social Services Committee has conducted the financial review of the 2011/12 performance and current operations of the Families Commission and recommends that the House take note of its report.

Introduction

The Families Commission is an autonomous Crown entity that was established by the Families Commission Act 2003. The commission advocates for the interests of families in general, and positions itself as “a centre of excellence for knowledge about family and whānau in New Zealand.”

The role and structure of the commission is expected to change following the passage of the Families Commission Amendment Bill, which has not yet passed its second reading. A Social Science Experts Panel would be established to provide guidance and academic peer review of any research undertaken by or on behalf of the commission. It would be given a new monitoring, evaluation, and research function, requiring it to determine where evidence and research should help decide or achieve Government priorities, and to commission research and manage research contracts in the social sector. The commission would also be required to prepare and publish an annual families status report to measure and monitor the well-being of New Zealand families. In 2011/12 the commission was restructured in anticipation of the changes provided for in the bill.

In the 2011/12 financial year the commission’s total revenue was $8.546 million, and its total expenditure was $8.035 million, leaving a surplus of $511,000. The commission’s 2012/13 appropriation was reduced by $1 million from the previous year, but it reports that this has not affected its capability and capacity to meet its mandated functions under the proposed legislation.

The commission received “very good” ratings from the Office of the Auditor-General for its management control environment, and financial information systems and controls. It received a “good” rating for its service performance information and associated systems and controls, with the Office of the Auditor-General recommending improvements to outcome descriptions and impact measures to reflect the commission’s aims and clarify what is meant by “strengthening families”. We understand that the commission will review its outcomes, output classes, and performance measures, and that the revised versions of them will be included in the 2013–2016 statement of intent. We expect them to reflect clearly the new mandate under the proposed legislation.

Unusual expenditure

The commission raised the issue of unusual expenditure which occurred during the time before the previous chief executive and interim commissioner were appointed. Upon further questioning, the commission expanded on the issue. A contractor was appointed to the position of General Manager, Knowledge Management and Relationships at a cost of $359,497 for the period May 2011 to October 2012. The contractor left before the contract was completed at no termination cost. The appointment followed the appointee’s
secondment from the Australian Institute of Family Studies from January to April 2011, at a cost to the commission of $52,235.

The acting chief executive said that while there appeared to be “no impropriety in the sense of personal gain”, the expenditure did not align with his view of good practice in the public service. We note the acting chief executive has asked Audit New Zealand to review the expenditure, and expect to be apprised of the findings at the next review. Some of us were surprised that the commission would spend so much money on one staff member in 17 months.

**Transition to new role and functions**

Once the bill is passed, the commission considers that its most important functions will be to advocate for the interests of families and to monitor and evaluate programmes and interventions in the social sector. Members of the Social Science Experts Panel have been selected and their appointment will be formalised upon the passage of the bill. It will be chaired by Len Cook, who is also the acting chief executive.

The commission said that the new evaluation role would change the nature of the commission. The Social Policy Evaluation and Research Unit (SuPERU) would be responsible for evaluations on specific topics such as youth mental health, drug and alcohol dependency, and resilience of children, while the Centre for Family and Whānau Knowledge would consider families using a “theme-based approach”.

The commission said it considered that the methodology for evaluating public service programmes is generally weak. It would seek to ensure that reviews of the quality of evidence regarding social sciences and families are not compromised by being “values focused”; to establish a best-practice model for other government entities to follow; offer expertise in research contract management; make existing research about New Zealand families and people accessible; and act as a point of focus for what it terms a “disconnected social science environment”.

Some of us felt the independent monitoring, evaluation, and research regarding social-sector issues, programmes, and interventions, which is one of the aims of the bill, could be understood quite narrowly and specifically. The commission has interpreted “social sector” broadly, saying that it has been made clear that it is to operate in the larger space between the work of various government agencies.

Some of us were worried that the commission would duplicate work already being undertaken by the Ministry of Social Development. The commission assured us that the work of SuPERU and that of the ministry’s Centre for Social Research and Evaluation are different. The centre provides internal research and evaluation of the ministry’s operational activities, whereas SuPERU is intended to undertake strategic evaluation of large programmes that often involve more than one agency. It also noted that the teams would continue to work together to coordinate activities.

**White Ribbon campaign**

The White Ribbon campaign opposing violence against women has been one of the commission’s most prominent pieces of work. The campaign has cost the commission about $2 million since it began in 2009. While it has achieved good results, the commission considers that with the pending change of focus the campaign should be transferred to another organisation.
The commission assured us that it was committed to the continuation of the successful campaign, but that a “big on-the-ground community delivery campaign” would not fit with its new structure or its direction under the impending legislation. The commission said it would continue to fund the campaign, but probably to a lesser extent. We commend the commission on the excellent work that has been done so far and hope the campaign will continue, whether it stays with the commission or not.
Appendix

Approach to this financial review
We met on 20 March and 8 May 2013 to consider the financial review of the Families Commission. We heard evidence from the Families Commission and received advice from the Office of the Auditor-General.

Committee members
Peseta Sam Lotu-Iiga (Chairperson)
Jacinda Ardern
Hon Phil Heatley
Melissa Lee
Jan Logie
Le’aufa’amulia Asenati Lole-Taylor
Alfred Ngaro
Dr Rajen Prasad
Mike Sabin
Phil Twyford
Hon Michael Woodhouse

Evidence and advice received
Families Commission, Responses to written questions, dated 15 and 20 March, and 4 April 2013.
2011/12 financial review of Genesis Power Limited

Report of the Commerce Committee

Contents

Recommendation 2
Introduction 2
Supply strategy 2
Preparation for partial sale 3
Customer-oriented technology 3
Tekapō canal remediation 4
Corporate social responsibility programme 4
New Zealand Labour Party minority view 4
Appendix A 5
Appendix B 6
Genesis Power Limited

Recommendation
The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of Genesis Power Limited and recommends that the House take note of its report.

Introduction
Genesis Power Limited is a state enterprise in terms of the State-Owned Enterprises Act 1986. It develops and procures fuel sources, generates electricity, and trades in wholesale and retail energy.

Genesis’s major physical assets include the Huntly power station, which makes Genesis New Zealand’s largest thermal generator of electricity. It also owns hydro stations at Tongariro and Waikaremoana, the Hau Nui Wind Farm in the Wairarapa, and a cogeneration facility at Kinleith, and holds a 31 percent interest in the Kupe oil and gas field. In June 2011 it acquired the Tekapō A and B power stations from Meridian Energy for $821 million, and suspended dividend payments for two years whilst absorbing the cost of this acquisition. In 2012/13 Genesis authorised an interim dividend payment of $57 million.

The chief executive of Genesis is Albert Brantley. Rt Hon Dame Jenny Shipley is the chairperson of the board.

In 2011/12 Genesis generated total revenue of $2.27 billion, up from $1.835 billion in 2010/11. It returned a net profit after tax of $90.25 million, compared with a net loss after tax of $16.6 million in 2010/11.

Supply strategy
We congratulated Genesis on its outstanding results for the year, and noted that its operating revenue had increased 24 percent. It said it sought to use its various generation assets to ensure stability of supply when variations in weather caused uncertainty. Part of this strategy involved procuring electricity on the wholesale market from other providers for onward sale to its customers when necessary. It said that its Tekapō and Kupe generation assets helped to diversify the energy sources from which it generates electricity, which promoted stability. It had been trialling multi-rate tariffs, with different pricing for electricity at different times of day, and had found that this could shift demand by up to 7 percent. Its customer retention rate increased significantly among those involved in the trial.

We asked whether Genesis had received any feedback from shareholding Ministers regarding its decision to diversify its business. It explained that it was diversifying only its mix of generation, without departing from its core business of generation. It did not have overseas projects. Its only non-generation focus was on innovation in customer service.

In keeping Ministers informed about its activities, Genesis said it had a “no surprises” policy, which meant regular updates on routine matters, and immediate contact with them.
if anything unusual occurred. Genesis said it would pay attention to any views Ministers might express on the company’s operations.

We asked what Genesis had done to retain customers during a period of high customer churn in the electricity retail market. It said that pricing needed to be competitive, and it had worked hard to reduce overhead costs. It had also staffed its call centre with permanent Genesis employees to ensure that its customer services team kept track of customers’ needs. Its customer churn had been below the industry average for the past 18 to 20 months.

**Preparation for partial sale**

We asked what Genesis considered the optimal time to sell shares in a company. It said that there was no single indicator, and ultimately it was the shareholders’ decision.

We heard that Genesis had spent an estimated $765,000 preparing for an initial public offering of shares. This amount included contracted services but excluded time spent by Genesis staff, as its systems did not track this information. It estimated that additional time spent on preparation would have represented about $375,000. No money had been spent on public relations consultants.

Genesis said that shareholding Ministers had approved an additional allowance to distribute to directors for time spent in connection with the proposed initial public offering, and that between 1 July 2011 and 30 June 2012 $128,000 was paid out. Members of the board were paid in the order of $1,200 per day for the cost of attending meetings about the initial public offering. It noted that the chief executive had not received additional payment for extra work on this issue.

We asked whether Genesis had undertaken any analysis of Māori water rights following the Supreme Court decision in February 2013. It said it had followed the discussion on this issue to ensure that it was prepared for any eventualities. It was not sure how the decision might affect its operations.

We asked whether Genesis had discussed with Ministers or officials in New Zealand or Australia the possibility of listing the company on the Australian stock exchange. The chair said she had heard a discussion between officials and chairs of state enterprises about the relative merits of dual listing for state enterprises in general. The chair did not wish to express a personal view on dual listing.

**Customer-oriented technology**

We asked what Genesis hoped to achieve with its Tomorrow Street trial, which consists of 15 households trying new energy-saving technology. It said the trial was intended to test new technologies in a controlled environment with real customers, to obtain feedback on any issues before rolling out new developments to all customers.

We asked about progress on advanced metering technology. Genesis believed adoption of this technology would be driven by the protocols used by the manufacturers of smart appliances. There were not yet many such appliances available as manufacturers had not observed much demand.

Genesis had undertaken trials with a system called Home IQ, a wireless appliance control system connected to power points that could be accessed via computers, smartphones, and tablets. From a trial of 500 users it had learnt how to make the system more user-friendly and had seen great potential for reducing power consumption. The system was not yet
widely available, as it was still being improved. Genesis pointed out that its customers could already observe their usage online, which it believed was a preliminary stage in creating a culture of informed and empowered customers. The next stages would involve providing a financial incentive to act upon the information provided, and the tools to do so easily.

**Tekapō canal remediation**

We noted that Genesis’s Tekapō assets had cost significantly more capital than initially expected, with $125 million allocated for remediation of the Tekapō canal. It said it had undertaken extensive due diligence, and the need for remediation had not been a surprise. It said it was maintaining the canal for long-term use, as well as ensuring compliance with revised legislation and regulations for dams resulting from the Canterbury earthquakes. It said the assets in the South Island helped to balance the load of generation geographically.

**Corporate social responsibility programme**

We asked about the effect of Genesis’s corporate social responsibility programme on the company’s culture. Genesis told us that such programmes operated over a long time-frame, but it had learnt that listening to stakeholders about the impact of the company was important. It invested in communities at multiple levels, using methods such as sponsorship, events, mitigation, and relationship agreements. Genesis said it had tried to distance itself from the tradition of sponsorship that consisted solely of distributing funds, and instead worked to involve employees in sponsorship activities in order to build relationships.

**New Zealand Labour Party minority view**

Labour members asked the chair of Genesis whether there was any reason her role as former director of Mainzeal would bring into question her role with Genesis, or the credibility and integrity of Genesis. The chair did not believe the question was relevant, but assured us that in all her roles she sought to work in the best interests of the company. She was very happy for Genesis to be compared both at the board level and at the executive level with any other listed entity in New Zealand.

Labour members asked the chair whether it was correct that she had given the Minister for State Owned Enterprises an assurance that her role as a former director of Mainzeal would not in any way call into question her role with Genesis, or the credibility or integrity of Genesis. She responded that she was “not going to discuss what I’ve discussed with Ministers, other than to say to you that I most certainly briefed a number of people prior to the company you refer to [Mainzeal] failing. But I have not discussed other matters beyond that.”
Appendix A

Approach to this financial review
We met on 7 March and 11 April 2013 to consider the financial review of Genesis Power Limited. We heard evidence from Genesis Power Limited and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received
Genesis Power, responses to written questions, received 1 February and 18 March 2013.
Organisation briefing paper, prepared by committee staff, dated 22 February 2013.
Corrected transcript of hearing of evidence 7 March 2013

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Gareth Hughes
Peseta Sam Lotu-Iiga
Mark Mitchell
Dr Jian Yang

Witnesses
Dame Jenny Shipley, Chairperson
Albert Brantley, Chief Executive Officer
Andrew Donaldson, Chief Financial Officer

Young Welcome to the Commerce Committee. We have an hour with you. If you could start off by giving us a presentation—5 to 7 minutes would be very good, thank you—and then we’ll come to questions. Thank you, madam.

Shipley Thank you, Mr Chairman. Thank you, members of the committee. It’s my pleasure as chair of Genesis Energy to present the 2011-12 result to you, and of course I have my colleague the Chief Executive, Albert Brantley, and our CFO, Andrew Donaldson, with us this afternoon.

If I can very briefly just take you through the full-year result. As we’ve just announced our results for the half year, I thought I might briefly touch on that as well. If I may clearly say our result for 2011-12, in our view, was a very good result—some would argue an outstanding result, given where we’ve come from. Over the last few years the board and our senior management team have worked very hard to transform Genesis Energy into what we consider a tightly run, highly disciplined commercial business.

In terms of our overall strategy, we are very clear about what we’re trying to achieve, where we’re heading, and what steps we need to take in order to get there. Put simply, we’re trying to focus on optimising the assets we hold and delivering genuine value to the New Zealand customers, and are proud to still describe ourselves as the largest retail energy company, with 670,000 customers as we speak. We’re trying also, on behalf of the shareholder, to generate value and consistent earnings year on year, no matter what the weather conditions, and this is a goal that is actually achievable now that we have a more balanced set of assets, given the recent acquisition of Tekapō. This strategy of diversification and improved customer focus again has been
a source of real attention by the senior management team over recent years. I’m pleased to say that it’s now delivering the financial results and other good results across the company. Last August we reported an increased net profit after tax of $90 million, up from a loss of $16.6 million in the previous year, and operating earnings, or EBITDAF, were up $100 million, or 34 percent, to $393 million.

It’s been an important year for the company in terms of the year that’s under review. Because of the acquisition of Tekapō, it’s actually the first year we’ve been genuinely a national energy company with assets across the country and new customers as well. A very significant drive to win South Island customers has been very successful, and we believe it does cement our credentials as being a New Zealand company focused on national coverage.

Perhaps finally on the year in terms of significant outcomes, we as a company focus on community and sustainability, and we were able to resolve two very significant issues that give us confidence in Genesis’s future. The first was resolving a longstanding legal dispute in relation to the TPS, which saw us again finally re-establish a 26-year working consent, which was the balance of the 35 years, which had been in the courts for a very long time. And in this year under review that matter was resolved and new systems put in place.

The second element that I think really demonstrates the capacity of our staff—and I’m very proud of both Albert and the team he works with in achieving this—is that we have succeeded in securing a 25-year consent in the Waikato for the Huntly site without actually having to go to a legal hearing. This is very unusual, but it’s an illustration of how the company works with stakeholders and genuinely seeks to resolve and mitigate issues so that we can get mutual agreement and allow us to effectively run our business in the environment in which we find ourselves.

Very briefly, if I can turn to the half-year result, we’ve again delivered some very strong figures—71 percent net profit after tax and a stable earnings EBITDAF of $196 million. I’m pleased to report that this positive result has allowed us to return to paying dividends. Genesis Energy’s policy is that the company will pay a dividend that provides the shareholder with a consistent, reliable, and attractive return, even in periods of business cycle downturn. It’s with this in mind that the board has authorised an interim dividend payment of $57 million, and this is the first dividend that’s been paid since 2010. You may remember that the company suspended dividend payments for 2 years while the acquisition of Tekapō A and B stations was being absorbed. This announcement of the dividends signals our intention to return to paying both interim and final dividends on a regular basis.

With those brief comments, can I ask my chief executive to cover some of the operational and financial features.

Young  Mr Brantley, you’ve got a couple of minutes.
Thank you, Dame Jenny. Mr Chair and members of the committee, my greetings as well. I’m just going to run briefly through a few key highlights and then certainly we’ll be pleased to take whatever questions. At Genesis Energy we are clearly a New Zealand energy company, and we do have a very strong emphasis on delivering value to our shareholder and at the same time excellent service to New Zealanders. We seek to operate our assets in a sustainable manner. We are strengthening our trading activities, and we seek to generate value for the company as well as our customers at the same time. We do have a significant customer focus as an essential plank of our strategy, and two examples of this are ongoing investment in the installation of advanced meters, as well as various innovative customer offerings such as multi-rate trials that we’ve been running—multi-rate tariff trials. During this half year we passed the major milestone of 300,000 advanced meters installed. That now represents about 60 percent of our electricity customer base having the ability to get their information, monitor their usage, and in the future take advantage of innovative tools such as advanced tariffs to help them manage and control their energy consumption better.

Tomorrow Street, which is our advanced energy neighbourhood in the North Shore of Auckland, has given us a great deal of information as we’ve interacted and listened to the customers about how we can make their service simple and more relevant and develop tools that they value going forward. This is going to determine a lot of the offerings that we offer in the future.

Turning to the asset base, we’ve been working on a number of projects recently that just demonstrate our commitment to maintaining that asset base in a good shape. Last year we started preparation work on the remediation work on the Tekapō canal, and we started the construction activity early this year. That remediation project is going to involve two 14-week outages of the Tekapō A and B stations while we drain sections of the canal, stabilise the canal, strengthen the bridges crossing the canal, and install a protective PVC liner on virtually all of the fill sections of the canal. The idea is that really it’s about making sure that those are sustainable assets for the long term.

This past 6 months we also did a major outage on the very efficient 400 megawatt combined cycle gas turbine in Huntly. After 50,000 hours of operations and 65,000 hours of work, a good safety outcome with no injuries at all, we found the plant to be in excellent condition, and we expect that having put it into service we’ll get that excellent reliability that that unit is well known for.

Great. Thank you. Thanks very much for your presentation, Dame Jenny and Mr Brantley. We’ll come to questions now from the committee.

Look, thank you for your presentation. Dame Jenny, I don’t want to be indelicate, but I’m going to ask if you recall the following quote: “We’re always here at the behest of our shareholders—this is true of any company whether it’s a government owned company or not. I’ve always been judged
by results in my career and I expect to be judged by my results in the future.” Do you recall that quote?

Shipley
Of course.

Cosgrove
Thank you. Do you stand by it?

Shipley
Of course.

Cosgrove
I know this isn’t directly part of the financial review, and I won’t be going down that track specifically, but you were a former director of *Mainzeal. We all know what has happened in respect of Mainzeal—2,000 creditors, it’s fallen over, hundreds of jobs lost—

Mitchell
Point of order, please, Mr Chair. This is the financial review of Genesis, not Mainzeal. I don’t know what relevance introducing Mainzeal into the financial review of Genesis has.

Cosgrove
If you let me finish the question, I’ll come to it. Thank you.

Mitchell
Well, if it includes Mainzeal, I don’t think you should be allowed to ask your question.

Cosgrove
Well, unless you’ve got a crystal ball, taihoa. My question relates directly to Genesis. Given the background of Mainzeal, given the quote, which you stand by, given that there has been no explanation from yourself or the company as to what occurred in that instance, you would understand that you chairing a State-owned enterprise in those circumstances may call into question your abilities or your credibility and integrity. And I suppose that is the nub of it. You are chairing Genesis, which is cited to be on the block in the near future, and anything that may impinge on that in your other capacity as a former director, in my view needs to be dealt with. So my question is are you prepared to give us an assurance, as I believe you have with the Minister for State Owned Enterprises, that there is nothing in your former role in respect of Mainzeal that would bring into question your role with Genesis or the credibility and integrity of Genesis itself?

Shipley
Mr Chairman, as I mentioned, the quote that the member cited was a quote I used last week when the company released its half-year results, and I simply reiterate that this company is wishing to be judged on its results. I have had the privilege of chairing this company for over 3 years. It has listed a vehicle on the NZX.

Cosgrove
Sorry, I missed that. I couldn’t hear your last comment, I’m sorry.

Shipley
Genesis Energy already has a listed vehicle on the NZX. The bond that was used to part-fund Tekapō was listed while I was Chairman. That bond continues to perform above its issue price. I’m not sure what you’re suggesting in terms of your questioning, but as I mentioned in my original quote, as a professional director I expect to be judged on results. And in the case of Genesis Energy, Mr Chair, I am very pleased and proud to present both last year’s and this half-year’s result. I think it absolutely stands scrutiny. In terms of listing, again I just draw the member’s attention to the fact that the market is already aware that this State-owned enterprise is on the NZX. We comply fully. We have an excellent board that I’ve been
involved in recruiting. I’m very proud of what Albert and the senior management team have achieved over the last 2 years. Mr Brantley has focused very much on getting this company fit for purpose, and we have recruited, in some instances, new people. I am very happy for this company to be compared both at the board level and at the executive level with any other listed entity in New Zealand.

Young

Thank you. Look, just in terms of comment, I think Mark Mitchell raised a very valid point. I think the answer is very adequate. Thank you.

Cosgrove

Can you assure us, my question was—and you said you may not have understood the point of my question—that there is nothing that would impinge on the reputation of Genesis Energy through your linkage to the failure of Mainzeal?

Shipley

Mr Chairman, I am the Chairman of Genesis Energy. The Government appointed me and reappointed me late last year. I don’t have anything further to add. It’s a matter of judgment. I hold a number of directorships. I take them all seriously. I constantly focus on whether I am working in the best interests of the company, and I can assure the member that in all of my roles—both current and former—I have sought to work in the best interests of the company.

Cosgrove

Is it correct that you have given the Minister for SOEs similar assurances as those I’ve asked for today?

Shipley

I’m not going to discuss what I discuss with Ministers, other than to say to you that I most certainly briefed a number of people prior to the company you refer to failing. But I have not discussed other matters beyond that.

Cosgrove

Well, that surprises me, given that the Minister for SOEs I recall—I think it was in an answer to my question in the House—stated, if I’m not misrepresenting him, that he had received assurances from you on similar issues that I’m questioning you about today.

Shipley

Look, Mr Chairman, I do not intend to either offend the Standing Orders or, indeed, this Parliament. I am here to discuss Genesis Energy. I am very familiar with the Standing Orders, as you would expect, and relevance is a key issue here.

Young

With respect, I think that you have pursued a line of questioning that is beyond the scope but no doubt you needed and wanted to ask. I have said that the chair has adequately answered your question, and I would suggest that you either go to a different line of questions or we go to a different question.

Mitchell

I’ve got a question, Mr Chairman. Dame Jenny, Mr Brantley, Mr Donaldson, I want to congratulate you on what I think actually are outstanding results. I was just wondering, I was wanting to dig into a little bit last year when you appeared in front of the committee you spoke about developing quite a strong corporate social responsibility programme within the company. I just wonder whether actually that’s become part of the culture and that’s now translating into results like we’re seeing, and the very
good example of being able to get a consent that normally would be very hard to achieve. So could you maybe just speak into that a little bit for us.

Shipley Well, I’ll start and then perhaps Albert will wish to add. Look, these things are not achieved in a short time frame. It’s an investment we take over a sustained period, and in the case of the Huntly site we have a team who are very well known to almost every level of their community. So it’s not just iwi Māori, for example; it may be local farmers, it may be the Fish and Game group. And I think we’ve learnt over the years that rather than just relying on our legislative framework, taking an approach of listening to what impact we’re having, so that we can cohabit effectively, we’ve really been able to make enormous strides and probably exceeded our own expectations. So we invest in communities. They, I think, see us as partners. We do it at multiple levels, so sometimes it’s children’s sports events, so it might be sponsorship; sometimes it is mitigation around a consent, which is quite specific; sometimes it may be a relationship agreement because we’re having a big impact on a particular area in which we work; and sometimes maybe local Māori who have other value propositions in the particular region that we work in. We have a very specific approach to sponsorship, which Albert might also want to cover.

Brantley Yeah, I think, if I may add to that, the approach that we take in interactions with the communities is very much as being part of the community. We have tried to tradition away from the accepted concept of us as being the bank and the source of funds; that we actually are the source of assistance. That means that we also get involved, we try to structure our relationship agreements, our sponsorship activities, and all of the activities that we conduct in the community in building activities around employees becoming involved, so it becomes a true relationship. That has helped to foster a new approach to the way in which we’ve been doing our business. I think Dame Jenny is quite right, you know, if we look at some of the results that we’ve achieved, such as the Huntley consent, that’s really symptomatic of the approach.

Cosgrove Can I finish my line of questioning?

Young Well, Mr Clark’s put his hand up.

Clark Firstly, can I say thank you very much for the fulsome and helpful way that you’ve engaged in the financial review process. The answers were generally helpful and generally kind of answered in the spirit in which they were asked, so thank you for that.

Cosgrove In fact, we’d go further: we’d suggest that it would be very helpful if you could give Ms Withers and Mr Heffernan a lesson on how to answer questions, because you did it very well.

Clark My question is around the final question in the supplementary questions about preparations for partial privatisation. The answer that you’ve given—and I am going to be slightly critical of this answer, notwithstanding my general point—doesn’t include provision for time spent by Genesis Energy employees. I am wondering if you could give us a fuller estimate of the
amount of costs involved in preparing for the IPO, and perhaps an update since the financial year—so, you know, how much has been spent towards that IPO so far.

Brantley Yes. We’ve recently sat down and had a look at it, because we had some additional requests for information. We’ve found that our total costs up to the end of December—31 December—on the IPO process is about $765,000. That is still exclusive of Genesis Energy staff time, simply because we don’t run a timesheet system internally for our employees that would actually allow us to track it. What we have done is that included in that expenditure is contracted services that we’ve brought in to assist us to undertake the readiness work, and any time that has been spent has not impacted on our ability to conduct our business-as-usual functions for the staff. So we’ve just—perhaps some of us have had to work extra hours or extra-long days, but we still run the business without having to contract staff to run the business.

Clark Could I push you a little bit on that, and just say, kind of, in order of magnitude in terms of staff time and staff costs—because others have supplied this particular answer; they’ve been able to make an estimate of just how, if a project group is working on it or if a particular group is devoting a portion of their time—I imagine that you have some kind of business discipline around understanding what people are doing in the business, and roughly whether it is of the order of magnitude that you’ve spent on consultants, roughly, in terms of time from internal people, or twice as much, or half as much.

Brantley Well, I could probably give you an estimate, but it would be nothing more than that.

Clark Could we have that maybe even as a supplementary, rather than today, when it might be a fruitless?

Brantley Yes, we’d be pleased to do that. But the one thing—just if I may—is that what we do is we concentrate on the business as usual, and then I track our ability to maintain business as usual, and if we see there’s any activity that’s involved around preparation work for the readiness project, and if I see that that’s impinging on business as usual, that’s when we employ contract services.

Clark I understand that point you’ve made, yes, thank you.

Brantley And those contract services were reflected in those costs. But we will provide you an estimate of that, in written form.

Hughes Thank you very much for your presentation. Dame Shipley, if I could ask, on 27 February you said Genesis was supremely well prepared to be partially privatised. Could you outline how much this has cost?

Shipley I think Albert just gave you the answer. He might want to reiterate again.

Brantley Yes, as I said, to 31 December information that we provided for those published updates for Treasury: $764,000 to $765,000.
Hughes Are directors or chief executive officers or any officers earning more as part of the preparation for asset sale; how much is that?

Shipley There is what we call a MOM process, a special committee which certainly earlier last year met reasonably regularly. I don’t have those figures, but I’d be very happy to provide them. If members of the board attend meeting days there is a daily payment available, and we’d be very happy to supply those to you.

Hughes We heard from Mighty River Power—

Brantley I can assure you, Mr Hughes, we’re not getting paid any more.

Shipley No, no.

Hughes We heard from Mighty River Power that it could be as high as $1,200 a day. Is that of a similar order of—

Shipley It is of a similar order.

Cosgrove I have a supplementary question. Isn’t it correct that an application was put to Treasury—we know Mighty River’s application was for about $190,000 supplementary payment. Isn’t it correct that Genesis was part of that application, and their supplementary requirement was $30,000?

Shipley Certainly up until now in the 6-month period there’s only been $30,000, and, to my knowledge—certainly in the last half year—we did not use all of that amount. But, again, if you’d like the figures, we’re very happy to supply those to you.

Cosgrove I appreciate that.

Young Do you anticipate that, as you might get closer to—

Shipley Of course.

Young —there would be an increase.

Shipley Well, again, we don’t do work that’s not required. At this stage we have not been told that we’ll be partially privatised in any particular time frame. Having said that, I did correctly say at half year that we have put a lot of work into this, but please remember that the backdrop of this is that we did have to put a prospectus and an investment statement together for the bond, and the majority of the board is familiar with that process. So it’s not as if we’re starting from zero.

Lotu-Iiga Through you, Mr Chair, first, welcome and congratulations on your result. I think you’ve summed it up well. You’ve hit over $2 billion in operating revenue. You’ve returned a net profit after tax of $90 million. Your EDITDAF figure is the highest since certainly I’ve reviewed this organisation, since I’ve been in Parliament. So I think well done. I think your leadership reflects that, and so does Mr Brantley and your team. But I just want to break it down. I’ve seen how the operating revenue has gone up 24 percent. Obviously you’ve got higher generation volumes. You’ve got, I think, gas sales—a number of things that have led to this result, apart from the people who have put it all together. Do you want to just—and
your half-year result, of course, is even, I think, more stunning, as you’ve progressed. In terms of the generators of that revenue, could you just sort of touch on how you’ve come about with what is a substantial increase in the operating revenue that has led to these results?

Brantley What we’ve done in terms of our strategy is that we’ve looked at trying to take advantage of the opportunities that we’ve got in terms of both geography and fuel diversity in our generating portfolio. For us it is very much about trying to take out the variation between wet and dry years, to get to more consistent, stable earnings and to actually take out the variations in our EBITDAF between first half and second half year, which often times is largely driven by weather. It is to concentrate on the ability that we’ve got to generate in dry conditions, and accept the fact that we may not get the best financial result in generating when it’s wet. If we’re able to procure electricity on the wholesale market to service our customer needs, we change the whole philosophy away from running it as a generation company to running it as an integrated company. I think that was one of the keys in the approach.

We would be the first to admit that acquisition of the Tekapō assets increased that diversity and the potential to trade a great deal, and we’ve certainly tended to take advantage of that. That is evidence of the rapid growth into the South Island, which has, once again, diversified earnings. We’ve also kept a very strong focus on Kupe as an integral part of our portfolio because, once again, it gives us that diversity of earnings. So our intent is to keep those variations from one year to the other—wet year, dry year—and to smooth those out over time. That’s why we’ve taken the philosophy on that dividend policy of rather than tying it to a pay-out ratio, when our NPAT would go up or down, in past years we now think that the NPAT is going to be much more stable, and we’ve taken a more stable view on almost like a yield platform on the dividend policy.

Lotu-Iiga In terms of your focus on customers, you’ve talked about being the biggest retail outfit in the country. It’s interesting. You’ve got to, obviously, retain and draw value out of those customers, and you’ve got innovative projects. Your Tomorrow Street is a really interesting project. With the churn rates the way they have been in recent times, how have you managed that? It’s quite difficult. You’re the big player and others are competing with that. What has been the strategy to retain those customers over that period?

Brantley What we’ve done is that we’ve realised that certainly pricing is part of the thing, and we’ve taken the view that we need to stay competitive pricing wise in all the markets that we serve. Having said that, we break our pricing strategy down into discrete components. Part of that is the wholesale price; part of that are the things that we can’t necessarily control, which are transmission or distribution charges; and then there is the cost to run the company, to physically do that. We’ve concentrated a lot on that cost to run the company—to do it as efficiently as we can, to contain our costs, and then to take advantage of what we see that we can do in either generating at a lower cost or buying on the wholesale market, if it gives us a better outcome, to deliver on that.
The other thing that we’ve done is that we’ve changed the engagement that we’re having with customers. You’re well aware that in April 2010 we took over our call centre, based it in Hamilton, and staffed it with Genesis Energy people instead of contractors, because before then they were not our customers; they were the contractors’ customers, because they were having the conversations. Then we started developing the systems to listen and track what the customer wanted, what their issues were, and how we could service better. If you look at our churn statistics, our churn statistics are down to about 16 percent, and it’s been tracking for the last 18 to 20 months well below the industry average. To us, it’s the way in which—if we can keep the costs down—we can keep our costs down by lowering the churn and we can provide a service that’s competitive with anyone and still stay in the pack.

Lotu-Iiga That’s good.

Brantley We’ll continue to develop new technologies, but it is much about developing the things that are simple and easy for the customer to use and what they want.

Bakshi You mentioned technology. What sort of technology are you bringing to retain the customers?

Brantley One of the things that we’ve been trialling and that we’re just moving to a commercial roll-out is multi-rate tariffs. With the technology that comes with advanced tariffs, we are able to collect information on energy usage down to the half hour. We can clip varying tariffs during the course of the day out to customers. Now, the trials that we’ve run, both in the North Island and the South Island, have clearly indicated that customers, without any tool, just simply a financial incentive of different tariffs, will move load around during the course of the day by as much as 6 or 7 percent. So already there is an incentive. Already the retention rate on those trials for those customers involved in those monthly rate tariffs has gone to 98 percent. Once again, the advantage for us—they get a financial benefit, and we get the benefit because we have no churn costs for those customers, because we’re providing that.

As we do a commercial roll-out, we’re going to try to drop the churn rate even more, on the back of that sort of an outcome. With Tomorrow Street we’ve trialled a variety of energy-saving technology. Once again, the mantra has always been in our industry that people think our business is to sell power. It is. But it’s not a revenue project; it’s a margin project. So the lower that I can get my cost to provide what we do sell, that’s where we will make the money—not by selling more power, but by selling what power we sell more efficiently with better margins.

Cosgrove Have you done any post-analysis of the Supreme Court decision in respect of Māori water rights, given that the Supreme Court has stressed the fact that the Government needs to take practical action on the Māori water rights issue and that could, as one lawyer has pointed out, manifest into an impact on operating costs and, ultimately—or increasing operating costs—
Brantley Mr Cosgrove, we’ve certainly tracked a lot of the discussions around the Supreme Court challenge and the Māori water rights issue as it developed through the consultation process. We track all risks that we see to our business and, at the end of the day, what we have to do is we have to prepare ourselves for any eventualities. It’s much like we would prepare ourselves for any changes in demand or any changes in capacity available—

Cosgrove I accept that. My question is have you done any analysis and have you done any preparation, and if you have, presumably you consider it as a risk?

Brantley Well, certainly it’s a risk, just as current freshwater reform that’s currently under way at Government levels. We don’t know what regulation may come out of that. We may not appreciate right now how it may impact our operations, but we have to constantly run risk scenarios and try to anticipate, and have some idea of how we might respond. But at the meantime what we have to do is we have to run ourselves with what the regulations are and what the rules are.

Cosgrove Mrs Shipley, you’ve said that in your view Genesis Energy is “extremely well prepared” for partial listing. In your experience as a professional director—and did put this to your kindred SOE—when is the optimum time to float a company? Is it when the—well, given—

Lotu-Iiga Hang on—

Cosgrove Well, it is germane, because they’ve already got one listed and they are on the block, by the Government’s own action. When is, in your professional view, the most optimal time to float a company and to maximise shareholder value? Is it when, at the top of the market, when demand for the service and product is high and risks are low, or at the bottom—

Lotu-Iiga Point of order. Sorry, I just want to get clarification around this. There are—

Cosgrove Getting clarification’s not a point of order. You can’t get clarification—wait until I’ve finished the question.

Lotu-Iiga Well, whether this line of questioning is actually relevant to the operation—

Shipley Well, Mr Chairman, it is a hypothetical question, so—generally speaking, there’s never a single indicator, and if I can just very briefly comment—

Cosgrove Thank you, I appreciate it—can I finish the question? Or is it when, at the bottom of the market, where you have risks, for instance, like the one I alluded to, or perhaps like the Tīwai contract and a flat electricity demand? When’s the most optimal time to sell—to float, I should say?

Shipley Yes, I don’t—well, one of the answers is when a shareholder decides, and if shareholders decide, then that clearly is a major decision. But one of my observations of the energy market is that knowledge is absorbed very quickly, so that if there are emerging trends it very rapidly gets built into both pricing and strategy. It never delays until a single event. At both board
level and senior management level, when you’re making decisions about how you respond in the market there’s a whole multiple of things. So, look, I don’t have a specific answer other than to observe that there’s a very large amount of appetite, by all accounts, for not only SOEs being partially listed but the stock exchange in general appears to be enjoying strong support. But these are matters, in the end, for our shareholder to decide if, and when, Genesis is partially privatised.

Cosgrove I accept that part of your answer—it’s extremely similar to Ms Withers’ answer, but she was constrained by listing rules and what have you, as you’d understand. But I just find it surprising that—and you do have extremely vast experience in these matters—that there seems to be an ongoing reluctance as to making a judgment on this. Yes, of course we know that when a shareholder wants to sell, a shareholder wants to sell. A shareholder could be mad and sell at the bottom of the market, a shareholder could do anything. But I would’ve thought it was sort of Economics 101 that you’re likely to get a better price for your shares when you float if there’s a highest possible demand, all risks to your service, all risks are nailed down—that’s the optimal time to go. I would’ve thought you could express a view on—and assist the committee in that way?

Shipley If I can assist, Mr Chairman, I’m not going to express a view, because it’s not relevant for me to do so. I am here and very pleased to chair this company. I intend to run it along with my colleagues, the senior management team. We set a standard for ourselves where—whether the shareholder is a Government or, indeed, a mix of Government and private shareholding—we think whoever is the shareholder is entitled to our best performance. And I can tell you, across the board and across the senior management team, that that is the standard we set ourselves and we’ll continue to do so.

Cosgrove Can I ask you, have you had any discussions with folks across the Ditch or officials or Ministers here in terms of potential listing and whether that potential listing would be dual-listed on the Australian stock exchange?

Shipley I haven’t had any discussions with Ministers on that specific issue.

Cosgrove And officials?

Shipley I’ve heard officials explore that concept in a general sense, not specifically to do with Genesis.

Cosgrove With your board?

Shipley I’m sorry?

Cosgrove Sorry—officials were exploring that with whom? Your board?

Shipley Amongst a group of chairs.

Cosgrove Amongst a group of SOE chairs?

Shipley Hmm, hmm.

Cosgrove So, officials have, what, expressed a recommendation or—
Shipley No, no—
Cosgrove —hypothesised?
Shipley No, not a specific—I've heard a discussion had about the relative merits of dual listing.
Cosgrove All right. Do you have a—[Interruption] Excuse me—
Young Well, I'd just like to make a point—sorry to Mr Cosgrove. I don't mean to interrupt—
Cosgrove You know, Chair, every time I ask a question I either get barraged by you or points of order from your people.
Young No, no, you've had a really good run at questions. I just want to make it clear that we actually doing a financial review regarding the scope of responsibility of the management and the governance of Genesis Energy. Right? You might pursue some of these questions, but I think that the chair has made comment that the decisions around this sit in the lap of the shareholder.
Cosgrove Yeah, that doesn’t preclude questions. Thank you for paraphrasing what the chair said. Could I ask you, do you have a personal view on the merits or otherwise of dual listing, because we’ve heard, for instance, from Mighty River Power today that one of the advantages is that certain institutions in Australia, if you couldn’t get a lick of Mighty River shares, will be able to get a lick of those shares if there’s dual listing. Do you have a view on that?
Lotu-Iiga Point of order—
Shipley No, well, let me assist. I have a view, but not one I’m going to express here.
Young I think that’s an adequate answer. Thank you, chair.
Lotu-Iiga Yeah, can we get clarification? We’re not here for personal views; we’re actually here to hear the financial review of Genesis Energy—
Cosgrove And the chair’s entitled to give a view on any question that’s asked.
Lotu-Iiga —sorry, let me finish; I’m speaking to my point of order—and the relevance of the questions to this financial review. Is that right, Mr Chair?
Young Yes.
Lotu-Iiga OK, thanks.
Curran Mrs Shipley, I draw your attention to question 23 on your replies—your fulsome replies—to the financial review standard financial review questions, which asked, and I'll just parphrase it for you, did you contract any consultants or contractors to provide communications, etc., advice and services during the financial year, which you answered kindly to that you had services provided up until June 2012 by a Mr Rob Fenwick and Mr Ross Vintner. Now, in the context of the previous question by my colleague around the preparation for the partial privatisation and the subsequent work that's been done, we’ve asked you to provide some information to us. Could I ask specifically that you provide us with information on the contracting
for public relations and consultant work that is part of that? So that’s a specific question to—and I don’t expect you to give me that—

Shipley All right.

Curran —information now, but that is a specific question to you to provide to the committee. But can I ask you to answer to the committee as to who is paying for Mr Bill Ralston to be your spokesperson? Is it Genesis Energy or is it yourself?

Shipley Mr Chairman, that’s an absurd question. It’s a private matter and I would never expect any company—I mean, Mr Ralston is—

Lotu-Iiga It’s out of order.

Shipley It is completely out of order—

Lotu-Iiga Out of order, sir, and—

Shipley —and I can assure you—

Cosgrove Point of order. Excuse me, point of order—

Shipley Well, Mr Chairman, I can categorically—

Cosgrove Point of order—

Shipley I can categorically assure you that Genesis Energy is not paying for any private services to myself.

Young Point of order, to Clayton Cosgrove.

Cosgrove With respect to the witness, whether it’s an absurd question or not, any question that leads to who paid for what, and whether the SOE paid for it, is a legitimate question.

Shipley The answer’s no.

Cosgrove Thank you.

Yang First of all, congratulations. I’m particularly interested in the title of the report, Transform. I’m not sure whether they used the title before but it means a lot to me. I’m just curious. What exactly are you trying to say, or the message—what message do you have in your mind with the title of Transform?

Brantley We had a lot of internal debates about this, so if I may, I’ll answer it. Our view in devising our strategy, which is very much customer-focused, we sat down and we looked at our industry, and our view is that our industry historically has been dominated by a concept of engineers and asset managers building bigger and better power stations, and really thinking that the paradigm is that that’s the end-all and the be-all. It was about generating electrons, putting them in transmission and distribution lines, delivering it to someone at the end that we call the customer, but really sort of viewing that customer as almost like an in-built hedge to take the electricity. It was about generating the electricity, and our view is that we’re trying to transform that equation, where we actually see that our purpose and what our strategy is centred on is doing what all of our activities, effectively, to
deliver value to the customer and align the value that the company gains with the value that the customer gains. So that's why we view it as a transformation. It's actually changing the way that our industry views the customer.

Yang Yeah, I want to just follow up on this. So you have transformed the neighbourhood? You have the Tomorrow Street trial. How much has been invested the trial, is it worthwhile, and what are you hoping to achieve?

Brantley What we wanted to do is that we've progressively looked at a variety of technologies, trying to determine what would be relevant and attractive in the New Zealand market, how we could gain some traction on innovation and delivery of innovation. Now I have a whole group of marketers that sit around our customer experience section that assure me that this works and that works and that works, when in actual fact, if you can get a controlled environment like Tomorrow Street, where you're dealing with real customers in real time with real feedback, they tell you what works, they tell you what doesn't work, they'll tell you what's simple, what's too complicated, what I couldn't be bothered with, or this is really neat. And if we could figure out some way to make this work better, simpler, easier, then we modify the things that we're doing before we do mass roll-outs and I find out that I've put it out to 300,000 customers, all of whom are so confused by it that they don't want it, and I've spent all the money to do a mass roll-out. So it's trying to do the test bit in a controlled environment with a relationship with real people, where you get the real dialogue. So that's the real purpose of Tomorrow Street.

Clark My question's for Dame Jenny. Dame Jenny, you've clearly got your hand firmly on the tiller of the organisation, and you used the phrase, I think, "proud of the board" that you'd help to recruit.

Shipley Yes.

Clark I'm wondering whether there has been discussion with SOE Ministers and questions asked about the strategy that appears on page 2 of your presentation in respect of, you know, a headline “Results driven by business diversity”, given that there's been a lot of media attention in recent days around a very similar strategy adopted by another company called Solid Energy, and whether you've received push-back by Ministers for going down that particular road and where your internal discussions are on that?

Shipley The diversification was part of the energy reform, where they decided that a better mix of assets across the group of State-owned companies would improve competition, and certainly our acquiring Tekapō A and B brought a quite different balance to the mix of assets. So the word “diversification” in relation to Genesis Energy is very much on the mix of assets, but we're very focused on our core business. We are not involved in any supplementary activity, with the exception of innovation around customers. So we are not doing anything offshore, we are not doing anything onshore that is not part of our core business.
Clark  So you’re saying that questions haven’t been raised around that particular, you know—I guess the example of Tekapō’ is a good one, because as I understand it, that’s had a whole lot more capital cost than was expected in the first instance. Can you say a little bit more about that?

Shipley  I wouldn’t say a whole lot more. The contract was estimated at $125 million but we were very clear as a board that until the canal was emptied nobody could calculate the parameters around risk. Our recent figures that we’ve released are between 145 and 155, and we’re very much on track. Albert, you might like to—

Brantley  When we acquired the Tekapō assets, as an example, we’d done a fairly extensive due diligence, and I don’t think any of the commitments or programmes that we’ve got now to do remediation works around the canal were any surprise to any of us. You remember, in the previous year when we had the $16 million loss, it was because we’d taken $100 million - odd—

Donaldson  Albert, 97 plus depreciation, yes.

Brantley  Yes, a $97 million write-down on the price that we paid for the assets, because we knew we were going to have to do those capital works. It’s just as we got more detail—as Dame Jenny says, by doing more detailed work and draining the canal we’d put better numbers around it.

Mitchell  Are you happy with the roll-out in the South Island?

Brantley  Absolutely. It’s gone very well for us. We’ve actually started a new acquisition campaign in the South Island now and that’s going extremely well. So we’re very pleased. A good balance—it helps trading strategy on having load exposure in different areas, so it’s been a great acquisition for us.

Bakshi  Talking about the Tekapō canal, what are the economic benefits of the canal? Can you elaborate on that?

Brantley  The work we’re doing on the canal?

Bakshi  Yes.

Brantley  The work that we’re doing on the canal is all about maintaining those assets for the long term. We carry a 50-year depreciation life on those assets, and we’re just putting that investment in the canal. As all of you are aware, there’s a lot more sensitivity about seismicity issues in Canterbury for some reason, and there’s been some revisions in the dam safety Act, and the canal is classed as a large dam, so we’ve had to go back and have made sure that we can comply with all the new regulations, and that we’ve addressed stability issues. Now, part of the work that we’re doing this year, for instance, is we’re doing reinforcement and stabilisation work on the bridge that crosses State Highway 8, where it crosses the canal. Normally, the transport authority would do that work, but it was actually more cost-effective for us to build the cost into our programme than to have to pull the canal out of service again when they got around to doing it 3 or 4 years from now. So that added some additional cost but, once again, it was more cost-effective to do it that way.
Cosgrove Could you outline for us in practical terms your disclosure process to Ministers, how you keep Ministers informed—I believe the lead role is with the chair—and from that just assure us whether there is anything Ministers would be surprised about in the last financial year? But could you just tell us how you keep the shareholding Ministers informed, for the benefit of us all?

Shipley Under the SOE Act you’ll understand that we as a board are required to run a company and report to Parliament. Obviously, directors are appointed by Ministers, and we have effectively a “no surprises” policy. So if there’s anything going on, one calls the Minister. If there’s nothing going on and the company’s performing, well from time to time you simply update them.

Cosgrove And presumably the Ministers are free at any point to express their views on the company—

Shipley Of course.

Cosgrove —without advocating section 13, but express their views, or pronouncements, or opinions on the company and its performance of its ongoing operations—and you would listen to those and take those on board?

Shipley Of course.

Cosgrove Thank you.

Clark Can I request that you might come back to us just with some fuller answers to questions 24, 25, and 26 supplied in the written questions from members. I earlier did make the point that you’ve made a fulsome attempt to answer most of the questions; those three were kind of obvious examples where the answer is somewhat abbreviated and probably doesn’t really get to the heart of the request—the questions around how many contractors, and what price, and so forth.

Brantley We can certainly undertake to get more fulsome record responses to that.

Clark Thank you very much.

Lotu-Iiga Just coming back to advanced meters and the roll-out that you’ve done. We obviously had a report by the Parliamentary Commissioner for the Environment that was tabled here, and we had quite healthy discussions around protocols and also the smart appliances going forward. You’re obviously doing a lot of work in that sort of customer-focused area. In terms of how you’re seeing the sort of smart appliances come to the fore, if you like, because, you know, because we’re going to get some real benefits from that advancement in technology. Any views about how that’s going and how, you know, looking into the future, because people were predicting 10 years out, 5 years out, don’t know. But how has it progressed since?

Brantley Well, a lot of the earlier debates around the advanced meter were centred around the views from the Parliamentary Commissioner for the Environment about the suitability of the protocols that were being built and the advanced meter roll-out. There was a strong push that we should have home-enabled networks built in at the very beginning. The view that we took is that the appropriate protocols for those home networks are really
going to be driven by the protocols that the manufacturers of smart appliances put out. And right now we don’t have a plethora of smart appliances in New Zealand because most of the manufacturers don’t see that there’s a market for it yet. So our view is that we did a functional specification for the advanced metre that tried to maximise the flexibility that would adapt to whatever technology was decided, and in fact we have made demonstrations to the committee, I think, at different times about how easy it is to install the ZigBee modems that were referred to repeatedly. It took us about 10 seconds and even I could do it. So it’s really easy.

What we’ve seen is there’s still a reluctance for smart appliances to come in, and one of the trials that we’ve done, both in Tomorrow Street and on a broader basis with about 500 customers is installed a system we called Home IQ. That’s a system that is a simple-to-install set of power boards that are connected to a wireless central module that allows each power point on the power board to be controlled individually, which then gives you individual appliance control, plugged into those points. It can be through the wireless system, controlled by an iPad or a computer or an iPhone or a smartphone. We’ve rolled that out in about 500 systems. We’ve got quite a good idea about the changes that we need to make in the system to make it easy, you know, so it can pass what I call my mother-in-law test. And we’ve also learnt about what people can do with that system.

I’ve installed it in my apartment in Auckland, and over an 8-month period I’ve dropped my power consumption by about 18 percent, just simply by going out of the apartment every morning, taking my iPhone out, turning everything in the house off but the refrigerator, and then leaving it off. Simply things like that that are technology driven is a bridging gap between the time that smart appliances come in and communicate directly with the metre. So those are the types of things that you’re going to see developing and we’re trying to concentrate on.

Lotu-Iiga And these are readily available now? Are you rolling them out?

Brantley They’re not readily available because we’re trying to get the technology just right; once again, as I said, do the trials, make sure the technology is right so that when you mass roll it out you don’t wind up with a lot of people who are so confused with it they can’t figure out how to make it work.

Shipley One of the things, if I may Mr Chairman—the meters have made a difference in many respects, and Albert’s description is really their future potential with apps and real hands-on. But today if any Genesis user wants to see what they’re using, they can go on to a laptop and see the peaks. I think we’re in very much an education period where people are not used to having that quality of information. They see a bill and they see some numbers they general don’t understand. Today they can go on and can tell what was on, and it’s creating a culture of both being informed and then empowered. So it’s almost a preliminary stage. And there’s also a huge benefit, by the way, of not having to have people knocking on doors—the dog bites and just the inconvenience—that smart meters allow for the company and I think for customers is very genuine.
<table>
<thead>
<tr>
<th>Name</th>
<th>Statement</th>
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<tbody>
<tr>
<td>Lotu-Iiga</td>
<td>So the evidence you’ve got is that it has changed behaviour, there has been conservation of energy.</td>
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<td>Brantley</td>
<td>What I would say is the smart meters are not an end in themselves. They’re like the cellphone platform. They give you a platform to work from. The next part was to give the information directly to the customer, which we’re doing through this energy usage. So everyone with a smart metre, a Genesis Energy customer, can go online and look at their consumption by the month, a week, a day, right down to the half-hour. Then the next stage is you give them a financial incentive to do something with the data, and then the final stage is you give them the tools to make it easy to do something with the data.</td>
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<td>Young</td>
<td>Thank you very much. We appreciate your appearance to the committee today. Thank you.</td>
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</table>

**Conclusion of evidence**
The Commerce Committee has conducted the financial reviews of the 2011/12 performance and current operations of the Government Superannuation Fund Authority, Meteorological Service of New Zealand Limited, Public Trust, and the Standards Council, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Jonathan Young
Chairperson
# 2011/12 financial review of Guardians of New Zealand Superannuation

## Report of the Commerce Committee

## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation</td>
<td>2</td>
</tr>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Benchmarking and performance</td>
<td>2</td>
</tr>
<tr>
<td>Investment strategy and risk management</td>
<td>3</td>
</tr>
<tr>
<td>Responsible investing</td>
<td>3</td>
</tr>
<tr>
<td>Appendix A</td>
<td>4</td>
</tr>
<tr>
<td>Appendix B</td>
<td>5</td>
</tr>
</tbody>
</table>
Guardians of New Zealand Superannuation

**Recommendation**

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of the Guardians of New Zealand Superannuation and recommends that the House take note of its report.

**Introduction**

Guardians of New Zealand Superannuation is a Crown entity established under the New Zealand Superannuation and Retirement Income Act 2001 to manage, administer, and invest the New Zealand Superannuation Fund, to reduce the tax burden on future New Zealand taxpayers of the cost of New Zealand superannuation. A board appointed by the Minister of Finance oversees the management team, which develops and implements investment policy. Under section 47 of the Act, no capital withdrawals from the fund are allowed before 1 July 2020. Capital contributions will cease by 2031, when the Crown will start to make capital withdrawals from the fund.

In the 2009 Budget the Government announced it would reduce contributions to the fund until the Crown operating balance returned to a sufficient surplus. At present the Treasury estimates this will happen in the 2017/18 financial year.

The asset mix of the fund is weighted toward growth assets, such as equity in companies. Total public equity in the fund increased slightly from $18.652 billion in 2010/11 to $18.703 billion in 2011/12. The fund outperformed expectations of the entity’s portfolio for the year (-0.23 percent), returning 1.21 percent (before tax, after costs) for 2011/12. 1

Guardians of New Zealand Superannuation’s revenue was $24.242 million for 2011/12, precisely equal to its expenditure.

**Benchmarking and performance**

We congratulated the entity on sustaining good long-term performance during the period in review. Despite the turbulent investment markets associated with the global financial crisis, the fund has exceeded its performance benchmarks.

The Guardians use global and domestic benchmarks to compare its operating and cost structures and share, compare, and contrast global funds. We heard that it sits in the top quartile in terms of adding value to investments, and in the lowest quartile in terms of costs. Cost control has partly been achieved by reducing the use of external managers in favour of management in-house.

We note that the entity considers its financial returns over the last 12 months to have been at the forefront of a strongly performing global market. The return on the fund since its inception has averaged 7.05 percent per annum. We were told that there is no annual target because, for a long-term investor, meeting short-term targets would unnecessarily increase risk.

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1 The Guardians benchmark the performance of its actual portfolio and the value added through active investment strategies.
**Investment strategy and risk management**

We heard that the Guardians factor in the potential for larger returns that it expects to receive in order to balance the risks associated with any particular investment. The higher the risk, the higher the expected return.

The Guardians has not done much preliminary work on the potential sale of state-owned assets. We note that it does intend to undertake more work in this area when pertinent information becomes available and would take into account any uncertainties and associated risk when making investment decisions regarding these assets at the time of sale.

We asked if the risk profile of the fund had been shifted toward more aggressive returns, noting the recent changes relative to the reference portfolio. We heard that the Guardians had widened its investment strategies, resulting in higher return for similar risk.

We wanted to know how the Guardians values its illiquid assets and how it could quickly recognise and mitigate substantial losses. It told us that its auditors, both internal and external, closely oversee valuations. An internal valuation working group also work to formulate the values of unlisted assets.

We heard that as a standing principle all overseas investments were fully hedged against exchange rate risk.

**Responsible investing**

The Guardians told us that it considers environmental, social, and governance issues when making investment decisions. It has a legislative requirement to consider responsible investment issues, and believe it is also obliged to do so as a matter of good investment practice. It said it has actively positioned itself in the top quartile of the United Nation Principles for Responsible Investment.

We asked about the Guardians’ screening processes for ensuring that it does not invest in companies involved in nuclear weapons or similar industries. It told us it is confident of its precautions. It has connections with global screening operations and it receives constant updates on a dynamic market. It has no plans to change this strategy, and have long since divested any investment in companies involved in the manufacture of nuclear warheads.

We note that the Guardians has made “resource scarcity” one of its three main “themes” for investment. It explained that this means one of its key aims is to avoid areas in which demand will slow in the long term, such as fossil fuels. The overall aim is to invest in an area of secure long-term demand.
Appendix A

Approach to this financial review
We met on 21 February and 21 March 2013 to consider the financial review of the Guardians of New Zealand Superannuation. We heard evidence from the Guardians of New Zealand Superannuation and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received
Guardians of New Zealand Superannuation, responses to written questions 1–116.
—— Responses to questions 13, 17, 20, 29, 30, 32, 46, 47, 51, 52, 58, 78 and 82 (Appendix A).
—— Response to question 3 (Appendix B).
—— Letter from Hon Bill English (Appendix C).
—— Forecast Statement of Service Performance (Appendix D).
—— Guardians and New Zealand Superannuation Fund Update 2011/12, PowerPoint presentation.

Office of the Auditor-General, Briefing on Guardians of New Zealand Superannuation dated 21 February 2013.

Organisation briefing paper, prepared by committee staff, dated 30 January 2013
Appendix B

Corrected transcript of hearing of evidence 21 February 2013

Members
Jonathan Young (chair)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Hon David Cunliffe
Clare Curran
Julia Anne Genter
Peseta Sam Lotu-Iiga
Mark Mitchell
Dr Jian Yang

Witnesses
Gavin Walker, Chair of the Guardians of New Zealand Superannuation
Adrian Orr, Chief Executive Officer of the Guardians of New Zealand Superannuation

Young Gentlemen, welcome to the Commerce Committee. Thank you for appearing. If you’d like to take us through your presentation—maybe, first, introductions would be great and then we’ll follow that up with questions.

Walker Firstly, good morning on behalf of the members of the New Zealand Superannuation Fund who are here with us this morning. For those of you who don’t know, my name is Gavin Walker and I am the chairman of the New Zealand Superannuation Fund. I’d like to introduce my fellow executives. On my right-hand side, Adrian Orr, who’s probably known to many of you, who is the chief executive officer of the fund. Behind me on my right-hand side, Stewart Brooks, who’s the general manager finance, and behind me—you can hardly see her—is Catherine Etheredge, who is head of communications for the fund.

To help with today’s discussions we have prepared a brief presentation, which has obviously just been handed out to you. What we don’t propose to do is to address this presentation in detail, but we will focus on those points that we deem are important on each page. Should at the end of the presentation there be any matters that you wish to address more fully, then please feel free to ask one of us and I’m sure we’ll do our very best to answer them as we can. I’d like to talk to the early slides in the presentation and then I’ll hand it over to Adrian to address the balance of the pack, and at the end of Adrian’s presentation I’ll provide a brief summary. What I’d
like to do is suggest that we turn to page 3 of the pack and I’d just like to make the following two points in relation to page 3.

First of all, just to refresh us all that the New Zealand Superannuation and Retirement Income Act of 2001 was the vehicle by which the New Zealand Superannuation Fund was established with the purpose of successive Governments using the fund as a vehicle to save today and invest these savings in order to smooth in future years the tax burden of New Zealand superannuation between taxpayers of today and also those of the future. Secondly, it’s likely that a successive Government will begin to withdraw money from the fund to help pay for New Zealand superannuation somewhere in the order of 2029/2030.

If I turn to page 4, I’d just like to draw your attention to the mandate of the Guardians, and the Guardians is the Crown agency vehicle charged with managing the fund, to invest the funds that the fund has on a prudent and commercial basis consistent with the following: firstly, best practice portfolio management; secondly, to maximise the returns without undue risk to the fund as a whole; and, thirdly, but not least, doing so in a manner that avoids damaging New Zealand’s reputation as a responsible member of the international community. The fund’s mission statement is therefore to maximise the returns over the long term without undue risk so as to reduce the future imposts on New Zealanders in terms of future superannuation requirements.

On page 5 we make reference to the directive received from the Minister of Finance in May 2009 regarding investment in New Zealand. The essence of that directive was for the Guardians to identify and consider within the bounds of section 58 of the Act ways of increasing the allocation to New Zealand assets in the fund. Further in the presentation Adrian will discuss how we’ve met that directive by identifying, considering, and selectively investing in New Zealand opportunities that meet our investment return and risk criteria. At this juncture I’d like to hand over to Adrian, who’ll walk us through the balance of the pack.

Thank you, chair, and good morning everyone. It’s a pleasure and an honour to be here representing the Guardians. I’m the CEO of the Guardians of New Zealand Superannuation. I will follow what the chairman’s just done, which is just provide a couple of headlines on each of the pages going ahead. Obviously this will be the public record. We’re an incredibly transparent operation and we always invite people to look at our website and get involved and understand what we’re doing and what we’re about.

Keying off from where the chair left, our task is to maximise a return without undue risk and invest without prejudice to New Zealand’s reputation globally. We kick off from that point around what is undue risk, and we see that as we want to maximise the chance of us being successful, i.e. meeting our purpose. So from that starting point we look at what combination of investments we can make that will maximise long-term returns whilst being within a manageable risk profile. We do that from our
own perspective, i.e. we think about what are our particular advantages and how can we maximise those advantages.

They include the fact that we have a very long horizon in our investment—2030 is the current scheduled first capital outflow. We are a very liquid portfolio. We have known liquidity requirements, so that allows us to go into certain types of investment activities that a lot of other—in fact, the vast majority of—funds wouldn’t be able to do. And we have this operational independence in terms of our governance in the sense that we are able to really discipline ourselves, have a very clear focus about our purpose, have a very clear focus on what our operational capabilities and our investment strategies are, and then hold the course, because that’s the critical part around the long-term investment. In order to do that as well we put a very high priority and importance on being transparent and being able to communicate what our activities are, because that’s about bringing stakeholders and our board with us in what can be some very challenging investment activities. Risk-return is completely related to risk, hence you must take risk on board.

In terms of slide 7, this gives you an idea of, starting from that position, how we’ve ended up investing and we do it in a very simple way. We have what would be a notional portfolio that we call our reference portfolio, and that is a portfolio that we could hold in a passive, listed, simple, most cost-effective form that would achieve our purpose. That’s just the reference portfolio. And you can see—it’s the top corner there—that over 80 percent of that reference portfolio is in growth assets, so direct holdings of equity or property and where we want to take part in the capital growth of those assets as well as the ongoing dividend yield or interest income that comes from those assets. So in that sense it’s a high-octane portfolio. It’s highly exposed to growth and all of the volatility that comes with it because we can afford to be exposed to that because of our horizon and our liquidity and our governance disciplines.

We then say: “Can we add value over and above just that simple passive reference portfolio by further leveraging our comparative advantages?” That is, can we actively invest and go into different asset classes where we can gain returns from risk premia that other people generally can’t access. The obvious one there would be, say, the illiquidity premium—going into unlisted asset classes or direct investments where generally people don’t want to go there because they are nervous that they might have to sell, they need the cash, and if you’re into some of these other active investments, where you have to sell quickly or because of reasons out of your control, then you might end up in very bad positions having to sell, you know, fire sale assets.

So we have our reference portfolio plus our value-adding investment strategies that equals our total portfolio. And you can see there that the actual portfolio we hold has a combination of standard listed global equities, global fixed interest, plus a lot of alternative investment—direct investment—activities: timber, private equity, all sorts of other types of activities. The beauty of this construct is that you measure what you want to
manage and we can be managed well to it. So we have clarity on what we are earning through the passive listed, over and above just simple debt instruments, and we are learning—we can very clearly identify whether we are adding value in addition to that through the active investment strategies we take. So we can be held accountable to total return and the value-add over and above the passive return.

On page 8, I just wanted to give the committee just a feel for what we have been doing since we last sat in front of a select committee over and above the business as usual—the investing. A very important part of our activity has been driving a single focus through our fund and our fund activity. There’s one fund, one return—all people work for that one fund. That is, we have developed frameworks for which we have been globally recognised where we can look at any single investment and compare it with all other opportunities that might be in front of us at a point in time in two ways. One, about its financial attractiveness—that is, given the risks that are inherent in an investment, are we being adequately rewarded, and are we being better rewarded than of the other alternatives in front of us—an apples with apples approach. That’s the financial attractiveness and then we also have established a very clear process around gaining our confidence that that financial attractiveness will exist, because we’re always talking about expected returns.

So we end up with a confidence-adjusted, risk-adjusted, expected return and that confidence-adjustment is about how we are undertaking that investment. Can we have the flexibility to get in and out as we need? Have we got enough line of sight over the risk that’s involved in that investment—the line of sight over the way in which capital is being allocated to that investment? And are we getting the most cost-effective access to that investment? You know, we could take a property on through a listed vehicle, a direct vehicle, through a private equity structure, or even some other derivative form; we are always looking for the most cost-effective access. Those have been the two driving things that I can now confidently say we are there. And it’s in a pretty unique environment for a global fund to be in a situation that we are, to be able to assess investments as we do.

On page 9 we refer to our very strong held investment beliefs around environmental, social, and governance issues. We have both a legislative requirement to consider responsible investment issues. We also believe we have a strong investment requirement to do that as well. So we have actively positioned ourselves into the top quartile of the United Nation Principles for Responsible Investment as a participant, as an investor, in there. And we are showing leadership across the wider Crown financial institutions in terms of we have resourced ourselves to the point of being able to undertake a very deliberate responsible investment programme through all of our portfolio. That programme is largely about embedding environmental, social, and governance decisions into our search for investments both through investment themes as well as manager selection, our ongoing monitoring against global best practice standards, and then our
activities—whether it is either to engage with companies or, at an extreme, exclude investments, and you’ve seen the list of exclusions we’ve made as well as the many, many engagements we’ve had. We do that as transparently as possible using global best benchmarks that are available.

On page 10, a very brief overview of how we benchmark—you know, what gets measured gets managed. We have global and domestic benchmarks that we believe are truly best in breed comparing our operating structures and cost structures. We use the global CEM benchmarking, which has thousands of global funds that we share, compare, contrast. Our governance performance, part of it is obviously is on display today, but we’re a very important member of the International Forum of Sovereign Wealth Funds and we help develop globally agreed practices and principles around how these should be operated and of course we adhere and transparently put out how we do that against it.

The important stuff—the dollars. Again, on a monthly basis, we can report how we are performing relative to both the opportunity costs, the Government’s short-term borrowing cost, as well as our expectations being both the Treasury bill return plus 2.5 percent, which we think on average we should outperform, which we have been to date, as well as our reference portfolio—i.e. are we outperforming just passive investment through our activity? Then there are the other issues around our commitment to transparency, responsible investment, and overall risk management. We report against all of those and we spend a lot of time with our global peers. We have put the three Cs there. We spend a lot of time with global large funds around comparing how we do our business; collaborating on issues of common concern; and, most important, looking for co-investment opportunities where we can stand on the shoulders of some global giants and work with them.

How have we performed? On page 11, in terms of financial returns over the last 12 months, it has been a very strong performance from global markets and we’ve been at the forefront of that. Since inception, we’re almost 10 years old now and we started first investing in September 2003. Since we began investing we’ve got an annual rate of return of 8.3 percent. That sits well ahead of the equivalent Treasury bill return of just over 5 percent and sits ahead of our reference portfolio, the passive portfolio, as well. These numbers they do translate into large dollar—billion—additional, both excess return to the Treasury bill and value-add over and above the passive investing. So although small percentages, you are keying off a big number so you can see the returns there in black and white.

And for those who like pictures, which includes me, on page 12 that’s just a simple graph to outline if you had invested a dollar with us back in 2003 how would you have got on if you had just put it with Treasury bills, or Treasury bills were 2.5 percent, or with the reference portfolio, and how we’ve actually invested. So you can see there just visually how we’ve got on.
In terms of page 13 is just the fund’s size as at the end of January this year. We’re just south of NZ$22 billion in terms of total fund size. That’s off $14.8 billion that has been the capital contributions from the Crown.

In terms of cost control on page 14, it’s nice to see a cost graph where the lines go down. You can achieve that by making sure the denominator goes up as well. It’s cost as a proportion of total funds under management, which is an important driver for us. The cost going down hadn’t been a large part of our external performance fees. We have been increasingly through time managing more of the investments ourselves actively in-house and that has been driven around improved confidence about the financial attractiveness. So our work on what gives us confidence as an investor has led us to do more investment ourselves internally and that has been rewarded both in the return side—net returns—and in part through that cost activity. Of course that has come with increased internal capability as we have grown the team out.

Page 15 is just to show you just a quick global snapshot of where sit amongst our peers. To do the apples with apples comparison we compare both our value-add—how much investment over and above passive investing—and our costs and I am pleased to report that we sit in the top quartile in terms of value-add of our investing over the horizon of this against our peers and in the lowest quartile around our costs. So we feel that we are on the right path in terms of managing those.

Lotu-Iiga  Cost as a percentage of total cost?

Orr Yes, yes. The graph on page 15 is interesting. All those speckles—it looks like a kind of a disease outbreak there, we’re the red dot—

Cunliffe You want to be in that zone.

Orr Yeah, you want to be in that top left-hand corner. Those costs are measured by funds who are undertaking the same types of investment activities. So those who have decided to be involved in active investment—so it’s getting proper apples with apples there.

Page 16—no one else will do it for us, so we will—is just outlining some of the external benchmarks. Global award around the innovation—that’s primarily around the ability to think as a single fund rather than operating within different investment silos and you can see in terms of Treasury, transparency, the leadership, and responsible investment stuff. That’s last year; that just makes this year much harder.

On the New Zealand investment front we are very pleased with the progress we are making. It hasn’t been simple progress. Our New Zealand directive is to actively seek and consider investments subject to meeting the overarching best practice activity. So when we approach New Zealand investments, we think very hard about: “What additional return are we getting for the additional risks we might be taking on by concentrating our portfolio here in New Zealand?” As you can see, we have 24 percent of the fund now; just short of a quarter of the fund is invested domestically across a combination of listed equity and direct investments, private equity
investments, and they are managed by very specific investment strategies that we’ve developed in order to make sure that we act consistent with our overarching goal of a strong performing portfolio.

You have to kick a lot of tyres to get some investments on the ground in terms of actively seeking. You know, we’ve looked at well over 100 types of opportunities. We’ve really got into bed and worked hard with a dozen or so of them and we’ve managed to invest quite large lumpy sums of money on a few which we mention on page 18, which we’re happy to answer questions on. So I’ll pass it back to the chairman.

Walker Thanks, Adrian. I think there are just a couple of core messages we’d just like to leave with the committee this morning. The first is that despite the turbulent investment markets associated with the global financial crisis, the fund has exceeded and continues to exceed its performance benchmarks. Secondly, we are a long-term fund, which allows us, probably more so than any other fund in New Zealand, to identify and invest in both domestic and international opportunities where we are rewarded with the long-term horizon views that we can and do take.

As we have seen in the past, and I have no doubt that we will witness again in the future due to the very nature of the investment markets, there will be periods of volatility and negative returns that investment markets and thus the fund will experience from time to time. I think, however, that the fund has a very sound and strong governance—independent governance—model in place and I think this, combined with the target operating model to the fund means that we are very well equipped to managed such periods of volatility. In fact, I’d go one step further and say that we are in a position that we can take advantage of times of volatility.

On behalf of Adrian and myself and the team we would like to thank you sincerely for having this opportunity to make this presentation to you and we look forward to addressing, no doubt, the many questions that you do have. Thank you.

Young Thank you very much, Mr Walker and Mr Orr for your presentations—very comprehensive, thank you. Congratulations on your returns as well. I think it’s been a great performance that you’ve overseen.

Cosgrove I just reiterate the chairman’s point. Given the climate, it’s a stunning—pretty stunning—performance. Those who I recall were opposed to your being set up are now starting to eat their words in a big way. I’m interested in a general sense in your investment and risk management strategy. In its crudest form—and correct me if I’m wrong—generically you look to buy cheap and sell when it’s up, in its crudest form, presumably. You’re after cheap—good-quality, but cheap—assets. So do you look, for instance, at assets where there is perhaps uncertainty, where there are assets being sold at the bottom of the market, say where there are supply issues that outstrip demand and devalue those assets. Are those the things you factor in?

Orr Yes. Yes is the answer. There are two legs. The first leg is about how we get the exposure to the level of risk that we think isn’t undue—so in other
words, exposure to the growth asset. And we do that with the aim of diversification. So by far the biggest part of the total risk that sits in this fund is through just access to global listed markets that give us that diversification—i.e. we don’t have a view of who’s going to outperform what. Then the second part, the value-adding over and above that, is in large part, as you describe. We think: “What else can we do, given our attributes, that might allow us to access investments that other people just can’t?”. And those reasons can happen and really in the simplest investment form that is when their current price may be well divorced from what we think their long-term underlying value.

Cosgrove Just on that point, you’ll be aware, and I’m sure you are focusing on it, that the Government intends to sell a number of electricity companies—State-owned. Do you, in your investment strategy, where there are uncertainties, factor in, as one commentator calls it, an uncertainty discount in your investment strategy?

Orr We definitely do factor in the risk premia we think we need to gain for holding an investment. Any investment, whether it be a building, a listed equity, a fixed-interest instrument—you know, an electricity-generating company—has the same underlying risk nutrients. You'll have a certain amount of market risk in terms of just like owning equity. You might have credit risk, as who is the person who is standing behind.

Cosgrove Legal risk.

Orr You'll have legal and operational risk. You’ll have liquidity risk—how long does it take to buy and sell it, on that side? You’ll have these underlying nutrients, and we will break down an investment and say what combinations of that sit in this particular activity—are we being rewarded sufficiently for that? So the higher the risk, the higher the return, we would expect.

Cosgrove So in the case of the State-owned enterprises that are on the block, you’ll be aware—I presume, you are focusing on it—of the legal uncertainties around those that still exist, in terms of the Supreme Court action, the contractual uncertainties that exist in respect of Meridian and the Tīwai contract. If those uncertainties still exist at the time of sale, one would presume that you would be looking for, and factoring in, an uncertainty discount in the price you would pay, given that if Tīwai doesn’t go ahead, you have got 14 percent projections are of capacity on the market, then it rolls on to do we close a power station—blah, blah, blah, blah, blah. Supply outstrips demand. The reason I ask, I suppose, is because is it that the Government’s made great play of mums and dads being first in the queue, and they include, interestingly in their definition, your fund, which is an interesting concept.

Orr What’s the question? Question rather than statement.

Cosgrove I’m coming to that. You’ve given other members latitude, so just, you know, taihoa and take a breath. This is a reasonably important issue, I would have thought. Even you fullas might want to take note of it, because you could hypothesise that selling in a down market, the shareholder is
likely to get at the bottom of the market, which we are at, a lesser price. And you guys and other investors are more likely to factor in uncertainty discounts and demand [ Interruption] so you’re not paying over the odds. What’s your strategy and what are you focusing on around that?

Orr For us, there are two legs again. The first leg is to the extent that if these assets are floated, they will become part of the New Zealand capital markets and we would end up holding a passive holding of the former State-owned enterprise, whatever form it is. So we have 5 percent of our listed equity allocated to New Zealand - listed markets that have been sitting in our reference portfolio. So we would end up being a passive holder of that. The next question is would we want to hold more than that, and that comes down to that price value consideration. Within that price you have to factor in all of the types of uncertainties that exist in any investment. We are investors in infrastructure, we are investors in a lot of illiquid assets, so this would not be a unique or new issue. Regulatory risk is something that any investor faces in any investment through time, and you would expect for it to be reflected in the price. It’s there, but of course there is one price for all investors. So that’s what, you know, we would have to approach.

Cosgrove So would you in your own investment strategies—I assume, but I will not put words in your mouth—that it would be extraordinary if the superannuation fund decided, for instance, to divest itself of assets at the bottom of the market.

Orr To divest itself, you say?

Cosgrove To divest itself. Would that be a strange investment strategy for the superannuation fund to make?

Orr You would have to think about it from the portfolio as a whole for our purpose. We do actively position the portfolio so that we don’t find ourselves in a position of being a forced seller—i.e. when we are selling when we don’t believe the value of that asset is going to be reflected properly to us.

Cosgrove But as a general rule—

Young Which brings me to my supplementary, if I can just come in. Thank you. Mr Cosgrove is presenting some hypotheticals, which we understand, because—

Cosgrove Well, no, there are a few facts in there, too.

Young In terms of your investment portfolio, you look for a long-term investment strategy—

Orr That’s right.

Young—which would probably indicate that energy consumption in New Zealand would increase, despite the scenarios that Mr Cosgrove presents, of which some are hypothetical, some are current, and no doubt will be proceeded through in due course. So in terms of that long-term strategy, if you were to
look at those offerings, what would your view be if there were, at that particular point in time, an excess of supply?

Orr For us, you’re absolutely correct, a strong point of differentiation for a fund like ours is that we can take a very long horizon view to an asset. So we would certainly be thinking about that asset over any investment over the life cycle of the investment, with that. You will still need to boil that back down to how much of that future, or whatever it is, is presented in the current price that’s there—i.e. is it already priced in or is it actually not priced in and we can pick something up where the price might be below the long-term value at that time? This is for us to take an active investment strategy on the way through.

These strategies, just so I can make the select committee clear, on our website we put down the underlying purposes of various investment strategies. With regard to infrastructure, which is a clear strategy, we like that because true infrastructure may be inflation proofed. That gives us certainty through time, whether inflation goes up or down. They can often be stable cash flows, which would help liquidity but also help diversification—i.e. if the New York Stock Exchange is hitting its normal tantrum. It’s still going to get a reasonably stable return from a reasonable proportion of the assets. So we will be looking at it from the perspective of our fund. How does it improve the performance of our fund, of the way it works?

Cosgrove Could I just pursue a couple of things there? Presumably there is a major risk with the fund, initially, anyway, in that there will be a price that’s offered. If these uncertainties, i.e. Tīwai, are not sorted before that, then at least in the short term you guys could take a hit, unless you’re focused on an uncertainty discount. Correct?

Orr To the extent that it’s just prices and we are owning it, then you’d have a market-to-market movement in the values.

Cosgrove So, despite the chairman sort of trying to make it myth or legend, do you agree with Contact Energy, PricewaterhouseCoopers, Statistics New Zealand, and the electricity—another agency—market that we are facing a flat demand period?

Orr I’m not an energy expert, so we’d have to sit there and look at all of those issues when it comes to our investment decision-making. That is the consistent view from most people.

Cosgrove Just one final question, because you’ve got a pretty formidable pedigree, in respect of your experience and we are lucky to have you. As a general rule when you’re either looking to invest in a company, but certainly where you’re offering a company on the market, isn’t it the case that in order to maximise the price that you want for your return that you tie down any uncertainties, say, legal, that you resolve any contractual issues, especially those that might impinge on demand for your product or service, and therefore impinge on the price—you tie all those things down and get them resolved if in order to maximise the attractiveness, the financial
Orr The general rule as an investor is all of the issues would be considered. From the perspective of someone making an offering, as long as it’s transparent as to what state the asset is when they’re selling it, then it’s really up to the purchaser to decide am I prepared to take on whatever residual risk is sitting there, and that would be—

Cosgrove But as a general rule, from an investor’s point of view, surely—

Orr You would be wanting to be rewarded for all of the outstanding risks.

Cosgrove If these risks were considered high, for instance, the demand for your service takes a hit, then presumably as an investor you would be looking very, very carefully at an uncertainty discount and the fact that you weren’t going to be paying over odds for those shares.

Orr Yep. The higher the risk, potentially the higher return, and that is reflected often through a lower entry price.

Young I’m presuming that you don’t have holdings in other equities or investments that are without risk.

Orr That’s the only reason we get rewarded, because we prepare to take on risk.

Young So risk is actually just part and parcel of all of that, as you can imagine.

Orr That’s what we do.

Lotu-Iiga Before I get into my questions, look, at this stage of the proposed transactions that my colleague here has referred to, it’s premature, I would presume, to go through that whole—you haven’t done due diligence or any risk analysis at this point to even comment. Would that be fair?

Orr That’s correct.

Lotu-Iiga Thank you.

Cosgrove Sorry, just to summarise—

Lotu-Iiga No, no you’ve had your go.

Cosgrove I just want to clarify something. No risk analysis at all in respect of potential investments—

Lotu-Iiga No, hang on, he’s not allowed. I’ve asked the question.

Young We’re going back to Sam, because you’ve had a run of about eight questions.

Lotu-Iiga Thank you.

Young Sam has had one question that was interrupted.

Lotu-Iiga Can I just say, first and foremost, well done on your long-term performance, which you’ve acknowledged in your annual report. I recall when you came here first—when I was first here in Parliament—you had a 22 percent loss and I don’t think the committee got too down on that,
because we knew your long-term objectives and we knew the financial climate at the time, just as you bounce back with 15 percent returns and 25 percent returns. So well done—7.05 percent over the life of the fund I think is to be commended.

My question on the, I suppose, benchmarking on the Treasury bills, because there has been some analysis that has looked at other benchmarking over a longer term bond rate—just your comments on that, but specifically with reference to how other sovereign funds measure that type of return, please. It is 250 basis points over the bills.

Orr I just want to make it clear that the Treasury bill is not our benchmark. The Treasury bill is a very simple measure of the opportunity cost of putting the money into this savings vehicle versus paying down Government debt. So that’s just an opportunity cost measure, and it’s why it sat there. The reason we have Treasury bill plus 2.5 percent there is because that is an expectation, not a target, of what a fund that is broadly 80 percent growth, 20 percent fixed income, should achieve on average over time. That is a 20-year moving average. In other words, we should be getting both the risk-free rate, the Treasury bill, plus 2.5 percent, which is the risk premia, the reward for taking on additional risk by having exposure to growth.

Lotu-Iiga But that’s the risk-free rate at that time, right—at any point in time? Or how do you—

Orr Yes, it’s always at any point in time.

Lotu-Iiga I suppose my point is that at any point in time it can vary, correct?

Orr That’s right.

Lotu-Iiga So I suppose the question is, and I’d like the other question answered if you could, how does that compare with how other sovereign funds are?

Orr Now, with other sovereign funds it is incredibly similar. In the sense that some funds are often explained as they’ll have a certain amount of real growth plus inflation—for example, the Australian Future Fund and Norwegian Fund have CPI, so that’s consumer price inflation, plus 4 percent or plus 2 percent or depending on what their particular liabilities are and what their risk profile is. That in itself actually boils back down to what we have, because sitting in the Treasury bill there is a certain amount of real growth plus the nominal part. So a T-bill plus 2.5 expectation is very similar to a CPI plus 4.

The reason that we don’t have a target is because we don’t want to be in a position that we think is incorrect as a long-term investor, where we are forced to put more and more risk on to the table to meet short-term targets, when the opportunities just aren’t there. So if you’ve got an annual target, it kind of forces you to take on more risk when the premiums are declining, which is when you should actually be taking risk off the table. That’s how we try to operate.

Cunliffe Just a supplementary question, if I look at the graph on page 12, it is interesting to compare the recovery portion from September and October
2008 through to, I guess, something like mid-2010, where the returns for the fund actually lagged the benchmark portfolio, and the strong performance in the latest uptick from about September 2011, where the returns to fund have greatly exceeded that of the reference portfolio. Does that imply a change in the risk profile of the fund, climbing into a little more risk to get those more aggressive returns? Or is it simply more skilled decision-making? How would you explain the differences?

Orr It’s sitting through here, you know, it’s always death through simplicity, although there is one line there, the brown line, the total fund, the underlying assets and investment strategies that make up that line have definitely changed through time.

Over the first period up till probably almost the beginning of 2007, it was largely a passive listed portfolio with very little additional active investment. Through the next period up to going through the global financial crisis, the fund was very limited in the active investment strategies it was taking. We had timber investments, direct active, we had some direct property investments, active investment, and we had some multi-strategy hedge fund-type investments.

In that latter part, since 2009 and onwards, we have managed to have a much wider range of active investment strategies going on. In terms of the risk it’s looking for additional return for the same level of risk. That’s the value-add type concept, and the board—

Cunliffe But the risk to Government profile has changed as an ingredient.

Orr We have managed to have a wider set of investment strategies going on. In particular, one of the large investment strategies where we spend a lot of our risk budget on is what we call strategic tilting. That is where if we believe that current pricing in equity markets or foreign exchange or fixed income and property—if current market pricing is well divorced from what we see as the long-term fair value of those markets, then we will either take on, if it looks very cheap, more; if it looks expensive, we’ll get out.

Through a big part of that period global markets had been so beaten up, with pricing so far below any what we see reasonable sense of long-term fair value, we have had a very large, additional allocation towards some of those asset classes, and that has paid off very well.

Lotu-Iiga You’ve talked about investing in illiquid assets. We know that there’s, you know, by and large there’s a premium on some of these assets, and you’ve referred to some of them: private equity, timber, and some of your infrastructure projects. Some of these are difficult to value, you know; it’s not market to market, and it’s not a shared portfolio. I suppose, you know, when you have volatile markets and the global financial crisis, with some of these assets—and they can lose value quickly—you’ve got in place, presumably, some risk management, you know, tools to look at how they change value. First, how does that work through in practice? Second, if you see some substantial losses, as you saw in, I think, the 2009 financial year,
how do you get that out quickly and report it and identify it and realise those, you know, within a fixed time period?

Orr I’ll open up, but I’ll pass over to the chair. But we have a very clear set of established practices and behaviours that we go through across all of our asset classes. First one, of course, is the standard—the audit committee have a very strong oversight, our own audit committee plus the external auditors, over the way in which we go through valuations. You’re correct. Some assets, you get mark-to-market pricing every day. Some assets, we only get them monthly—some of our timber valuations. Some are done only annually through different types of accounting practices of valuation that go on. We have an internal valuation working group that focuses specifically on that latter group to ask how you can triangulate different ways of getting at what an unlisted value is. The simplest and most wonderful method is observing transactions of similar assets or your own assets that go through that side. There’s other cash-flow methods of valuing that go through. So we try and take as many different approaches as you can to get at a value, and we—

Lotu-Iiga And, I suppose, critically, these are internal processes, right?

Walker Not necessarily and not exclusively. The way that we think about this from a governance point of view, and Adrian’s quite right, that this is one area where, in any investment portfolio when you are dealing with unlisted assets, it could be suggested that a level of discretion is applied in terms of determining the valuation of non-listed assets. So to overcome that concern at the fund, what we’ve done is we’ve actually appointed external, independent parties to help us, help the board, review the underlying value of those assets. And, if I take forestry as an explicit example, what we’ve done there, we’ve evolved our thinking too, I might say, over the last few years. First of all, we even rotate now those independent valuers every 2 to 3 years, and we’ve recently gone to a second stage where we now separate the valuers in terms of valuing the underlying land—where we own the land—as distinct from appointing a separate valuer to value the forest.

In addition, we are always looking at international comparatives. In other words, in terms of forests held in Canada or Latin America, what’s happening to the underlying value of those forests? And we also look at international forestry transactions, so, where forests have been bought and sold both within New Zealand and internationally, what’s happening to the value parameters around those transactions, and what does that mean for us in terms of the carrying value of our own assets? So there’s a high level of transparency and an independent view brought to it.

Lotu-Iiga I’m satisfied with you. Just on that last point, and it’s a final sort of supp. Given the exposure to overseas, particularly equities, managing exchange rate risk, do you want to just comment on that quickly, because I know someone else wants to ask? That’s an important part.

Orr Yeah, the currency risk is a very simple one in that we 100 percent hedge our portfolio back into New Zealand dollars as a standing principle. We do that because we pick up a significant positive interest rate differential by
being back in New Zealand dollars—about 1.5 percent per annum on that side. We do have an active investment strategy, though, where we can at times deviate from that hedge, but that goes onto our risk book. In other words, that’s an active decision where, if we decide not to 100 percent hedge but, for example, leave an open foreign exchange exposure based on a valuation model, then that gets marked into the “active” book. And we do do that from time to time.

Cosgrove Sorry, could I go back to my question a little while ago? Could I just get you to—it was a supplementary I was going to ask. I just wanted you—in case I didn’t hear it right—Sam asked you as to had you done any risk management work, in respect of analysis, in respect of the upcoming asset sales of electricity companies; and was I correct in hearing that you’ve done absolutely no risk management analysis or analysis on those at all?

Orr We have not done any detailed analysis around those opportunities at this point. Some of the key issues still remain to be put on the table for us to be able to do the type of due diligence that we would need to do to have the confidence to take an investment beyond just a passive holding.

Cosgrove So no detail, but you have done some analysis, and I presume part of that analysis is scenario planning?

Orr We’re aware of what the assets are that have been talked about, and we have seen various reports from standard, publicly available documents. We haven’t gone beyond that.

Bakshi Looking at your performance graph, it is quite similar to the NZX50 graphs, which constantly went up until 2007 and then dropped until almost 2009, and yours also is on the same lines. How do you feel that—what’s the future of the investments in New Zealand? How confident you are about those?

Orr You’re correct that the single biggest driver of our performance in the short term—i.e., this volatility—is the performance of listed equity markets. The New Zealand equity market performed very similar to global markets. They had a very strong rally in the first part of the new millennium, absolutely smashed in the global financial crisis, and have fought their way back since on that side. That volatility that we have seen in these markets sat within our initial confidence index of this, which is why we’ve always reported and, as the Minister mentioned, why we completely anticipate continued volatility, but with long-term growth rewards.

Genter Thank you for your presentation. Sorry I wasn’t here for the beginning of it. I have some questions specifically about responsible investment, and I was interested to see that there’s been some work done on integrating responsible investment more broadly across the investment group, but wondering if there’s been any progress on beefing up the screening so that you’re confident that you are divesting in companies that aren’t involved in tobacco and nuclear weapons and similar.

Orr We are confident that we have the best in breed access to the screening available globally. We hold over 6,500 shares in different companies, and we
are connected to global screening operations. Our investment managers know and have responsibility for ensuring that the investments that we’ve said should not be in there are not in there, so, you know, we are doing the best that is available to us. We continuously also like and receive updates from other groups who tell us, you know, because it’s a continuously dynamic market, as to what companies are coming in and out of our portfolio, and what those companies are actually doing. And, so, you know, that’s why we operate transparently—so that people can, from time to time, which they do, inform us of changing company behaviours or arising issues. So it’s a very deliberate framework for identifying what issues matter to us and why and how they can be flagged to us in our portfolio, and then a deliberate process that we have internally as to what we should do about that.

Genter Has the delivery of nuclear systems been changed at all in its category? Is it a reason for excluding investment in companies or not?

Orr For our fund, we have been long divested from companies that are involved in the manufacture of nuclear warheads. We stopped our divestment at that point based on legal advice we received, which is linked back to the New Zealand legislation, antinuclear legislation. Some of the other CFIs have also divested from firms that are involved in the maintenance of those nuclear weapons, so there is a difference, a minor difference, between the Crown financial institutions on that specific issue. And we’ve been working with them as to how the various boards of the CFIs got to those different positions. We’ve been in that situation now for, I think, over 3 years, and the legislation’s on our website, and our decision process of how we got there to that point.

Genter So there’s no plan to change that at any time to expand the possibilities for excluding—

Orr I think there’s always a watching brief on these issues—you know, how are companies changing through time, etc. So at the moment we don’t have any specific plan to be revisiting that, but I would never say never.

Genter I note that you’ve introduced resource scarcity as of three main themes for investment. Can you tell me practically what that means?

Orr Yes. I mean, so, investment can be kind of driven by two sides. One, it can be supply driven, where people are coming up with great ideas and cunning plans, and they come and sell those to you, and you do your own due diligence. The other one is demand driven, where, being a long-horizon investor, we can sit here and think about what type of issues in the future—what things now that we know are happening may lead to opportunities in the future. And some of those issues that we’ve seen coming up are exactly around resource scarcity, a very clear and continuous—in fact, that is the underlying reason for economics. And we’re saying, OK, with that, being a long-horizon investor, are there certain things that we may be able to get into either because other funds can’t, because they might have liquidity issues or risk premium they’re not prepared to take on, or because the horizon over which they’re worried about is just too long, or the entry price,
you know, we might be able to find, get an earlier life cycle. So we’ve pushed hard on that theme to come out and to say, OK, are there investible activities? That’s the hard part. We can think about great themes. The next bit is then: “And so what?”. The challenge is, if I have thought about it, then it’s probably already in the price. So it’s about saying, are there then, you know, from that, are there ways in which we can get into some of these things—might be alternative energy activities, and we are actively considering and looking at those types of areas. The key economic drivers are that we don’t want to be as best as possible having a portfolio where we end up with stranded assets, for example, or regulatory risk that says you can no longer use a certain fossil fuel. So, you know, we want to avoid stranded assets, we want to be in assets where consumers have very high demand, or we want to be an early adopter of the next big thing. So that’s how we use it.

Young

All right. Well, thank you very much, Mr Orr, Mr Walker, for your presentation today. Again, congratulations on a good return for this last financial year you’ve reported on. Thank you for your staff that are here today, and all the best for this coming year ahead. Thank you.

conclusion of evidence
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Hawke’s Bay District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Health and Disability Commissioner, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Health Quality and Safety commission, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2011/12 financial review of the Health Research Council of New Zealand

Report of the Health Committee

Contents

Recommendation 2
Introduction 2
Financial and service performance 2
Contract selection and management 2
Application process 3
Research investment streams 3
Co-investment 3
Evidence-based policy 3
Intellectual property 4
Workforce capability 4
Appendix 5
Health Research Council of New Zealand

Recommendation

The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Health Research Council of New Zealand, and recommends that the House take note of its report.

Introduction

The Health Research Council of New Zealand is a Crown entity, with responsibility for administering the Government’s investment in health research. The council is responsible to the Minister of Health, although most of its funding comes from Vote Science and Innovation, with only a small proportion from Vote Health. The relationship between the Minister of Science and Innovation and the Minister of Health is covered by a memorandum of understanding.

Financial and service performance

In 2011/12, the council had a total income of $85.513 million, and spent a total of $91.152 million, resulting in a deficit of $5.639 million. The deficit was funded from reserves, resulting in a reduction in equity from $15.15 million at the beginning of the financial year to $9.505 million at 30 June 2012. The council plans to manage its expenditure over the next three years by varying the number and size of research contracts to progressively reduce equity to approximately $5 million.

The Office of the Auditor-General rated the council’s management control environment and financial information systems and controls as “very good”. Its service performance information and associated systems and controls were assessed as “good”.

The council has reduced its operating costs from $4.6 million in 2007 to $3.72 million in 2012. It said efficiency and value for money are its top priorities. We wish to congratulate the council on the efficient management of their organisation, and their positive audit results.

Contract selection and management

The council invests in health research contracts by providing contestable funding and co-funding partnerships. In 2011/12, the council invested $80.306 million in existing and new contracts, the five largest areas of investment being cancer and related disorders, child health, the cardiovascular system and disorders, infectious diseases, and public health.

The council told us that they direct research closely, and support the development of the health research workforce. At present they fund 2,300 mostly part-time positions in more than 30 institutions, a mixture of universities, district health boards, and community and independent organisations. To be eligible for a grant a project must be led by a New Zealand researcher or hosted by a New Zealand organisation. In 2011/12, the council managed 552 separate contracts for health research.
The council said that their budget for particular research streams is indicative, with a degree of flexibility. Contracts are funded for an average period of three years. The council considered that health would benefit from a greater share of public funding.

We were pleased to hear that the council emphasises research quality, which has led to a large number of citations in international publications, and 10 full patents granted in the last financial year.

Application process

In 2009, the council changed its application process to help reduce transaction costs for researchers. The new two-stage process requires researchers to submit a brief expression of interest, then, if it is accepted, a full application. We heard that the council gives constructive feedback to unsuccessful candidates so that their subsequent applications can reach the standard for consideration.

However, we are aware that overall a large portion of research applications are turned down. In 2012, the council received 764 applications and awarded only 149. We are concerned by this, and will monitor future approval rates closely. The council commented that “with static funding and annual expenditure at or slightly below the current level this translates to a static or slightly reduced number of research contracts”. The council also expects a gradual reduction in health research outputs, as inflationary pressures are reducing the purchasing power of its investment.

Research investment streams

In 2010/11, the council introduced four priority research investment streams, to improve value for money by focusing on areas where the need and opportunity for research was greatest. The streams, with their indicative proportions of investment, are health delivery with 20 percent, improving outcomes for acute and chronic conditions with 35–40 percent, Rangahau Hauora Māori with 10 percent, and health and wellbeing, which includes obesity and diabetes prevention, with 30–35 percent.

Co-investment

We note that the council has been reducing the amount of its cash reserves it uses to supplement its income, with this set to be reduced further over the coming years; so we asked how the council plans to find other income sources. We were told that there has been a recent move to include economic gain as a targeted research outcome, in addition to the principal outcome of health gain.

The council told us that for 10 years it has been using partnerships to secure co-investment, mostly with the Ministry of Health. We heard that it has become increasingly difficult to form partnerships, however, as many agencies are cutting back on research investment in difficult economic times.

Recent co-investment has been made in partnership with the National Health Committee, and $1 million has been invested for primary care research in partnership with Canada, which has contributed $2.5 million.

Evidence-based policy

We recognise the importance of evidence-based policy, and asked what policy has been produced on the basis of council-funded research. We heard how healthy housing research led to the Warm Up New Zealand home insulation campaign. Professor David Fergusson
of the University of Otago undertook the Christchurch Health and Development Study, a longitudinal study of 1,265 children, the results of which have highlighted the importance of early intervention to improve child wellbeing. This led to Early Start, a long-term intensive home visitation programme for children under five.

**Intellectual property**

We were interested to hear that the council cannot make a claim on any patents granted as a result of its research contracts. We would be interested to hear how this compares with other countries and whether the council will advocate a review of this policy.

We are aware that the Ethics Committee is no longer required to look at the soundness of the science behind a project. We recognise that if the science is flawed this has ethical implications for a research project. We were reassured that guidelines on good peer review science are followed.

**Workforce capability**

We asked about workforce capability, and heard that there is a gender imbalance in the workforce, with senior management positions occupied by predominantly male staff and research positions predominantly female. We will monitor this issue. The council said it is committed to encouraging bright New Zealanders to return to New Zealand after gaining experience overseas. To this end it is giving 11 or 12 emerging researchers a grant of $150,000 each year, and awarding the Sir Charles Hercus Health Research Fellowship, an advanced post-doctoral fellowship, which provides three candidates each year with up to $500,000 over four years. We agree that this area is very important.

The council said that the percentage of researchers who are clinically trained has grown recently, now making up 43 percent of the research workforce; and 48 percent of this group are practising clinicians. We were also told that the split between biomedical and clinical research and public health research has evened to about one half, compared with the one third that public health used to constitute a few years ago.
Appendix

Approach to this financial review

We met on 13 March and 27 March 2013 to consider the financial review of the Health Research Council of New Zealand. We heard evidence from the Health Research Council of New Zealand and received advice from the Office of the Auditor-General.

Committee members

Dr Paul Hutchison (Chairperson)
Shane Ardern
Dr Jackie Blue
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Scott Simpson
Barbara Stewart
Louisa Wall
Dr Jian Yang

Evidence and advice received

Health Research Council of New Zealand, responses to questions, received 7 March and 25 March 2013.


Organisation briefing paper, prepared by committee staff, dated 15 January 2013.
The Health Committee has conducted the financial review of the 2011/12 performance of the Health Sponsorship Council and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2011/12 financial review of Housing New Zealand Corporation

Report of the Social Services Committee

Contents

Recommendation 2
Introduction 2
2011/12 performance 2
Service delivery 3
Social housing 3
Canterbury earthquakes 4
Appendix 6
Recommendation

The Social Services Committee has conducted the financial review of the 2011/12 performance and current operations of Housing New Zealand Corporation and recommends that the House take note of its report.

Introduction

Housing New Zealand Corporation is responsible for managing the government housing stock. It provides housing for people on low incomes or with specific housing needs, managing a portfolio of about 69,400 properties (as at 30 June 2012), provides operational policy advice to the Government, and undertakes targeted research on housing issues. The corporation has two subsidiaries, Housing New Zealand Limited and Hobsonville Land Company Limited. It has a new chief executive officer, Glen Sowry, who took up the role in January 2013.

2011/12 performance

In 2011/12, the total revenue of the corporation (including its subsidiaries) was $1.078 billion, which includes $44 million of insurance claim revenue. Its total expenditure was $857 million, and there was an operating surplus of $158 million.

The corporation and its subsidiaries received a “good” rating from the Office of the Auditor-General for their management control environment and financial information systems and controls. However, the corporation received a “needs improvement” rating for service performance information and associated systems and controls, as it did in 2009/10 and 2010/11. Last year, the Office of the Auditor-General recommended a number of improvements, but we understand the deficiencies found in 2010/11 have not yet been resolved, and those from the 2009/10 audit have been only partially resolved. We understand the corporation was undergoing implementation of the Enterprise Transformation Programme during this period. The Office of the Auditor-General has recommended that the corporation work with stakeholders to establish appropriate outcome performance indicators to articulate more clearly the social impact of the sector’s outputs. The corporation should also re-assess, on the basis of available information, what measures are the most appropriate indicators that it houses the right people in the right properties for the duration of their need.

The Office of the Auditor-General also noted that there is no specific team responsible for validating output measures, and that it is not clear who has central management responsibility for the integrity of service performance information. It recommended that specific staff be made responsible for the integrity of the output measure data, and perform a quarterly assessment of the data.

We urge the corporation to address the Office of the Auditor-General’s recommendations and expect improvement by the next review.
Service delivery

The corporation has changed its initial needs assessment from a face-to-face interview in a local office to a telephone interview conducted through a call centre. After this initial assessment, prospective tenants are given an appointment at their local office, typically within 10 to 14 days, or immediately for urgent cases. The corporation errs on the side of caution in assessing needs by telephone, giving the prospective tenant the benefit of any doubt.

The corporation maintains that customer satisfaction has remained stable since the introduction of the call-centre approach, with 70 to 80 percent of customers expressing satisfaction. The corporation acknowledges that call wait times were unacceptable at first, but we are pleased to hear that the waiting time for callers now averages two and a half minutes. Some of us, however, remain concerned that this change in service delivery has had a detrimental effect on clients.

In response to our concern that the call-centre approach might not always work, for example because of cultural or language barriers, the corporation clarified that the number of offices has not been reduced, and that people in these circumstances can still schedule an interview at a local office. The corporation also maintains communication with community advocacy groups, which can contact local offices directly to discuss particular cases.

The corporation acknowledges that issues arise regularly regarding tenants, their behaviour, and the property. Tenancy service managers are expected to spend 70 percent of their time out of the office with tenants and in the corporation’s properties to address issues as they arise.

We look forward to being updated about customer’s satisfaction and their perception of the service delivery approach at the next review.

Social housing

Housing New Zealand is the main provider of social housing in New Zealand, with a portfolio of approximately 69,400 properties, including 1,580 properties rented to community groups. Social housing is also provided by local government, with about 14,000 units, and by third-sector organisations, with about 5,000 units.

Although the corporation recorded a net loss of 310 houses in the last financial year, it said that its intention to “provide more homes where they are needed” was being realised by selling and building houses to match local demand. The corporation also explained it had moved away from buying large numbers of houses because such activity disadvantages new-home buyers. Instead, the focus has moved to building new houses, adding to the overall housing stock. The cost of housing is an important issue for the Government and the public; most of us support the corporation’s approach. Some of us remain concerned that Housing New Zealand’s strategy is not meeting the needs of our most vulnerable, and is moving away from a mixed-community model.

Housing New Zealand’s development programmes aim to deliver about 2,500 houses by July 2015 to the general housing stock. Of these, 1,795 will be in Auckland, 165 in Wellington, and 519 in Christchurch. Other Crown developments, such as those at Hobsonville and Weymouth, are expected to deliver a further 700 homes to the general housing stock over this period. We note that 1,750 properties are expected to be retained...
as state housing, while the number likely to be made available for other sectors of the housing market would depend on factors outside the corporation’s control, such as demand, resource consents, funding available to third parties, and construction costs.

The corporation also intends to extend existing houses to suit changing population demographics. In South Auckland, for example, where the corporation has many three-bedroom properties, there is now more demand for four- or five-bedroom houses.

Since December 2010 the corporation has also noted a substantial increase in the number of single adult applicants for housing (from 29 percent of applicants to 40 percent), and a decrease in applications from couples with children (from 23 percent to 13 percent). The corporation said it is taking into account the changing needs of applicants as best it can, for example by modifying houses. We recommend that the corporation give further thought to particular strategies to accommodate changing housing needs.

We also understand that Housing New Zealand does not systematically collate or report information about tenants or applicants with a disability, or with mental health problems. Because this is an area of such importance, we recommend that the corporation begin to collate and report such information, and be prepared to answer questions on it at the next review.

**Hobsonville Point**

The corporation acquired land at Hobsonville Point under the Public Works Act 1981 “for state housing purposes”. Some of us were concerned about the acquisition because the houses to be built are to be sold rather than retained by the Crown as state housing. The corporation explained that the term “state housing purposes” is defined in section 2 of the Housing Act 1955, and includes “acquisition, or holding of dwellings and ancillary commercial buildings by the Crown under this Act for disposal by way of sale, lease, or tenancy”.

**Length of vacant tenancies**

The corporation told us that it needs to reduce the amount of time Housing New Zealand houses are vacant. Damaged properties in the Christchurch red zone, some of which have been empty for three years, have raised the average length of vacancy. However, the corporation acknowledged that the onus is on it to provide a more meaningful measure of occupancy. This acknowledgement reflects the recommendation made by the Office of the Auditor-General regarding meaningful measures of effectiveness (see page 2 above), and we urge the corporation to act upon it.

We also note that the key performance indicator of 45 days for housing turnaround does not differentiate between houses needing earthquake repair work and others. Given the extraordinary circumstances resulting from the Canterbury earthquakes, we strongly recommend that the corporation introduce separate measures of vacancy for affected and unaffected properties.

**Canterbury earthquakes**

Repairing and rebuilding damaged Housing New Zealand properties has been a major undertaking for the corporation over the last year. Of the 6,000 properties in the Canterbury portfolio, 95 percent were damaged in the earthquakes, and many of them cannot be repaired economically. However, the corporation gives repair work such a high priority that it began repairs while still negotiating insurance cover. Since July 2012, 212
vacant properties have been fully repaired and tenanted, another 95 properties are expected
to be tenanted by June 2013, and the procurement processes have begun for 700 new
builds. The corporation has also completed about 27,000 urgent health and safety repair
jobs to more than 5,000 properties since September 2010.

The corporation has set a target of repairing earthquake damage to a further 5,000 currently
occupied properties by the end of 2015; of these, 2,000 are expected to be repaired in the
next 12 months.

A trial programme involving the repair of 38 occupied earthquake-damaged properties is
almost complete. The trial will be used to assess the practicalities of tenants remaining in
their homes whilst repairs are undertaken, to shorten the turnaround time for repairs.
Working with the Department of Corrections, the corporation has removed houses from
the residential red zone to Rolleston Prison, where they will be repaired and moved to
suitable corporation sites in Canterbury. Approximately 30 houses are expected to be
repaired each year for five years.

We agree that the work in the Canterbury region is a central issue for the corporation. We
congratulate the corporation for its efforts in Canterbury and look forward to a
comprehensive update of progress against these targets at the next financial review.
Appendix

Approach to this financial review

We met on 13 February, 27 March, and 10 April 2013 to consider the financial review of Housing New Zealand Corporation. We heard evidence from Housing New Zealand Corporation and received advice from the Office of the Auditor-General.

Committee members

Peseta Sam Lotu-Iiga (Chairperson)
Jacinda Ardern
Hon Phil Heatley
Melissa Lee
Jan Logie
Le’aufa’amulia Asenati Lole-Taylor
Alfred Ngaro
Dr Rajen Prasad
Mike Sabin
Phil Twyford
Hon Michael Woodhouse

Evidence and advice received

Office of the Auditor-General, Briefing on Housing New Zealand Corporation, dated 13 February 2013.

Housing New Zealand Corporation, Responses to written questions, dated 3 December 2012, and 15 March 2013.
2011/12 financial review of the Human Rights Commission

Report of the Justice and Electoral Committee

Contents

Recommendation 2
Introduction 2
Cash reserves 2
Race relations 2
Canterbury earthquakes 2
Appendix 4
Introduction

The Human Rights Commission is an independent Crown entity created to protect, promote and monitor respect for human rights in New Zealand. It is funded through Vote Justice. The chief commissioner, David Rutherford, was appointed in September 2011.

In 2011/12, the total revenue of the commission was $10.264 million and its total expenditure was $10.141 million, resulting in a net surplus of $122,619 (the 2010/11 net surplus was $186,000).

We understand that the commission will be concluding an internal organisational review in June 2013. We look forward to hearing about the outcome.

Cash reserves

Analysis of the commission’s budgeted versus actual revenue and expenditure by the Office of the Auditor-General reveals a pattern, over the last four years, of under-budgeting of revenue and over-budgeting of expenditure. This has allowed the commission to generate surpluses, which have contributed to its growing cash reserves.

We were informed that this strategy has been adopted in anticipation of static baseline funding and rising costs in the current economic climate. The commission assured us that it has delivered on its service performance measures, and that savings have come from tighter budgeting of projects, the timing of additional funding received for the promotion and monitoring of the UN Convention on the Rights of Persons with Disabilities, and a series of efficiencies. However, the commission noted that it has now run out of scope for efficiencies. It is running to budget this year, and is expecting to record a planned deficit at the end of the year. An organisational review is currently under way to determine an appropriate level of reserves for the future.

Race relations

We asked the commission about the current challenges to race relations in New Zealand and how it intends to address them. We were told that because of the recent appointment of the new Race Relations Commissioner, Dame Susan Devoy, who is due to start on 1 April 2013, the commission had not yet published its priorities. However, addressing inequalities in the areas of work, health, and education in decile 1 to 3 areas of New Zealand is considered to be of strategic importance.

Canterbury earthquakes

We asked what the commission is doing to ensure human rights are protected during the recovery from the Canterbury earthquakes. We heard that the commission has been involved in the development of an internationally benchmarked monitoring framework to
ensure the recovery is inclusive and non-discriminatory. As part of its work to provide advocacy and advice, the commission has been meeting affected people and bringing their issues to the attention of officials for practical solutions, such as promoting the installation of insulation in houses when they are being repaired. We also asked whether there was a discrimination issue where the Crown has offered some property owners in the residential red zone 50 per cent of the most recent rating valuation of their sections while owners of other properties were offered 100 per cent of the rating valuation. The commission has written to the Minister for Canterbury Earthquake Recovery asking him to reconsider this matter and to consider an extension of time for owners to respond to offers.

Finally, we asked about progress on a gender analysis of policies concerning recovery from the 2011 earthquakes, a matter raised in the concluding observations of CEDAW (the Committee on the Elimination of All Forms of Discrimination Against Women). We were told that work on this was yet to start. We look forward to reading the analysis on its completion.
Appendix

Approach to this financial review

We met on 21 and 28 March 2013 to consider the financial review of the Human Rights Commission. We heard evidence from the Human Rights Commission and received advice from the Office of the Auditor-General.

Committee members

Scott Simpson (Chairperson)
Dr Jackie Blue
Hon Lianne Dalziel
Julie Anne Genter
Andrew Little
Alfred Ngaro
Denis O’Rourke
Katrina Shanks
Hon Kate Wilkinson

Mojo Mathers replaced Julie Anne Genter for this item of business.

Evidence and advice received


Organisation briefing paper, prepared by committee staff, dated 2 November 2012.
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Hutt District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2011/12 financial review of the Independent Police Conduct Authority

Report of the Law and Order Committee

Contents

Recommendation 2
Introduction 2
Complaints 2
Delays 2
Initiation of inquiries 2
Staffing 3
Public reporting 3
Appendix A 4
Appendix B 5
Recommendation

The Law and Order Committee has conducted the financial review of the 2011/12 performance and current operations of the Independent Police Conduct Authority and recommends that the House take note of its report.

Introduction

The Independent Police Conduct Authority is an independent Crown entity. It aims to provide reassurance for the public and for Parliament that policing standards are the highest possible. It examines independently and reports constructively on issues within the Police or regarding members of the public in their interaction with police. The authority’s total revenue for the 2011/12 financial year was $3.901 million, and its total expenses were $3.795 million, resulting in a net surplus of $106,553.

The Office of the Auditor-General assessed the authority’s financial information systems and controls as “very good”, and its service performance information and associated systems and controls as “good”, both improvements on the previous year’s assessments of these areas.

Complaints

In 2011/12, the number of complaints the authority received were at a six-year low, and we asked why. The authority has not conducted research into this decrease because the statistics vary considerably from year to year. Complaints can arise from minor or serious matters, and we heard that they can result from one-off incidents, such as a riot. It can therefore be difficult to establish norms for complaints or to notice trends.

The authority sorts complaints received into five categories according to seriousness. We heard that the authority spends approximately 90 percent of its time working on cases in the two most serious categories because of the complexities involved. The authority acknowledged that it could improve its output by discerning trends within these categories and applying them throughout its work. Should such an initiative be implemented, we would be interested to see the results.

Delays

Sometimes the authority is prevented from closing a file, which can be distressing for all those subject to it; for example, a delay might occur while the Police complete their own internal investigation of a complaint. We asked what was being done to reduce delays. The authority believes that it could hold more hearings before the court hearings on the cases in question are complete, taking care not to prejudice the judicial process. We also heard that the Police are currently undertaking a review of their professional standards, the outcome of which may have a bearing on some of the delays the authority encounters.

Initiation of inquiries

The committee noted that in some situations the authority might have to wait five years or more in order to initiate an inquiry, for example while the appeals process ran its course.
After so much time, we believe an inquiry would lose some of its cogency. We asked whether the authority has the discretion to initiate an inquiry without waiting for an appeal to be decided. The authority noted that it would be useful as a residuary power for the organisation, especially where there is significant public interest but no formal complaint has been made. The authority considered that it would only use such a power rarely. The committee heard that in parallel jurisdictions the equivalent authority has the power to initiate its own inquiry, but in New Zealand this power does not exist. The Minister may wish to consider this option.

**Staffing**

The authority said that all of its investigators are former police officers, and we asked if this represented a conflict with its status as an independent authority. We heard that in an organisational review, the authority plans to explore the possibility of training employees with non-police backgrounds as investigators, or specifically recruiting candidates for such training. However, it is important that the authority maintains credibility with the police, which may mean that its investigators will continue to need police experience. The authority believes that its investigators would ideally be a mixture of former police officers and people with other backgrounds, and would also reflect the cultural mix of New Zealand society. We intend to monitor the effects of the authority’s organisational review.

**Public reporting**

The authority believes that public interest in its work has increased, and it is considering adjusting its processes accordingly. It has recently sought advice from a senior Queens Counsel on the legality of reporting its findings publicly. The authority considers that eventually it will probably report all its investigations publicly with very few exceptions. We heard that legislation already allows the authority to gauge public interest and adjust its practices accordingly. We intend to monitor this situation with interest.
Appendix A

Approach to this financial review
We met on 20 February, 20 March, and 27 March 2013 to consider the financial review of the Independent Police Conduct Authority. We heard evidence from the Independent Police Conduct Authority and received advice from the Office of the Auditor-General.

Committee members
Jacqui Dean (Chairperson)
David Clendon
Kris Faafoi
Hon Phil Goff
Ian McKelvie
Mark Mitchell
Richard Prosser
Jami-Lee Ross
Lindsay Tisch

Evidence and advice received
Independent Police Conduct Authority, Responses to questions, received 1 February and 19 March 2013.


Organisation briefing paper, prepared by committee staff, dated 7 December 2012.
Appendix B

Corrected transcript of hearing of evidence 20 February 2013

Members
Mark Mitchell (Deputy Chairperson)
David Clendon
Kris Faafoi
Hon Phil Goff
Ian McKelvie
Richard Prosser
Jami-Lee Ross
Lindsay Tisch
Louise Upston

 Witnesses
Andrew Baxter, General Manager, Operations
Sir David Carruthers, Chair
Daiman Smith, General Manager, Corporate

Mitchell In front of the Law and Order Committee. I’d just like to introduce myself. My name’s Mark Mitchell and I’m the deputy chair of the committee, and—
Carruthers Thank you.
Mitchell I’m chairing today in the place of the chairwoman, Jacqui Dean.
Carruthers Thank you.
Mitchell I’d just like to draw to your attention that this is a public hearing of evidence, and the hearing will be recorded. I was wondering if you would take the opportunity to introduce your team and we will quickly go round the committee and introduce ourselves. Some of us don’t need any introduction, but others like me do.
Carruthers Thank you very much. Well, I’m David Carruthers, and I now chair the Independent Police Conduct Authority, and I have with me Andrew Baxter who’s in charge of operations, and he’s from Scotland—so there’ll be an interpreter needed for that—and Daiman Smith, who’s in charge of our corporate and financial affairs. He’s from Palmerston North and, similarly, I’m happy to—[Interruption]
Goff Welcome.
Carruthers I’ve said to both of them: “Don’t worry, I’ll look after you today.”
Mitchell [Introductions]

Mitchell Look, Sir David, I was wondering if you could brief the committee and then leave some time at the end for some questions. That would be great, thank you.

Carruthers Thank you. Thank you, Mr Chairman. I’m happy to do that and make a brief statement, which I have prepared, but which I always get excited and depart from as well, so you’ll forgive me. But I know that it’s more important for the questioning, so I’ll just say some opening things, if I could.

Everyone will know that the Independent Police Conduct Authority was set up to receive complaints and investigate serious incidents involving death and bodily harm. I was appointed in April of last year, but I continued also to be the chairman of the New Zealand Parole Board, and so it wasn’t until July that I took over full-time duties as chair of the authority, and I answer to a board, and I must say it’s been different for me to have a board to answer to, and to appear before a select committee.

We’ve got an excellent board, and so I’m really enjoying it, but it’s a different exercise, and one, which I think I can understand, is actually very important. We’ve been through a lot of changes over the last few years. We’ve changed our approach to both complainants and to the work. We’ve recently received some pretty high-level affirmations of the effectiveness and the importance of the authority.

But there are a number of challenges, which I believe we are facing, and I will talk honestly and openly about those to the committee today, and the issues and the challenges, I think, relate to our independence, which has to be thought about daily, every minute of the day; to profile; to accessibility; to speed and delay, which I’ll come back to; and about quality and training for us. And I think that there’s room for us to make significant improvements in all of those areas. I want to see this organisation becoming a world-class oversight body, and I believe we can do that, and then, obviously, that would flow through to supporting a world-class police force, which we can be proud of. So it’s important work and I just want to acknowledge that to start with.

We get about 2,000 complaints a year, and this last year the numbers were down slightly, but that is almost irrelevant because we have a triaging process. We prioritise our investigations. We don’t investigate anything like that number. Most or many are referred back to police to investigate themselves, with our oversight, and so we review or audit their own investigation. We have a number of investigators and some of them speak in the languages of the Commonwealth—all ex-police—and their job is to investigate what we call category 1 complaints, which involve death, serious bodily harm, or very serious misconduct. Last year 87 of the complaints we categorised as category 1 of that sort of investigation.

We’re required by law to maintain secrecy. It’s an issue that I’ll just talk about briefly. The purpose of it is so that people will speak to us with
confidence and not have to worry about criminal prosecutions or, you know, other consequences, but we have a discretion about publishing reports, and I’ll return to that, too. Most of the complaints that we investigate, we do not report on publicly. Most are concluded by way of direct correspondence with the complainants themselves and with the Commissioner of Police. The year before last we produced 17 public reports; this last year it is 14, and that included the major thematic review, which I appeared before the select committee more recently about—the police detention of young people. That was part of our OPCAT year, United Nations obligations, and I need to just report to you again about that. That is, we had confirmation from the police that they accepted all of the recommendations, which were made in that review, and we meet again in March to see what actions have been taken to implement them. So they’ve set up a team to do that. So it’s very good progress from what, I think, was a very good piece of work.

In the coming months—actually, probably coming weeks, really—we will be issuing a number of other public reports, and one of them will be a report into the termination of what is called Operation Eight. It’s the Urewera inquiry. That was the largest police operation that had taken place for many years. It’s been a real burden on us. The investigation and the reports consumed a large part of our resources, and this year we will be going into our reserves, because of it, at the end of the financial year.

As for timing, I just want to say this to you. We’re asked often about it. You’ll be aware that criminal charges have taken a very, very long time to have been concluded. They are not yet concluded. Each of the four convicted defendants went to the Court of Appeal, as is their right, and then applied for leave to appeal to the Supreme Court. That has not yet been dealt with, and that leave relates to both conviction and sentence. Now, we expect them next—it’s up to the Supreme Court, so can’t predict what they will do, but from what I hear, there should be an answer to their leave application within the next few weeks, and when the criminal proceedings are concluded, we will be ready to report. We have some process matters, but we’ll be in a position to do that. But, of course, if leave is granted and the criminal proceedings continue in some way, members here will understand that we will be holding back until that’s all over, for obvious reasons. But it will be an enormous relief to us, when we can conclude that work. And I can tell you that we’ve been absolutely determined to do it fairly and honestly and professionally, and there’s been no mean effort put in to doing that and achieving that. So I can’t tell you what the results will be, but it will be a very thorough piece of work from a huge inquiry—perhaps thousands of documents and files and so forth.

I’d like to talk to you just quickly about this issue of public and private reporting, which has been an issue for us. The legislation is framed in a way that seems to imply that public reporting would be the exception. It talks about public reports being issued only when it’s in the public interest to do so, and, as I’ve said, we’ve tended to report only a few matters each year. I’ve taken the view from the start in a pretty, I suppose, naïve and innocent
way, that we should report more publicly so people can see what we do and why we’re doing it and how we do it.

We’ve just received, and have been waiting for it for a while, advice from a senior QC about our legal ability to publicly report, and I can just say to the select committee, in future it’s likely that we will be reporting on all our investigations, unless there is an overwhelming private interest that’s going on. So we think there’s been a change in both public attitudes and in public interest, we think, and that there is a need for us to report publicly in some way. Sometimes that might be in summary form. Sometimes it might be anonymised, and that will be both reporting what we consider to be brave and good police conduct as well as conduct that hasn’t come up to that expectation. So we’ve got to make that assessment individually, and that will be a change to the way we work in future.

I think that that will also have some effect on our public profile, which has been quite low, and the only significance about that is because we shouldn’t be trying to get a public profile, in particular. We do have a need to be accessible and to be known to the public, so that people know where to go if they have a complaint, and who to contact. So that, I think, will help with that. There’s a real obligation on us to be responsible and mature about how we make our findings, and we’ll be doing that.

I talked about timeliness and delay. I can acknowledge that there’s been significant delays in the work that we’ve done. Some of those delays have been inevitable, such as the Operation Eight, based on there having been criminal proceedings. We have to be very careful not to interfere with the rights of defendants, who might be affected by our publication. Sometimes there’s an inquest, which we have to be equally respectful of, and sometimes we have to wait for police to conduct their investigations and conclude them before we get involved, and sometimes that’s taken a long time.

But there have also been delays due to our own resources and our structure. We’ve got a very hard-working team of people, but the sheer volume means that sometimes it’s been weeks or months before they can get on to it. I have a plan for dealing with that, which will be put before the board next week, and it involves some restructuring of our organisation, much greater focus on team work and on planning and reviewing what we’re doing. So we’re in the middle of that at the moment—drawn up a proposal for organisational change, and we’re consulting on that now, but it’s very clear to me that some change is necessary.

And I also want to develop a rapid response capability, so we can do that in some appropriate cases, because we’re aware of the fact, too, that when something goes dramatically wrong and people are hurt or killed, there are sometimes young police officers who are waiting and waiting, and waiting anxiously, for what the outcome will be, and so it can be very cruel on everybody—families, victims, and police officers, too—to have too long a wait before that’s concluded. So we’re very conscious of that. We’re going to trial a new model of operating in a team way about those reports.
Another aspect we’ve been working on is tighter and much more action-based recommendations to the police for change. We’ve issued a lot of recommendations. Largely, they’re accepted, but we think we’ve got a job to do to ensure that they can be monitored effectively, and that means looking at what we recommend, so that it’s not flimsy or whimsical or soft, but actually hard and pithy, and able to be followed up on. So we’re going to be tougher on ourselves about what we recommend so we can follow up better and make sure that change follows from what we find, where necessary. And there may be a need, following all that, for us to have one or two more members of staff to further investigate and a further complaints assessor, but we’ll be working our way through that in the next 2 or 3 weeks.

Two other things. We have a triage arrangement, so we look at everything that comes in. The flow of complaints, as you can imagine, covers some things that are not really complaints at all; some things that are really hard to follow; some things that come from very disturbed people; some things, that are couched in abusive, inflammatory language—we’ll all be very familiar with all that.

Goff

Never happens to us!

Carruthers

But, as you do, we also think that that’s exactly the voices we have to listen to, in case hidden in there is something that’s delivered by unattractive people in an undesirable way, but doesn’t mean that it might be something very real that we have to be aware of and follow up. So we look at all of this seriously, and try to prioritise our investigations. We have the means to do that in our legislation, but I just need to say that there are risks for us if we are too tough about it. So we can raise the floodgates, depending on our resources and our workload, and there are some things that are really easy—you know, death is easy to identify, and serious injury is—but there are other areas where if you have to prioritise too toughly, you can miss important things. Sexual misconduct, for example, which our friends in Britain are struggling with, is an area where you really easily make the wrong call if it’s a matter of prioritising scarce resources. I think we do that really well, but I just signal that it’s an area that can become tougher, as limited resources get more and more pressed.

Turning to finances, last year we ended up with a surplus of about $100,000. This year, largely because of Operation Eight, we’ll be in deficit. I think we’ll be about $200,000 in deficit, into our reserves. We’ve got good reserves, so it’s not a problem. Daiman thinks it will be less than that, but we have some way to go yet—he knows more about it than I do. So we are budgeting for a deficit now. The board has told me really clearly that the restructuring we’re doing has to provide a sustainable operation in the next financial year, and we can and must do that. But it will be because we prioritise with the risks I’ve just mentioned. We’ll be doing that as best we can. Daiman Smith is happy to go into any questions about the financing.

I want to talk about OPCAT really briefly. We’re one of the national preventative mechanisms under that United Nations convention against torture, which involves us in reviewing detention facilities around New
Zealand. It’s fair to say that that work has been out of proportion for us in the past. We have, I think, allocated too great resources—funding and people—to it. We’re going to have to bring that back under control within our budget. So we won’t be able to do the work that we would like to do, but we will do what we can with the limited money that is allocated for it. So all I’m signalling about that is, you know, I think the United Nations subcommittee is coming here soon, looking at all that. Well, we’ll be doing our best, but it won’t be what we want to do; it will be what we can afford to do.

I’ve got a heading in my notes about overseas examples. We’ve been at pains to make contact with our friends in Australia doing similar jobs. None of them are exactly similar, but they do it in their Australian way. But I’m going to travel to England in May, because there are some very interesting things happening there. The Scots have now got a single police force for the first time, and they’ve set up a new system for scrutiny and oversight. I’ll find out what they’ve decided in their canny way—with great respect. We shouldn’t trespass when we’re there, but it will be very interesting to hear what those thoughtful people have come up with. The Irish Police Integrity Commissioner is having a tough time at the moment, for obvious reasons, but, again, under pressure that’s when you see what works and what doesn’t. So we’ll be spending a bit of time there.

The IPCC, which is the big organisation in England, is before the select committee at the moment—there’s a major inquiry going on. It has been heavily criticised for inadequacies. I’m in touch with them almost daily at the moment, and I would say we have things to learn from those people that we translate into our own culture and our own climate, so we don’t get captured by the things that we don’t need to. But we’re foolish if we don’t learn from other people and their experience, to help to see whether there are some techniques or options for us that we can use. So I’ll be doing that and just learning as much as I can, so that can feed into our changes.

So that is just a very glimpse into what we’re doing at the present time, Mr Chairman and members. There’s been a real challenge being involved in this organisation, but it’s actually very interesting and stimulating, and, I think, worthwhile. And I expect when I come back here next year to be judged against those issues, those challenges which I’ve identified, because I accept the responsibility to get on with that and to do it as well as I possibly can. And we are really happy to answer questions about any of those things.

Mitchell
Excellent, thank you, Sir David. Excellent briefing. Kris, you have a question?

Faafai
Thanks, David. Can I just start on timeliness and delays. I may be wrong, but I sensed a bit of diplomacy when you made your comments around the length of time that you’re waiting for the police to complete their own internal investigation before you can close a file. Can I get an idea of how much of a problem that is for you to close a file, and what’s being done to try and shorten that time frame?
Carruthers: Can I start, and then I'll ask Andrew to comment as well. There are a number of different levels at which we expect police to respond to our requests for reviewing their work and for them allocating someone from another part of the country to do it and so on. So some of them are very simple, and some of it is complex, and some of it's very, very subtle, and there are nuances in it, which are difficult. So the brief answer is that in some areas it's fine, and in some districts it's fine, and some places are not quite so fine and are a worry to us. And we've got some techniques which, I think, we can use more. For example, we can hold a hearing under our legislation if we wish to do so to bring things to a head, and the police are very used to that, court cases and so forth, and I think there's opportunities for us to do that in future more often, provided that we're monitoring things and find that it isn't working as well as we hoped it to. But I would just ask Andrew if he wouldn't mind to add to that.

Baxter: Certainly, Sir David. We have a good working relationship with police with regard to, especially, the high profile, major investigations, which are very well resourced and meet our expectations when it comes to the time that they're completed within. However, we do encounter occasional problems with regard to the smaller events, the less sensational investigations, which quite often can be just devoted to the integrity of the force. And police are currently undergoing a review of professional standards at the moment. I would expect that that review will make a number of recommendations for change, and I think together—we're having some input into that—and I think they will continue to improve from that process.

Ross: Good morning. I notice in your annual report that the number of complaints that are at a 6-year low, which on the surface of it is pretty good—do you have much of an idea as to what drives the complaints, why we're seeing this reduction in complaints? It's a good news story, but there must be some thinking behind it. Can you give us an idea in that area?

Carruthers: I'll just ask the others if they have. We try and capture patterns of complaint. We try and capture places that complaints come from, because that's sometimes an indication of a subculture that's growing up that's not satisfactory. We try and capture names in case the same names appear again and again. So, you know, those things are significant and helpful to us. I don't think the patterns have changed too much. We haven't done any research about what is responsible for dropping that number, because we're conscious that it's not a big drop and could be remedied itself any minute. For example, over Christmas we generally get a spike in complaints, and quite a few of them are from people who've had their alcohol poured out in front of them, and so forth. So, you know, there's a range of things that are complained about, which move from the quite minor to very serious, and you can get a huge number of complaints from, say, out of the student riots situation, which are people involved in it themselves and bystanders and then parents around the country, and so forth. So sometimes it is incident driven like that, which can suddenly produce a number; sometimes it's not. We can't be more specific than that, but I'll just check with my colleagues in case they have—
2011/12 FINANCIAL REVIEW OF THE INDEPENDENT POLICE CONDUCT AUTHORITY

Smith
I’d tend to agree with Sir David. It’s difficult based on 1 year to say that it’s a trend and it’s a little bit difficult for us to say it has an impact in terms of we’re having a greater effect on policing standards or vice versa. I think probably, and Andrew can confirm, in this current year we’re noticing a trend line that would perhaps bring the complaint levels up to what they have been in those other 5 years. So it’s difficult to say.

Ross
Sitting below your high-level figure of overall performance, I imagine you categorise them into serious to—

Smith
Five. Five. Yes, we do.

Ross
Five categories? Are you seeing any trends within the categories, or are you seeing more serious complaints? Are you seeing more low-level complaints?

Baxter
Those numbers remain almost constant, I think, unsurprisingly. The number of serious notifications that we receive remain around the mid-70s to 80 mark most years. It doesn’t really change. The greater disparity comes in the more minor events, and they’re reported less or more.

Ross
And some might say for people to be able to claim that they know that you exist, or know of the work you do, what work is undertaken to—I wouldn’t say to market your services but—let people know that you are available and they can complain if they feel they have a genuine issue?

Carruthers
There are number of players in that. Police themselves are often helpful in saying: “Well, write to the IPCA, let them know.” So police do it and they’re encouraged to. There are pamphlets and booklets that sit in the advice bureaux and places of public attendance, but I think the bigger impact is when it is known that we have reported on something serious, and then there’s considerable publicity about that, and people who have a grievance then know about it. So there are the low-level things about pamphlets and booklets that go out, and then there’s the general publicity. We haven’t had a campaign about that. We think that before we start doing something more active about that, we need to be able to deal with the flow we’ve got at them moment in a very good way.

Faafoi
Can I just go back to the categories of files. How much time and resources are taken up by those different categories, and have you seen it change over the last 3 or 4 years?

Baxter
As you’d expect, categories 1 and 2, which are the most serious—death, serious injury, or serious misconduct—take far more of our time, and they would take about 90 percent of the authority’s time. About 10 percent of our time is spent on the 4s and 5s and the 3s, sometimes fit in with the higher and more serious matters and sometimes they can drift into the more minor as we progress an investigation and realise, in fact, that’s not really what happened and we get to the bottom of it. So the far more serious incidents take up much more of our time, and the complexities around those investigations and the legal issues, and the natural justice issues that we have to take into account, sort of provide that impact. That’s the reason for it. It can get more extreme.
Sometimes it’s a couple of years or even more before we’ve got through all of that, particularly if they’re common law prosecutions or police are doing work as well.

That doesn’t mean, though, that we can’t perhaps do a better job in terms of—look, you know—that 90 percent of the volumes, which is the lower categories matters or issues, that we can’t actually spend more time thinking about whether there are discernible trends or important trends coming through in that work, and making sure that we’re picking up on things in terms of flowing that back into our work in the way that we deliver.

First of all, thank you for the work you’re doing, David, and your team. That’s vital, both that there is oversight of the police but also for confidence in the police, and that’s why the job’s so critical, in my view. Can I come back to the question of public inquiries. First of all, you mentioned that generally you’ve tended to report privately because that’s the way the legislation seems to be slanted. Do you need a change in legislation? Because that seems to be quite wrong.

No. Thank you for that. The advice we’ve got is that we can interpret public interest differently, and it’s open to us to do so, so that the test is able to be seen as a different one now. The public interest is in our publicly reporting much more, rather than thinking about public interest in a rather narrower way, as happened in the past, I think.

OK. Could I go back to the Urewera inquiry—not that you can talk a lot about it until you’re ready to publish, but maybe you should be doing an inquiry into why the justice system took so long to bring people to court, as well, because that, I think, is a huge worry. But looking at your inquiry now, it would be 5 years after the event. I understand that you’re waiting to see if there’s any challenges before the Supreme Court, and you need to protect the interests of the defendants, but it just seems to me that so long after the event the inquiry loses some of its force and some of its cogency, and I just wondered whether you’ve got a discretion whereby you don’t actually have to wait until the end of appeals, but you might be careful around those aspects of the report that you make. Five years after the event is a long time, when there’s been lots of questions about why did the police act in the way they did, and was it correct. Is there a way in which you can actually come out and discuss critical aspects of the case, while being mindful of protecting the rights of defendants, if there are still appeal rights?

With respect, that’s an excellent question, and I think mostly the answer is yes, there is a way that we could do that in most cases. The Urewera thing has been exceptional, and the legal challenges have been difficult as witness to the fact that finally it’s made its way to the Supreme Court more than once, to get resolution to very difficult questions around the search and surveillance, which have largely now been resolved by new legislation, which you know. So that’s been a case, really, standing on its own, and I agree with you about the comments you make about delay. It’s exceptional. I think that in other cases where there are criminal prosecutions, we can sometimes dissect our job about conduct, misconduct, and the rights of
defendants to a fair trial, and get on with our part of the job, and that we
need to do that and look at it very carefully on a case by case basis. There
will still be some, where our interference would not fair, but there will be a
lot, I think, just as you suggest, where we could actively make our findings
without interfering with different people’s rights. And we’ll be looking at
that very hard in the future.

Goff This investigation is of your own initiative?

Carruthers No, we don’t have the right to do that, which is one major thing—we don’t
have own motion.

Goff Should you? Should you? Because it seems to me that would be a good
thing.

Carruthers Well, I’m assuming—

Goff This is your chance to lobby the committee.

Carruthers I’m a servant of the law and I’ll do what is decided. But it surprises me,
frankly, when there is something constantly in the media about police
conduct and behaviour, that we don’t get complaints. And so people can
say what they like, but no one independently investigates, and I think it
would be a very useful thing if we had own motion jurisdiction at a high
level, because you wouldn’t want to be constantly poking your nose in.

Tisch Sir David, do other jurisdictions have that discretion?

Carruthers Yes, some do.

Tisch They do, but we don’t?

Carruthers Yeah.

Tisch Thank you.

Goff Can I relate it back to—I don’t know quite what the circumstances were,
but a few years ago we had the serious incidence of police misconduct that
resulted in conviction of police officers for sexual abuse—the Louise
Nicholson case. That was a case that was crying out for investigation,
because you had a subculture within the police force that was hugely
damaging to police reputations and to public confidence. If you had the
ability—this is historical now—if the authority had the ability to conduct an
own motion investigation, would you be able to act, do you think, in a
situation like that much more quickly, rather than after the event?

Carruthers Yes, I would have thought so, because—well, one of the things, which our
involvement does is it alerts everyone else in the police, particularly the
senior officers, to something about the scrutiny of something going wrong,
which can otherwise be hidden, and the light is everything in this area. So
having seen patterns of complaints, common names coming up again and
again, and then beginning to launch an investigation ourselves would alert
very senior officers to a problem, which otherwise could go under the radar.

Prosser Thank you very much, Sir David. You talked about resourcing and the fact
that although you expect to go into deficit, you do have reserves that you
can fall back on. So if you need to ramp up, you can take on extra people. In terms of the time that it takes for police to respond both to investigations and to do their internal investigations, obviously resourcing is going to be an issue for them. Do you get a sense from them that their reliance on resourcing as an explanation has anything to do with their perception one way or the other of the relative validity of complaints?

Baxter No, I don’t get that at all from them. I think, in the vast majority of cases, they make strong efforts to actually conduct a sensible and robust investigation and get to the truth of the matter. I think in the 2½ years I’ve been here, I’ve not heard them once suggest that they’ve any questions around the validity. They’re very quick to accept when they’ve got it wrong and, as Sir David mentioned earlier, they are frequently accepting the recommendations being made with regard to change in business practices and policy.

Clendon Thank you. Yes, hello. I’m interested that you acknowledged in your opening comments that all of your investigators are, or have been, serving police officers. That’s correct, I think. Is that not a problem in terms of the perceived independence of the body? I would’ve thought for two reasons you’d want to include other than police officers. One is the perception that this is still police investigating themselves, and the other, that people from different backgrounds, dare I say it, different cultural backgrounds in the more specific sense, would actually bring in a richness, another point of view, might ask different questions— acknowledging you bring investigators from I believe, Australia, Canada, elsewhere?

Ross Scotland.

Clendon Well, I suspected Scotland, of course. Yes, not forgetting that. But I suspect that officers from all of those countries would have a great deal in common in terms of a general, an overall culture, so yeah, why not bring in—stir the pot, mix it up a little bit?

Carruthers Absolutely right, and it’s been a major criticism of the IPCC in England—that all of their investigators have got police backgrounds wherever they’re from. I think that’s a really good point. As part of this reorganisation we are looking at—it’s a matter of what we’ve got the ability to do—either training an investigator or investigators with non-police backgrounds, or recruiting for that. I think you make a good point. There’s a little bit of a tension for us in it. It is really important that we retain credibility with police, and very often we get this reaction from police, which you would understand: how can you possibly judge us, unless you’ve been there yourself and you understand in the chaos of alcohol-fuelled riots how difficult it is to make decisions? Well, we understand that, and so it’d be necessary for us to have a number of investigators who have had that background and that experience, and know about it, but I think it would be an advantage to us to have the other, of course, just as you suggest, and we’re planning for that now.

Clendon I appreciate that. Thank you.
McKelvie Thank you, Sir David. I thought it was a pretty good report. When you go through these things before you come to these meetings, you sort of think, make a whole lot of marks—I think you must have had the same copy I did, because I think you answered a lot of the questions clearly, and, of course, that’s a good politician that does that. I was interested in a point you touched on, and that was following up the unpleasant, or I guess vindictive type of complaints and, obviously, it’s a business we live in, but inevitably, almost, those types of complaints involve innocent people, and I guess, very topical in the last year has been, well more than that really, the victims of crime and victims of all this sort of thing seem to me to be the real victims and constantly remain a victim. But the vindictive complaint leads to this sort of thing frequently. How do you judge and balance that and get it out of the way as quickly as you can?

Carruthers There are two answers in my mind. We've got very experienced people now who are at the edge of receiving the first complaints. We get all the letters and the emails, and go on the web, so there's a flood of stuff that comes in, and people who’ve done this work for a long time read it. There are some names which in this little country are very common to us all and we probably share some of those with you folk. There are sometimes people who've been to see us often in the past. So there are people who we've got to know very well, and sometimes we get stuff which is sent in not just a letter but a whole file, a bundle of things, we get this as well. And sometimes there's supporting documents and things, which make you think it's important we look at this really thoroughly. And sometimes, on the surface of it, it's batty and nonsense right from the start.

We got one the other day about below every police station there's an implant cell now—did we know this—where police are putting little objects into people and then sending them out again. So, you know, we take that seriously, but not too seriously. [Interruption] Then there's the ones in the middle, which are worries and we often end up asking for more information or information from the police just to give us some background or other flesh to it. And so in these different ways we try and get a pretty immediate group on whether there is something with validity, or whether it is something that shouldn't be troubling us or the taxpayer. And sometimes we'll make mistakes about that, and sometimes people who get dismissed from us will come again with some other information. So it's a dusty answer because there's no, I think, correct answer. You want to add anything to that?

Baxter Yep. The only point I would add to that, Sir David, is that we frequently conduct an extended assessment of a complaint, especially when the complaint comes from someone we may appraise as being vulnerable in some way or another. These people frequently are the individuals in society who suffer the most. So we do conduct many extended assessments, and there's further information from police, further information from the complainant, and we team them in discussing the matter. So it's a very difficult thing and a very dangerous thing to write off a paper-based
complaint, unless we’re making sure we’re properly informed ourselves before we actually finalise that decision.

Faafoi Can I just go back to David’s question about the perception of independence, and ask you what you think the ideal situation is, in terms of the make up of your investigators, for the public to have that confidence in your organisation?

Carruthers Well, we’ve often been asked about _______. We’re sometimes asked to have a non-ex-New Zealand police investigator, and we have some of those who, you know, can be involved, so that’s one thing, and people are trying to avoid the “mates” notion that can bedevil us in New Zealand, but—so that’s one way that you can do it, and that’s usually very apparent to people who’ve been interviewed by someone with a weird accent. What’s the make up which I prefer? I’d prefer that what we did our office reflected better the make up of New Zealand as it now is, which is changing, as you know. We have a Tokelauan investigator, so, you know, that’s a pretty—

Goff That community must be well over-represented.

Carruthers That’s right—a man for everybody. We have a very limited resource. On a quite small amount of money I think we do a really good job, and when I see us against other international agencies, I think New Zealand is really well served. If we had more money, it would be really good to have some more overseas and recent investigators and a better mix of the racial groups in New Zealand, just to show that in an open way, but it’s about doing the job very well, first, and the colour of the skin, second.

Prosser Yeah, thanks. Supplementary to that, I understand some jurisdictions—some legal jurisdictions in the United States particularly—have investigators who are trained from day one to be internal investigators. So they are part of the policing organisation, but they’ve never been on the front line. Is that something that you would give consideration to? Is that something that has been looked at as well?

Carruthers I think we’ve got very limited ability to train our own, frankly.

Prosser If there was sufficient resourcing, would that be something that would be worth looking at, in order to overcome that perception of—

Carruthers Yeah, it would be. I think the answer for us is to think of ourselves as part of a wider justice sector and to look at our friends in the Office of the Ombudsmen, Serious Fraud Office—other comparable places who do carry out investigations—and to move people around a bit at those places. So I think now that we talk very readily to other Crown entities about this, I think there are people who do investigations, and do them really well, that we could borrow or second or move, and that would give us the sort of environment that you’re talking about.

Prosser And that would be part of your overall mix then?

Carruthers That would be part of the mix.

Prosser Which would help the public perception of this, you know, potential conflict of interest there?
Carruthers: Well, I’m not unhappy with what we’ve got. I just think the point you’re making, about what does it look like, is a really important one.

Prosser: Thank you.

Goff: Just on the cultural mix of what you’re doing. I mean, one of the things that really shocked me was to hear young people talking about their attitude to police, and particularly young people from the Pasifika and the Māori community. And one way or the other we’ve got a problem there, whether it’s of perception and, quite possibly, of reality. Is that the sort of thing that your office could usefully investigate to see, where you’ve got that poor relationship—and it links back to your, you know, alcohol, parties, kids. You know, you understand why that problem is there, but it is how we deal with that. Is that within your remit to something on that, or is that—I mean, if you had the right to launch your own investigation. It’s almost in a preventative sense. It might not be a specific complaint, but it’s something that is a recurring problem out there—kids, you know, talking in derogatory terms about the police and how they’ve been handled. We’ve never really given much thought to that problem and it’s a real one.

Carruthers: We’ve had to think about our core business and our statutory responsibilities, and doing that well, without extending ourselves into more preventive work or doing something extra. I agree that there is a problem about that. In doing our core work really well, it’s important that investigators are able to strike common ground with people they talk to, and if we’re getting a lot of Pacific Island complaints, then the person who is most likely to successfully interview those people, and get information from them, is someone they trust. Obviously, that brings in what you’re saying. Within a small resource, I think, we can do more, but I’m really keen to preserve the excellence of the professional work we do, first, and then start adding value to—

Mitchell: Sir David, could I just ask a quick supplementary question on that, and there’s two parts to the question. The first part is: when you decide to refer a case back to the police—and maybe you could expand a little bit on that process for us—No. 1, how much oversight do you continue to have on that file, and No. 2, I think our police force here, or our police service, seems to be very committed to, you know, take their own reputation fairly seriously, so their investigations, if anything, you hear when they think they’ve got a bad apple, they tend to go after them fairly hard. Is that your experience? Is that what you’re seeing in your role; and also, just going back to what is the relationship between your office and the police when a case is referred back to them?

Baxter: Well, the relationship varies depending on the nature of the complaint and the nature of the investigation that is required. We can refer a matter back that we believe is suitable for conciliation because it is a very minor complaint with regard to rudeness or something, a relatively straightforward event. That relationship goes from almost no involvement apart from the initial letter requesting an independent officer to be brought in, to make sure the conciliation occurs, to us having active oversight of an
investigation and being involved on an almost daily basis, getting regular updates and providing some suggestions and direction as to how we think the investigation should be progressed. With regard to the police’s view of their own officers, when they do have a suggestion or an indication of criminal behaviour by one of their own officers, I would agree with you. They do take it very seriously and they conduct very forthright and strong investigations to identify those and remove them from the force.

Faafoi  If you were able to initiate your own investigations, given what you’ve seen over the last 12 months, how often would you think you would use that power?

Carruthers  Rarely. I would have thought that it’s a residuary power for us, to be used at a high level. Otherwise it would become silly. But it just disturbs me when something is in the paper all the time about police conduct, we’ve had no complaint, and I feel slightly foolish that we don’t have any ability to step in and look at it ourselves independently.

Faafoi  Was that Red Devils incident in Nelson, where you had a situation where a judge made comments about the police behaviour—was that the kind of thing you’re talking about?

Carruthers  Not really, but that’s actually not a bad example where there’s been judicial comment about police behaviour, no complaint, and so we just sit there waiting for someone who we think is sufficiently important to write to us. And sometimes they don’t, because it’s strategy or a tactic to get some other advantage. So, you know, people talk about complaining, but don’t actually ever do it, but it is for the purpose of some other game that is being played. So we’re not innocent about all that, but it would be useful from time to time, I think, in a small number of cases, for us to be able to say: “Right, we’re stepping in here. Let’s have a look at the file.”

Mitchell  Sir David. Thank you. We’re just about out of time. We’ve got time for one more question. Anyone want a go? Right. Thank you very much for coming in. Thank you very much. Thank Mr Baxter and Mr Smith also. We very much appreciate it.

Carruthers  Thank you Mr Chairman, Thank you members for being so gentle with us.
2011/12 financial review of Industrial Research Limited

Report of the Education and Science Committee

Contents

Recommendation 2
Introduction 2
Transition to Callaghan Innovation 2
Casual employees 2
Interaction with business 2
Christchurch rebuild 3
Appendix 4
Industrial Research Limited

Recommendation
The Education and Science Committee has conducted the financial review of the 2011/12 performance and current operations of Industrial Research Limited and recommends that the House take note of its report.

Introduction
Industrial Research Limited (IRL) was a Crown research institute, which sought to increase the contribution of industrial manufacturing and associated sectors to the economy. From 1 February 2013, IRL became a subsidiary of Callaghan Innovation, known as Callaghan Innovation Research Limited. Since the merger, the management team at Callaghan Innovation has been conducting a capability alignment project, to determine which parts of IRL it should retain and which parts should be relocated, either to another Crown research institute or to a university.

Transition to Callaghan Innovation
We were interested to learn more detail about the transition. We heard that only three positions from IRL were not transferred to Callaghan Innovation: Chief Executive, Deputy Chief Executive, and Executive Officer. All other positions, filled or vacant, were transferred to Callaghan Innovation, and everyone who was employed by IRL on 31 January 2013 is still employed by Callaghan Innovation. We heard that the budget for the merger was $3 million; the final cost has not yet been calculated, but Callaghan Innovation is confident it will come in under budget.

Casual employees
We noted that the number of casual employees at the organisation had increased over the past five years and asked whether there had been a corresponding reduction in full-timers. We heard that more casual employees were employed to complete specific tasks, such as building prototypes for different projects. Typically such specialised skills are needed only intermittently, so the organisation relies on contractors for them. We were assured that over the same time there was a significant increase in full-time employees.

Interaction with business
We asked about the organisation’s interaction with the business sector. We were told that it has a dedicated industry engagement team, which often visits businesses, either cold-calling, or in response to requests from businesses or referrals from other government agencies or economic development agencies. Once the team has established a relationship with a client, it will discuss potential engagement. The client will then meet with the research and technical staff at Callaghan Innovation Research Limited about the specific project, after which it will sign a contract for services with the business. Callaghan Innovation Research Limited is seeking to increase its interaction with firms.

We also heard that Callaghan Innovation Research Limited has engaged with all universities, but specific reference was given to the relationship established with the engineering department at Auckland University, with the purpose of encouraging students.
to pursue post-graduate studies in engineering and then helping them with job opportunities. Callaghan Innovation Research Limited has not yet started to offer scholarships to students in this area, but will consider the possibility.

**Christchurch rebuild**

We heard that Callaghan Innovation Research Limited has been working to increase its presence in Christchurch, and sees the rebuilding of the city as an exciting opportunity. Callaghan Innovation Research Limited has created two new research groups in Christchurch; one targets manufacturing in the region, working particularly with small- and medium-sized enterprises, while the other is a science and chemistry group at Canterbury University. Both of these teams are proactively seeking businesses to work with in Christchurch. The plans for the Christchurch CBD include an innovation centre, and Callaghan Innovation is planning to be at the centre of it.
Appendix

Approach to this financial review

We met on 27 February and 20 March 2013 to consider the 2011/12 financial review of Industrial Research Limited. We heard evidence from Callaghan Innovation Research Limited and received advice from the Office of the Auditor-General.

Committee members

Dr Cam Calder (Chairperson)
Catherine Delahunty
Hon Jo Goodhew
Chris Hipkins
Colin King
Tim Macindoe
Tracey Martin
Sue Moroney
Simon O’Connor
Dr Megan Woods

Evidence and advice received


Organisation briefing paper, prepared by committee staff, dated 26 February 2013.

Industrial Research Limited, response to written questions 1 to 115.

Industrial Research Limited, response to written questions 116 to 125.
# Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation</td>
<td>2</td>
</tr>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Orcon</td>
<td>2</td>
</tr>
<tr>
<td>Risk management</td>
<td>3</td>
</tr>
<tr>
<td>Digital services</td>
<td>3</td>
</tr>
<tr>
<td>Gearing</td>
<td>3</td>
</tr>
<tr>
<td>Labour Party minority view</td>
<td>3</td>
</tr>
<tr>
<td>Appendix A</td>
<td>5</td>
</tr>
<tr>
<td>Appendix B</td>
<td>6</td>
</tr>
</tbody>
</table>
Kordia Group Limited

**Recommendation**

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of Kordia Group Limited, and recommends that the House take note of its report.

**Introduction**

Kordia Group Limited provides transmission, operations and maintenance, telecommunications, and internet services; it is the parent company of Kordia Networks, Orcon, Kordia Solutions Australia, and Kordia Solutions New Zealand. In the 2011/12 financial year, it recorded a net profit after tax of $12.102 million. Its board chairman is David Clarke, and its chief executive during this financial year was Geoff Hunt, who finished in March 2013. His role was disestablished, and the chief executives of Kordia Solutions Australia and Kordia Solutions New Zealand now report directly to the board.

**Orcon**

Kordia is negotiating with various parties with a view to selling Orcon, an internet service provider. It is under significant pressure to sell from would-be owners, but said that it would sell only for an appropriate price.

We acknowledged that an asset may be more valuable and realise greater gains for another owner; nevertheless, as it is a sizeable and growing part of Kordia's operations, we wondered whether it would be better to retain Orcon than sell it.

We heard that next financial year Kordia will lose up to 40 percent of its cash flow, as a result of the cessation of analogue television, and the sale of Orcon would help to consolidate the business. Also, there are pricing pressures in internet service delivery, and strong competition from the major telecommunications companies. Kordia believes it is therefore appropriate to seek the best strategic acquirer of Orcon.

If Kordia were to sell Orcon, we asked how it would redeploy the proceeds from the sale, and heard that it would consider three options. First, it would consider investing in other parts of the business to counteract the loss of analogue television, preferring investments in initiatives that do not compete with large multi-national companies, so that the business could grow. Secondly, it would consider retiring debt, and finally, it would look at paying a special dividend to shareholders. We asked whether investing in another form of internet service provision was an option, and heard that Kordia would not discount the possibility, but would consider the business case at the time.

**Other sales**

We asked whether Kordia is considering selling any other parts of its business, and were told that it would not rule it out. Kordia said that on average it is approached once a month about selling various assets, but not its core asset, the digital television network. The sale of a block of unutilised radio frequency spectrum management rights is being discussed; because the proceedings are confidential, Kordia cannot comment further.
Risk management

We asked about the long-term risks to Kordia, and how it is managing them. We heard that its main risks come from the large contracts it enters into, such as a $100 million contract to design and construct the entire communications infrastructure for a coal seam gas project in Queensland. To offset these risks, Kordia plans to use the knowledge gained from the Queensland project to initiate similar projects elsewhere, spreading its investments wider. It is also diversifying its telecommunication services in the Australian market, which offers more opportunity for growth than New Zealand. Such services have the potential for rapid revenue growth, and Kordia has planned its largest-ever investment in telecommunications infrastructure in the next 18 months. Kordia believes that in the longer term its Australian investments may provide an increasingly large component of its revenue.

Digital services

By the end of 2013, all of New Zealand will have switched to digital television. Apart from diversifying into telecommunications, we heard that Kordia has been planning for this change for several years. We heard that it has secured digital television transmission contracts, but does not expect this alone to deliver enough revenue to replace the analogue system. Kordia has developed products for delivery through the digital television network, in which it has already invested about $13–14 million to develop this platform. The acquisition of Orcon increased its capacity to deliver content over broadband to new residential customers, and maintained its focus on servicing the rise in corporate use of broadband.

Business strategy

We discussed with Kordia the possibility of convergence of the broadcasting and telecommunications sectors. The two sectors are regulated differently, but we heard that this has not concerned Kordia; numerous broadcasters want space on its digital terrestrial television platform, and there is also growth in content distributors seeking to deliver content via its telecommunications network. It said that it could face competition from companies delivering content via the broadband infrastructure, but this has not affected its strategy.

Gearing

We asked what discussions Kordia has had with Ministers. The Kordia chairman said it has discussed improving its performance, but he could not recall discussions with Ministers about dividends, which is a decision for the board, or about increasing its gearing. Kordia noted that it was well inside its gearing ratio covenant and stated that it was quite comfortable with the current gearing ratio. We also asked whether Kordia agrees with the imposition of uniform gearing ratios on state enterprises, and heard that it does not because each business has different risks and capital requirements. Kordia agreed that a gearing ratio should be “fit for purpose”, but also noted that there are different definitions of gearing.

Labour Party minority view

Labour members noted that the Government had formally, by letter and by meeting, requested that all state enterprises, including Kordia, increase their dividend pay-out to the
Crown, and further that there be a uniform gearing ratio of 40 percent across all state enterprises.
Appendix A

Approach to this financial review
We met on 21 March and 11 April 2013 to consider the financial review of Kordia Group Limited. We heard evidence from Kordia Group Limited and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received
Kordia Group Limited, Responses to written questions, dated 1 March and 4 April 2013.
Appendix B

Corrected transcript of hearing of evidence 21 March 2013

Members
Hon Clayton Cosgrove
Kanwaljit Singh Bakshi
Clare Curran
Dr David Clark
Julie Anne Genter
Peseta Sam Lotu-Iiga
Todd McClay
Mark Mitchell
Dr Jian Yang

Witnesses
David Clarke
Geoff Hunt
Shaun Rendell

Cosgrove
Can I thank you, gentlemen. We’re just sorting out a couple of minor procedural matters. I must say, to use the words of the new Speaker, “New Chair, new style.” So thank you for allowing us to just talk amongst ourselves, like church. We’ll be allowing 20 minutes for you guys. How you use that is up to you. I’ll refer to the senior member here, and it’s over to you. Unlike the other chair, we operate differently. Gentlemen, we’ve got 60 minutes with you—in fact we don’t. Do we? We do. We’d appreciate a short presentation, not War and Peace, because my colleagues will have questions. So if you limit that to about 5, and then we’ll go from there. We’re in your hands.

Clarke
Thank you. I’d like to introduce the team here. [Introductions.] Thank you very much. We’ll give a—I don’t know if it’s 5 minutes, but we’ll try—presentation to the committee.

Cosgrove
I’d like it to be 5 minutes, chief, because these guys will have questions, but away you go.

Hunt
In terms of the presentation, to get that on the screen—can somebody do that for me?

Cosgrove
Do we have an operator for the screen, do we?

Hunt
No, I think we gave everybody hard copies, and I passed them out to members yesterday.

Cosgrove
OK. [Interruption] No, we’ve got hard copies.

Hunt
No, I was told that you guys have hard copies.
Siebert (Clerk) OK, so you’ve all got hard copies of the presentation?

Hunt If I can just take you through the presentation. We’ve got some more copies here, if anybody is missing them. They look like this. Does anybody need one? You’ve all got copies? Yes, great.

First up I would just like to introduce Kordia, so you’ve got a good understanding of the business. Kordia is a telecommunications business. It is a network-centric business. More than half our revenue comes from our engineering and field services operations in Australia. We are best known for television transmission, and a lot of TV transmission, digital TV transmission, the original reason for being for the business. We deliver content from sports events, live content, to the broadcasters both here in New Zealand and overseas. We had a pretty key role in the Rugby World Cup in terms of getting the content out to the viewers, and we operate Parliament TV.

Cosgrove That’ll be a big money-spinner.

Clarke Very popular.

Hunt It’s not, but the actors are free in this case. We provide maritime services. So we listen for ships in distress, covering a quarter of the world’s oceans. We operate out of both Australia and New Zealand to provide that service. We have a system whereby we track shipping movements in New Zealand coastal waters, and provide that data to Government agencies and others. Our highest growth area in the network business is in what we call our customised data services, and we provide those data services to companies that see communications as business critical—so a very high standard of service. Just to make that sound a bit more real: we provide national and international wide area networks. So, for example, we connect up the offices of Tourism New Zealand around the world, and once they’re connected they can run voice video and data over those networks.

Our engineering and field services business is where most of our staff are employed—about 800 staff between New Zealand and Australia, most of them in Australia. We do high-end engineering design for telecommunications networks, and have a large team of technicians who build and maintain those networks. I just want to talk to you about two projects that we are undertaking at present, because they demonstrate the capability of the business. The first one is the APLNG coal seam gas project in Queensland. It’s that particular photo there. It is very difficult for us to convey the scope of that job in one picture, because the coal seam gasfield covers an area two-thirds the size of the South Island. The project is an A$32 billion—Australian dollars—development. Our contribution to that project is a $100 million contract, and that is for the design and construction of the communications infrastructure for that whole project.

Curran What’s it called, again?

Hunt It’s the APLNG coal seam gas project in Queensland. So that’s at one end of the size of the project that we can undertake. At the smaller end, this particular photo here is of a job we’ve done for a customer in PNG. The
challenge for that project was the customer wanted to provide wireless broadband services in a remote part of PNG. It is part of an educational institute. PNG isn’t the sort of place that you can ship in engineers and technicians and find construction materials on hand. So our solution was to actually build the whole base station into a shipping container, in our Christchurch facility, so the shipping container is fitted out with the electronics, with the back-up diesel generator, and so on. Then we left sufficient space in the shipping container, such that we could put the solar panels and the antennas and so on that you can see in this picture here into the container. That was shipped to site. The container was mounted on foundations that were prepared by a local construction company, and it was a matter of opening the doors of the container, getting out the solar panels, putting those in place, erecting the antennas, waiting for the sun to shine to charge the batteries, and the first call was a video call from a remote part of PNG to our offices here in New Zealand. That is another example of the kind of project we can undertake.

We own internet specialist Orcon. Orcon has about 60,000 customers—a good growth story there. The final part of my portion of this presentation, before I hand over to Shaun, is the next three slides. Going back about 7 years, the future for Kordia was actually quite dire. For that first column—so this is EBIT, profit before interest and tax—we were delivering a profit of $24 million, but we could look out and see that a business we had in Australia was going to be in-sourced by the customer—$6 million of EBIT was going to disappear per year. We had a very nice contract with Telecom New Zealand that was going to come to an end—a further $6 million of EBIT would disappear. And analogue television, which was the mainstay of the business, was going to be turned off around about now. At that point there would have been about 0 EBIT for a company that did have bank loans to service. So we had time.

We commenced a project, which we eventually called the “broadcast to broadband” transformation. So the broadcast business was actually in decline. We had to shift the business into a modern telco—and we call it the broadband space. We bought businesses and we developed new products and services. That has really been the task for the last 7 years.

Unfortunately, we’ve only got black-and-white copies, but on this chart here the grey colours down the bottom are the original revenues from the original businesses. The colours—if you can see the blue here, that is the new Australian business, the business we acquired in 2006, and you can see how we’ve achieved quite dramatic growth in that business. It was acquired at about $60 million turnover, and had a turnover of nearly $200 million in the last year. The magenta colour is Orcon.

Lotu-Iiga Is that KS you’re referring to, the Australian?

Hunt Correct, yes. That’s correct, yes, KS is the Australian business. The orange, which—KM New, you’ll see down here, they are the new products and services we’ve developed and are selling off our Kordia networks business in New Zealand. So the nature of the transformation is that 60 percent of the revenue, roughly, now is from sources, services, and products that we
didn’t have in the business 6 years ago. So the business is now in a position where it’s got a viable future, and quite a different product set to operate from. This next slide is quite interesting.

Cosgrove

Sorry, gentlemen, I’m going to ask you to turbo-boost it a bit. We’ve got limited time on it.

Hunt

OK. We’ve got about three or four slides to go. This next slide is total shareholder return. Total shareholder return is one of Treasury’s prime measures of SOE performance. It’s a combination of valuation implement year on year in the business and dividend paid. We’ve just used the COMU data from their annual report. We listed the SOEs in order, covering the last 3 years, and we find that Kordia is a leading performer in terms of total shareholder return. So that’s really the transformation story, taking the business from a point where it didn’t have a future to one where it has a future and, in terms of that measure, is performing very well.

Lotu-Iiga

Sorry, the 44 percent in brackets, can you just—you’ve got an asterisk on the 7. What’s that?

Hunt

Yes, sorry, I should have covered that point. In FY11 we had an impairment charge of about $30 million on the business.

Lotu-Iiga

Yes, I’ve remembered that, yes.

Hunt

That was the analogue TV being turned off earlier than we had planned for. So the negative 44 is the impact of the analogue TV impairment charge. Seven percent is what it appears to be if we take that out.

Lotu-Iiga

If you’d taken that out of the accounts?

Hunt

Yes.

Lotu-Iiga

And there’s no impairment charge this year?

Hunt

Correct.

Rendell

Thanks, Geoff. We’re just conscious of time. I mean, obviously, 2012 was a very strong year for Kordia. We did over 35 percent revenue growth year on year from the prior year, and a net profit after tax of $12 million, which, compared with the reported number, was a loss of $15 million as a result of the analogue switch-off impairment charge that was in the 2011 year, as Geoff just previously mentioned, so a really strong year. Australia in particular was strong. It grew by 65 percent revenue growth in 2012 over 2011, as we’ve won some of those large projects, and Geoff gave you an overview of the key one there, which was the APLNG one. So I’m happy to take questions on 2012. I’m conscious of time, so I’ll probably just skip to the half-year result for this year—

Lotu-Iiga

Oh, no, just really quickly, do you have an interest cover ratio that you use?

Rendell

Yes, we do. We have bank covenants.

Lotu-Iiga

How are they going?

Rendell

We have sufficient—

Clarke

The target’s three, and we’re at nine. Way above.
Lotu-Iiga Yeah, that’s good.

Rendell Just turning over to the half-year result—again, we’ve just recently reported our half-year, so, again, a pleasing result. Our revenue is up 6 percent for the half-year over the prior year, so we’ve still got continued growth in Australia, which is now offset, obviously, as we’re losing some revenues with the analogue switch-off, which is, you know, due to commence and complete this year. And on an adjusted NPAT basis there you can see we’re in line with the prior year. We have adjusted the prior year for a one-off settlement we received in the first half of 2012. So overall, we’ve continued to generate strong cash flows and manage our banking arrangements and how comfortable with our debt position that we have today.

Curran I’ve got a few different tracks of questioning, but I’ll start with Orcon, given that I don’t think it’s any secret that there is, and I think it’s confirmed by Kordia, that there are discussions in track to sell Orcon. Orcon’s one of your most successful parts of your business, and—

Clarke Most what, sorry?

Curran Successful parts of your business, yes?

Clarke Depends on what measure you use to analyse that. I’m happy to talk about the issues that Orcon face—

Curran Let’s just leave that to one side for a minute. I mean, it’s been very aggressive, and, you know, I’d like to compliment you on its performance and its, I guess, being aggressive, or assertive perhaps is the better word, in the ultra-fast broadband market as being out there as one of the first telcos which is offering product, is signing people up, and has, as I understand it, perhaps the bulk of those 3,806 people who are actually connected to ultra-fast broadband. In that environment, when it’s nimble, it’s flexible, it’s got a very hungry attitude, do you not see it as a strategic asset that is a useful one for the company going forward and to build, and, you know, particularly given this chart here, which, sorry, I don’t have in colour, but where Orcon is, you know, is a substantial and sizeable part of your operation, that it would not be a more sensible thing to hang on to it?

Clarke Well, thank you very much for that. Let me start the rationale of what triggered the interest in Orcon, and, fundamentally, next year we lose significant revenue. We lose 40 percent of our cash flow from analogue TV going off. We therefore had a strategy to consolidate our businesses, reduce costs, you know, to try and deal with that, as good businesses do. And the consolidation of Orcon and the networks business as one new entity, sparked—taking costs out—a lot of interest from the market. Therefore we got a lot of inquiries as to, you know, “Why are you doing it?” and “We’ve always been interested in Orcon.” So we are under significant acquirer pressure for Orcon. So that’s the first point. Second point: it comes down to price. There are some prices where even a strategic asset, if it is, is worth selling. Sometimes it is worth not. And so we’re debating that as good businesses do. The issue that’s current on the market is that it is extremely volatile. We now have not three but two major players, Vodafone and
Telecom, with very large advertising budgets. And if you watch the TV advertisements, you could argue now for broad vanilla ISP services. It's almost a race to the bottom. So they have large balance sheets, can raise capital. What we do have, and you're entirely correct here, is that we are quicker and, we like to think, smarter.

Curran That's right, and isn't it that, as a Government-owned asset, would it not make more sense to have a lever that can be used to ramp up the connectivity? That would seem to me that that is a strategic decision. So my question is, you know, you're talking about: “Oh, well, you know, if we get an offer too good to refuse, you know, maybe we shouldn’t refuse it.”, and whatever. Is your strategy around selling Orcon, then, to retire debt?

Clarke No.

Curran Is that part of your debt reduction strategy?

Clarke The issue of Orcon is, one, there is significant acquirer pressure, and we have to look at that. Second issue, though: the market is intensifying, OK? Broadband in all reality we price cheaper than copper. We’ve invested heavily in copper. It’s our competitive advantage. So while we think it’s quick and nimble and, you know, we think better product development, it has got some future issues of how it’s going to compete with the two giants in particular, and that’s our biggest concern strategically.

Cosgrove Supplementary, Sam Lotu-Iiga.

Lotu-Iiga Sorry, are you finished?

Curran I want to keep going on this one.

Cosgrove Just a minute. We’ve got a supplementary question. Entitled to a supplementary.

Lotu-Iiga Yeah, I mean, just that, to flesh this out, you know, the strategic positioning of—so you’re saying the growth prospects aren’t high and that Miss Curran said that it’s important in terms of the revenue, but how important is it in terms of the profit and the growth prospects of Orcon?

Clarke Well, with the—

Lotu-Iiga In a sense, you know, the profit?

Clarke Well, it’s grown very—the thing about Orcon is that it’s innovative and grows fast because it’s a great brand. So let’s tick that box. The other issue, though, is, as I said before, there are huge pricing pressures in delivering that both in terms of the current copper offering and the ability that fibre will be priced less. So we have to look long term. Now, of course we’re going to back ourselves if we kept the asset to compete with those, but we’ve got heavy marketing expenditure we’re going to have to invest, and if you add this all up, then it is, you know, we do have to look at the best strategic acquirer for that business.

Curran So this is a growth business, and you are selling a growth business. You are looking at selling a growth business, so where is the future growth and
returns for the shareholder; and are there and have there been any other interest in selling or approaches to buy any other parts of the business?

Clarke  On the first—

Curran  And that’s two questions.

Clarke  I understand that. On the first issue, we are a growth business because we have underlying growths.

Curran  I’m talking about Orcon as a growth business.

Clarke  But the other—if I could just reiterate, the fastest-growth business we’ve got is the Australian business. You’re talking about business that grows. Mobile is growing 70 percent compound annual growth rate a year. So while Orcon is growth, we have other businesses that are growing quicker. And you have to allocate capital for the best return, so that’s the first thing. Your second question—not explicitly. We do get inquiries from time to time, and, as I’ve said, as business people in charge of getting a return on assets, we do look at those from time to time.

Curran  So have you had any interest in any other parts of the business at this point?

Clarke  Recently?

Curran  Yes.

Clarke  Yes, we do. We’ve had inquiries on certain parts.

Curran  Which parts? Are you in negotiations or discussions for sale of any other parts of the business?

Clarke  No. No. We’re not.

Curran  Has there been any discussions with regards to sale, whether there are negotiations or not, for the Australian part of the business?

Clarke  No. We’ve been approached from time to time for Australia, but we’ve got no negotiations at this point in time. You must understand—when you grow so fast, people do approach you. And that’s fine.

Curran  So, turning to copper, because you mentioned copper and the importance of the copper part of your business, are you concerned and what is the level of your concern at the recent announcement by Amy Adams, the Minister of the telecommunications review, which is bypassing the decision of the Commerce Commission on the copper prices—wholesale copper prices?

Hunt  Yep. Clearly, it’s going to have a fundamental impact on the future of the business, so we’re keen to get to a position where we know what the future is.

Curran  Do you feel that there’s a high degree of uncertainty that this has created?

Hunt  Look, the industry is uncertain. We live in uncertainty, so it’s just another one of the impacts of being in this industry.

Curran  Well, I think it’s really important to be clear on this, is that, was the commission’s draft decision an expected—not necessarily what the outcome of its decision was, but the fact that it was undergoing a decision
that the copper prices were likely to drop—was that an anticipated part that you factored into your business strategy?

Hunt In terms of developing the business strategy, we do try and pick where trends will go.

Curran So is that a yes?

Hunt Well, no, I’m giving you a qualified answer here. But there is so much uncertainty. Draft determinations come out, then there’s a year-long process before they become final, so we tend not to build in draft determinations into our planning.

Rendell We didn’t build in that reduction in our business plan.

Curran But now you’ve got another review that’s been announced, so has that added a degree of complexity and uncertainty?

Hunt No more complexity than we’ve lived with for the last 5 years.

Curran So you have no concerns at all about the review that’s been announced by Amy Adams?

Hunt We always have concerns about where the regulator, the Government in this case, is going to go, but it’s the environment in which we live.

Curran OK. All right. Well, just a series of hopefully yes/no questions. Do you agree that the advent of digital has or soon will lead to technology convergence across most aspects of telecommunications and broadcasting, including transmissions networks and distribution?

Hunt Yep.

Curran Yes?

Hunt Yes.

Curran So when Kordia provides digital telco services, is it regulated under the Telecommunications Act?

Hunt So we’re regulated under the Telecommunications Act, yes.

Curran When Kordia provides digital services to broadcasters, is it also regulated under the Telecommunications Act?

Hunt Not as far as I’m aware, other than in terms of using the telco network to deliver that content we’ve got to comply with the telecommunications regulations.

Bakshi My question is, as the digital switchover is going to happen in 2013, what strategies you have in broadcasting to update the change on that on that?

Hunt OK. So we knew that analogue TV was going to be turned off around about now, 5 or 7 years ago. So the whole point of our “broadcast to broadband” transformation was to accommodate that change that we saw coming. Does that answer your question?

Bakshi Basically, I want to know what further plans you have—

Hunt Other plans?
Bakshi —to accommodate all that.

Hunt OK. So we went for and secured the digital TV transmission contracts, but there’s an expression that says analogue pounds become digital pennies, so you don’t make nearly as much out of the digital TV services. We knew that content was going to be delivered over copper and fibre, and hence the Orcon acquisition was part of being able to service customers by serving content over copper or fibre in terms of residential customers. We also saw a big shift in terms of business use of broadband infrastructure, and that’s actually been a key focus for the business.

Bakshi So what sort of investment has been put into this strategy?

Hunt Right. OK. I don’t have the numbers in terms of total investment.

Clarke We can estimate it, but we have developed off the platform which is going to deliver the digital TV network, we’ve developed network types of products, to manage network bottlenecks and make it more efficient for people, particularly the small-medium enterprise. That business we’ve got is growing at about 100 percent a year. And off the top of my head I estimate that we’ve probably invested something like $13 million or $14 million in developing that platform over the last 4 years. We’re very pleased with it. It’s one of the key growth structures to get over the switch-off of analogue.

Bakshi Thank you.

Mitchell Yeah, firstly I want to congratulate you on your results.

Clarke Thank you.

Mitchell They’re excellent. And they do mean, obviously, that you are returning back to the Government. But I just want to talk a little bit about risk, and you spoke about the APLNG contract, which, obviously, is a very good contract worth $100 million over how many years?

Clarke About one and a bit years.

Mitchell One and a bit years. But, you know, for a company your size, if something goes wrong with a contract like that, it can have a fairly big impact. How are you sort of managing those types of risks?

Clarke That’s a very good point, because you’re absolutely right. I mean, out of a $200 million dollar business, you’ve got $90 million. There’s two ways we do it. One is we actually have now in the mining vertical, with APLNG, we actually have a deliberate strategy to use the knowledge—we used to gain APLNG—into other mining projects, and I would say right now we have got probably $200 million to $300 million of other projects we’re bidding for in that sector. That’s one way. The other way we deal with a lot of telcos in Australia—there’s a lot of telcos in Australia; it’s a lot more diverse than here—so we’re moving our business and offering different services to those as well, trying to diversify our platform.

Mitchell And just the last thing, just very quickly, the mobile unit that you’ve developed that you can sort of put into a container and take it to Papua
New Guinea and unpack—is that part of the business that you see some real potential in developing? Is there some growth in there?

Hunt Yes, we see potential, but we don’t expect a large amount of growth in that area, so for Pacific Islands territories such as PNG, it tends to be quite slow moving. So that’s a product we’ve put out there. I’d like to think we’ll sell a number of copies of that.

Mitchell Is it in your marketing plan for that?

Hunt Yes.

Mitchell Are you looking at going more global, or are you still very focused on—

Hunt It’s really Pacific, round to PNG, and a little bit in Asia. We’re actually doing a job in Albania at present, but it’s a job where we’re providing some very specific consulting advice.

Mitchell And, sorry, just very quickly, you’re monitoring coastal shipping and ships and things like that in terms of if they get into trouble. Does that cover as far as the Horn of Africa? Are you sort of in that—

Hunt We go halfway across the Pacific, down to Antarctica. I can’t recall how far to the west. But the world’s divided into, I think, about seven or 12 blocks, and we’ve got two of those blocks.

Mitchell I was just interested in terms of whether you guys see whether you’re carrying any risk in actually having oversight on the welfare of some of these ships, especially if they’re moving through high sort of piracy areas like the Horn of Africa.

Hunt OK. So we’re not monitoring those areas.

Mitchell You’re not?

Hunt No.

Mitchell OK, that’s fine.

Yang Basically, I’m happy to see a New Zealand company investing in Australia, because very often it’s Australian companies investing in New Zealand. How long have you been operating in Australia?

Hunt The predecessor to Kordia was THL Group, and that was split off Television New Zealand. I’m not sure which year it was, but I’d be thinking maybe 20 years ago—15 to 20 years ago. There was a company established in Australia called Television New Zealand (Australia) Ltd. So that was the original business—

Cosgrove Sir, could you just speak into the microphone? The acoustics are a bit—

Hunt Yes, sorry. The original business in Australia, established about 15 or 20 years ago, was called Television New Zealand (Australia) Ltd, and that got that company operational in Australia. Off that experience we bought another business in 2006—sorry, 2005—and that is the business that we’ve taken forward. The first one operated in the broadcast sector. This one operates in the telco sector.
Yang Yes, looking at the last year’s revenue, I find that your Australian side is making more revenue—

Hunt Yes.

Yang —of $80 million. And your understanding of Australian prospects, your gross product has been quite strong. But for the second half of this year it’s going to be softer.

Hunt Yes.

Yang My question is: what are the real risks in the longer term—what do you see are the real risks in the longer term? Secondly, are you going to see the Australian business as being the main source of revenue in coming years, for how long, or do you believe your New Zealand business will create more revenue in the end?

Clarke Let me answer the first question about risk—and I think Mr Mitchell asked a question. Yes, with these large contracts we’ve got to be very careful, we understand that. There are big working capital requirements for those large contracts. As I said, we’re diversifying—the answer I gave previously. I think long term getting into the Australian mining vertical, resources vertical, is a very strong strategy. It does have the risk of commodity pricing in China, but we understand that. Longer term in Australia—well, it could well be. Currently it’s a large component of our business, if not the largest revenue, and if we’re successful with the growth in economy and the multitude of diversification of telecommunication companies in there, and their huge broadband roll-out as well, and their requirement of mobile, because of the vast distances. We’re very good at mobile. I wouldn’t be surprised if it dominates this business for some time to come.

Mitchell You’ve got a strong pipeline, though, haven’t you?

Clarke Yes.

Yang So you still believe that the Australian part of your business will continue to be a major source of revenue in the coming years?

Clarke Yes.

Hunt If I could just give you an example: to tender for work in New Zealand, for our New Zealand engineering and field services business, for a particular block of tendering effort we might secure a $100,000 contract. For the same amount of effort in Australia we may secure a $2 million or $5 million contract. So it’s an attractive market for us to be in.

Lotu-Iiga Just in terms of managing that, given your exposure to commodity price risk and exchange rate risk, you’re comfortable with the risk management on those things?

Clarke Yes, there’s a lot of natural hedging.

Genter Thanks for your presentation. I want to track to the potential sale of Orcon. I was just wondering if—I note that when Orcon came on it provided some greater competition in terms of ISP providers. If Orcon is sold, is there any risk, do you think—I know it has only, what, 5 percent of the market share,
which is pretty significant, but at the margin it’s been really good at introducing greater competition.

Clarke: We would prefer that it stayed in competition with the large incumbents. We would prefer that.

Genter: If Orcon is sold, what was the way in which you were thinking of redeploying the proceeds from that sale?

Clarke: Two ways. We would look to—sorry, three ways. We would look to invest more heavily into dealing with the switch-off of analogue television, and that’s particularly not in the Australian business, actually, but in the New Zealand business, product development. We would look to retire some debt. And, if it is sold, we would look at whether in fact we could pay a special dividend. We would look at all those.

Genter: But you wouldn’t be moving in some other way into ISP provision, it would be moving completely away from that?

Clarke: Well, it could be. It depends on the ability of the new product development pipeline of the remaining New Zealand business, and we have got some good ideas and opportunities there. So we would weigh all those up, if and when it happened, as is normal business practice.

Curran: So you are confirming that, through the sale of Orcon, there will be some retirement of debt and a return, a dividend, to the Government?

Clarke: No, I’m not saying that. What I’m saying is, if any asset of that size is sold, what we will do, like any business should do, is look at the following: reinvesting in the business, retiring debt, and/or paying dividends to shareholders. We haven’t made any decisions on that whatsoever, because it hasn’t been sold.

Hunt: They’re options.

Clarke: They’re all options.

Genter: What are the main considerations that you’re weighing up for potential sale—like how would you make that decision?

Clarke: I think the key one is, basically, because the analogue switch-off is such a critical thing to us—we lose 40 percent of our cash in 1 year—our inclination is to reinvest in our product pipeline in areas where we don’t have to compete in commodities with very large multinationals in New Zealand. That is where we’d like to go—to build the business.

Genter: To build the business—you’d be selling Orcon to build the business in other ways?

Clarke: Selling any asset.

Genter: Yes, selling any asset. But considerations about, for example, the competitiveness of the market for ISP and consumers in New Zealand are not going to come into play in your decision making—that’s not a factor?

Clarke: Could I—I just didn’t quite understand the question, sorry?
Genter Sorry. So the main considerations are going to be building the business and the dividend, there is no consideration about the benefit to New Zealand of having an additional player on the ISP market?

Clarke No, it’s not the top priority for us, no.

Curran Just turning to Orcon, are you close to announcing a decision on the sale of Orcon?

Clarke No.

Curran And the comment—

Clarke Right now it doesn’t appear we are. Capital markets are a funny thing. We are getting inquiries about quite significant parts of the business not infrequently.

Curran But you’re in negotiations with one particular organisation?

Clarke We’re not in negotiation with one; we’re actually in negotiation discussions, if I may say, with several, as we speak.

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Curran OK. And the comment—

Clarke Right now it doesn’t appear we are. Capital markets are a funny thing. We are getting inquiries about quite significant parts of the business not infrequently.
Clarke: The Australian business?

Curran: Yes.

Clarke: No. To be honest, we have been approached for that from time to time as well, from various large entities in Australia and overseas.

Curran: OK. So, just going back to what I was asking before around the regulation within the telco sector and the lack of regulation in the broadcasting sector, would you accept that that is inconsistent with the trend towards convergence between broadcasting and digital?

Hunt: Umm.

Curran: I really do want a yes or no answer.

Cosgrove: We all hope for that.

Hunt: We can’t say “not sure”? It’s hard to give a yes or a no, because we haven’t actually gone down that path. The broadcasting market is quite a vibrant market, with numerous broadcasters wanting space on our digital terrestrial TV platform. We equally see the growth of content distribution networks to deliver content from broadcasters over fibre—or over around the telco network. So whether it is inconsistent or not is something that hasn’t actually troubled us.

Curran: Is that a matter that you would advocate should be addressed in this review of the Telecommunications Act?

Hunt: It’s not something that is top of mind for the company, and it isn’t part of our thinking.

Curran: It’s not part of your thinking?

Hunt: Correct.

Curran: So how many companies, how many other companies, do you compete with in providing digital terrestrial broadcasting services?

Hunt: So the—Kordia owns the platform that covers, from memory, about 78 percent of the country, and another company covers the next portion, but it doesn’t get to 100 percent coverage for digital terrestrial TV. Kordia has the head lease on the satellite transponder capacity for the satellite-delivered digital TV transmission.

Curran: But you control the best broadcasting and established locations throughout the country, that would be correct, wouldn’t it, to say? So, in order to—any competitor essentially has to deal with you to get access to those sites, yes?

Hunt: Yes, the—

Mitchell: Sorry, could I interject here just for a second because—

Cosgrove: No, you can’t interject.
Mitchell: Then can I raise a point of order, then, because Clare made a statement, and before she actually gave him a chance to respond she moved straight into a question.

Cosgrove: That’s not a point of order; it’s a debating matter to answer the question. It’s not a point of order. It’s a debating matter. Taihoa. It’s a debating matter. Would you answer the question.

Hunt: OK. We have established a platform, and anybody who wishes to broadcast off this platform, we’ve got a rate card that establishes the rate that we will sell services from. If another party decided they wished to build a digital terrestrial TV network, I’m not aware of any restrictions on them doing so. We don’t broadcast off the Sky Tower, I don’t believe, in Auckland. Does that answer your question, Clare?

Curran: Well, I guess you control those best locations in the established locations, and your competitors do have to go through you to get access to them. So I guess my question is going to don’t you have, essentially, a monopoly?

Hunt: I’d answer the question this way: in terms of—

Curran: It’s not necessarily a criticism, obviously.

Hunt: Yeah, yeah, sure. In broadcast we have a very nice position, both via the satellite and via the terrestrial deployment, but increasingly content will be delivered over the broadband infrastructure, and we see that as actually significant competition for our broadcast facilities.

Curran: OK. That goes to my question around the regulatory environment in the telecommunications environment versus the lack of regulation in the broadcasting environment. So I think that point is made that there are two different regimes operating. You’re telling me, though, that this is not an issue for you in terms of looking forward and a strategy in a converged market.

Hunt: Correct.

Clarke: I’d be very disappointed if we in any way abused what someone could view as a large position in the market.

Curran: Right. And just one final question: the impact of the digital switch-over on Kordia, the opportunities, I suppose, for that—and you alluded to this in terms of the sale of Orcon and money that you may use and options for spending money that you may use—would you be thinking about investing some of that in opportunities in content?

Hunt: Not in content production or sourcing. We would like to think that some of our platforms could help distribute content in a very effective and efficient way. In fact, we were looking and looked at that. We’re very good at managing networks to get content to various places. It’s our core competence.

Curran: But not in the content, so you’re not going to be entering into the content business?

Hunt: We stopped at Parliament TV.
Cosgrove: It’s a very high-risk strategy.

Curran: Very well watched. OK. Thank you.

Cosgrove: Right. Are there any other questions?

Yang: You say that it’s a next-generation network. You compare your business with other providers of communication. So what’s your strength, basically?

Hunt: OK. So Kordia had the first next-generation network in the country. It was built for digital TV, and that’s one of our key advantages. All our platforms are IP—internet protocol based. We don’t use the legacy networks that our competitors have to maintain, and that’s one of our key strengths. So the platforms that we’ve built sit on top of that all IP network, and then there are further platforms that sit on top of those. So that’s really where our strength is. We’re a niche player. We’ve got very a high reliability network, so we look for customers who would appreciate having high reliability services, and we look for customers who see communications as business critical. So we’re not going to be the lowest-cost provider in town, but we’re going to be a provider of somewhat specialised services. So a niche player.

Yang: You are a niche player but you are the third-largest telecommunications network.

Hunt: Third.

Yang: The third-largest.

Hunt: Yeah, but very small compared with the other two.

Yang: So how many networks do we have in New Zealand?

Hunt: Yes. So the other thing is our advantage comes out of, let’s call it, the black boxes that we put on top of the physical infrastructure. So we buy access to long-haul fibre, for example, up and down the country, but we don’t intend to invest further in that kind of area. We will invest in the black boxes—the things that enable us to provide smart services to customers.

Cosgrove: Any other questions?

Curran: Thank you. I just would like to clarify—and excuse me for asking you this question again—around the sale of Orcon and how close you are to making a deal. So you are confirming today that Orcon is not—you’re not near to making a decision, and that Orcon hasn’t already been sold to another provider. So that’s the first question. And the second question is whether the radiofrequency spectrum management rights are being sold too.

Clarke: Three questions. We are in negotiations with various parties about Orcon. We’ve been quite open about that. We haven’t got a conditional sale as we speak. I don’t know the time frame we will finish those or whether that will happen. And that’s the first question.

Curran: So that deal has not been done.

Clarke: No deal has been consolidated and finalised, not at all. We are talking to various parties, as I said before many times, as we speak, about that and
other parts of our business from time to time. The radio spectrum question again—sorry?

Curran Will the radio spectrum management rights be sold too?
Hunt Which rights are you referring to?
Curran Well, I’m talking about Kordia networks, Kordia Australia. I mean, so are there any negotiations around that sale? And radio frequency spectrum management rights?
Hunt Right. OK. So we have quite a number of blocks of management rights to radio spectrum, and most of those are important to the business.
Curran Is Kordia Australia, Kordia networks, and the—
Hunt Kordia Australia has no management rights, only Kordia networks in New Zealand.
Curran Are any of those under discussion for sale right now?
Hunt One block.
Curran One block of what?
Hunt I think there’s a confidentiality around that, so if I can just take that question back and just review what I’m able to say.
Curran So there is another sale in progress at the moment.
Hunt Of a small spectrum holding.
Cosgrove And just to confirm, you’re saying you’ll come back to us with an appropriate answer.
Hunt I’ll come back, yes.
Clarke Yeah, because it might be commercially sensitive.
Lotu-Iiga Like my colleague, well done on your financial result. I think you guys are doing well and I think that growth and diversification strategy that you started some time ago is starting to bear some fruit. But in terms of the future, I suppose, and your outlook to joint venturing and the—I know you’ve touched on some of the possible future investments that you may make. And I know it’s subject to a whole bunch of things, like funding and sales of various assets and things, but your future direction—and you’ve touched on Australia and perhaps part of the Pacific. Are some of these investments, are they capital intensive, some of the risks around it, I suppose, because we have heard in recent days about diversification strategies that have gone a bit awry. Are you projecting out? Are you managing those sorts of strategies well? And how are you going about it?
Clarke In terms of capital, sir, there’s two types of capital requirements. The Australian contracting market has large working capital starts, and that challenges us because they’re big numbers. So that’s OK. We’re working our way through that. That’s point one. Point two—our telco products are capital intensive and low in payback, and that’s just the way of the business. The good news is, though, there’s high-growth revenue. There’s more
telecommunications, mobile phones, content being used in the industry, in the world, as we speak, in education, health. So the market’s growing. We’ve got to grow smart and quick.

Lotu-Iiga But bearing in mind also that you’ve noted around your gearing, although your covenants are in good shape—interest cover. If you’re going to invest, you’re going to need some levels of capital, right? Injections.

Clarke And we realise that and we’ve got discussions under way. You’re right. We have discussions with joint ventures and various players in the market and combinations. We bid now, together with Vodafone, for example, for networks, and that’s fine. It’s the nature of the beast. Telecom and Vodafone get together and bid. That’s the nature of the beast.

Hunt We have an approach, which we’re calling capital light in the network, and to give you an example of that, we offer a network security product—virus and so on. So we have an appliance in our network owned by somebody else. They look after that appliance. They do all the updates and we sell the service but just take a margin.

Lotu-Iiga So that’s sharing the risk and getting some return for it.

Clarke Yes. We see Microsoft Link, for example, at a margin.

Cosgrove Gentlemen, could I ask a couple of questions to finish off. You’ll recall that all SOEs were written to in 2009 by the then Minister in respect of a uniform gearing ratio and increased dividends. What discussions, if any, did you have with the then Minister and/or officials or other Ministers in relation to that request?

Clarke In 2009?

Cosgrove There was a letter in 2009 that went to all SOEs.

Clarke What discussion did we have in 2009?

Cosgrove What discussions have you had then and subsequent.

Clarke Then and subsequent. I can’t recall.

Cosgrove I hate to put you into a position where you misunderstand the question, like your Solid Energy counterparts.

Clarke No, no, we’re at pains not to be compared with—

Cosgrove Indeed.

Clarke So in terms of discussion on dividends—

Cosgrove And gearing.

Clarke And gearing. The discussions we had with our owners are two-fold. One is improving our performance—

Cosgrove Yeah, I know all that. It’s a specific question.

Clarke Let me finish. Improving our performance, which we’re up for. The issue of dividends is a decision for the board. We are not under pressure to pay more dividends. We are under pressure to always increase our performance.
What we use that increased performance for, as I said before, could be joint ventures, new product development, dealing with ACO, etc., and we've received very open discussion with our owners on the various uses of those. We are quite comfortable with our gearing. We are well inside our bank covenant ratios. Our debt's $85 million. We've got facility to $125 million. We have brought debt down—deliberately brought down. It was $125 million, now it's around about $82 million or $83 million. We aim to get it lower once the Australian working capital gets under way.

Clark Just a supplementary question—do you think it would have been wise to take on more debt at the time that Ministers were requesting you consider to do that? I mean, on the surface it seems you don't, because you—

Clarke With regards to this company?

Clark Yes.

Clarke I don't recall ever being asked.

Hunt We've never been asked to do that.

Clark The letter that came from SOE Ministers explicitly asked—

Clarke In 2009?

Clark Yes.

Clarke I've never had discussions with any Minister about that requirement.

Cosgrove I'd check your correspondence if I were you.

Clarke No, I understand what you're saying, but all I want to say is that at the end of the day we are left to make a decision of what gearing and dividend we can do in the best interest of the business and the best interest of creating value.

Clark The Ministers don't and haven't asked questions around the nature of how you're doing your job? They're not monitoring or measuring that?

Clarke In terms of increasing performance we are absolutely requested to improve performance, and we're up for that.

Cosgrove Could I ask you do you agree—I asked Dr Cullen this in respect of New Zealand Post—do you agree with a uniform gearing ratio?

Clarke Across all SOEs?

Cosgrove Yes.

Clarke No, I don't.

Cosgrove Why is that?

Clarke Because I think different businesses have different risks, different capital requirements, and, most important, gearing's a funny term. I can tell you about the various definitions of gearing. We don't have a debt-to-equity ratio in our banking covenants. We have a cash-flow gearing interest cover. And those we are well within. So fundamentally in terms of those ratios they are different depending on what business and markets you operate in.
Cosgrove  Could I just finally—because we are out of time—ask you, if I’m characterising correctly, you would argue that a gearing ratio should be fit for purpose, if you like, in terms of assessing the risks of the various business entities and fitting in the gearing ratios around those, given the individual risks. Is that a fair characterisation?

Clarke  Absolutely, in our own business. With Australia and various other bits we do exactly that.

Cosgrove  So, by contract, the counterfactual would be having a uniform gearing ratio that didn’t take account of the various different varying business models and risks would be high risk, I would have thought.

Clarke  Well, it would be interesting. We don’t do that ourselves now.

Cosgrove  Thank you, sir—appreciate your time.

_**conclusion of evidence**_
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Lakes District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
# 2011/12 Financial Review of Landcorp Farming Limited

Report of the Primary Production Committee

## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation</td>
<td>2</td>
</tr>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Financial performance</td>
<td>2</td>
</tr>
<tr>
<td>Staffing</td>
<td>2</td>
</tr>
<tr>
<td>Farm indebtedness</td>
<td>3</td>
</tr>
<tr>
<td>Domestic production and distribution of milk</td>
<td>3</td>
</tr>
<tr>
<td>Trading Among Farmers scheme</td>
<td>3</td>
</tr>
<tr>
<td>Robotic dairy farming</td>
<td>3</td>
</tr>
<tr>
<td>Environmental data collection</td>
<td>3</td>
</tr>
<tr>
<td>Farming using different models</td>
<td>4</td>
</tr>
<tr>
<td>Supplier contracts</td>
<td>4</td>
</tr>
<tr>
<td>Appendix</td>
<td>5</td>
</tr>
</tbody>
</table>
Landcorp Farming Limited

Recommendation
The Primary Production Committee has conducted the financial review of the 2011/12 performance and current operations of Landcorp Farming Limited, and recommends that the House take note of its report.

Introduction
Landcorp Farming Limited is New Zealand’s largest farmer. It is a state enterprise under the State-Owned Enterprises Act 1986, and a registered company. Landcorp is responsible to the Minister for State Owned Enterprises, and the Minister of Finance. Its chief executive is Chris Kelly, and the chair of the board of directors is Bill Bayliss.

Landcorp owns three subsidiary companies: Landcorp Estates Limited, Landcorp Holdings Limited, and Landcorp Pastoral Limited.

Landcorp has recently signed a joint venture with Shanghai Pengxin, whereby Landcorp will manage the Crafar farms. Its management of the 16 central North Island farms was a condition of the Government’s consent to their sale to a Chinese company.

Financial performance
In 2011/12, Landcorp had total revenue of $215.739 million and a total expenditure of $178.488 million, resulting in a net operating profit, after finance costs, of $27.013 million.

The Office of the Auditor-General rated Landcorp’s management control environment and its financial information systems and controls as “very good”. All ratings achieved were the same as those in 2010/11.

Staffing
We were told that the main factors in Landcorp’s staffing problems were the expansion of the dairy industry and a lack of young people entering the profession. Landcorp pay rates are in the middle band for farming, but the total remuneration package is near the top of the national scale; but this had failed to retain workers, especially in the entry level of dairy milking. With increasing seniority, however, the attrition rate falls considerably. Migrant labour continues to contribute to recruitment and includes Fijians, other Pacific people and Indians. 595 people are currently employed by Landcorp.

We asked if the large pay gap between management and workers contributed to turnover at the lower levels. Landcorp agreed that there was a case for a pay review, but cautioned that there had to be a balance between company performance and personal performance in calculating basic remuneration levels.

We were told that dialogue with iwi groups is frequent and some good partnerships, such as Sweetwater Station in the Far North, have been developed. Other partnerships are
exploiting marginal provincial farm areas, and have local benefits for youth employment. We urged Landcorp to continue this valuable dialogue.

**Farm indebtedness**

The Reserve Bank recently expressed concern about farm indebtedness. We heard that Landcorp also believes farmers to be too indebted, especially in the dairy sector because of heavy investment borrowing during good years. Landcorp said that the most successful way out for farmers is to cut costs and “farm their way through” the problems with economies such as stopping feed supplements. It suggested such issues are unlikely to arise for Landcorp, which maintains a conservative balance sheet.

**Domestic production and distribution of milk**

Landcorp said it produces around 2 percent of the national milk output. Fonterra takes 58 percent of this production, with 12 percent going to Westland, 8 percent to Synlait, and the remainder to Open Country Cheese. Factors in this distribution include geography, milk lactose levels, and economics. For example, geography decides the volume supplied to Westland, and Synlait offers a better return for milk with high lactose levels.

**Trading Among Farmers scheme**

Fonterra has implemented the Trading Among Farmers scheme, which allows Fonterra’s farmer-shareholders to sell up to 25 percent of their shares to the Fonterra Shareholders’ Fund. Outside investors can then buy and sell units in the fund and receive dividends from the shares it holds, while the farmers keep the voting rights tied to the shares they have sold to the fund. One of the reasons for the fund is to manage “redemption risk”—the possibility that a large number of farmers might leave at any one time by selling their shares back to the co-op, which is obliged to pay them out.

We asked for Landcorp’s views on the scheme, and any risks it might entail for Landcorp. We were told that the redemption risk is real, and the need for a safeguard such as the scheme was evident. There are proposals to reduce the cap on the size of the fund from 25 to 20 percent of the total shareholding, which Landcorp would welcome.

**Robotic dairy farming**

The committee had recently visited a robotic dairy farm and asked if Landcorp was considering converting any of its farms to this model. Landcorp pointed out that establishing a robotic farm is very expensive, requiring a lot of infrastructure reorganisation. So far, they are not entirely persuaded of its worth, especially because there are fewer employment opportunities on robotic farms.

**Environmental data collection**

Obtaining accurate environmental data is important for New Zealand agriculture. We asked whether Landcorp thought it is getting the right measurements to inform decisions on land use. We heard that much analysis is based on theoretical models rather than data from tests in the field, and that unsound land use decisions are sometimes made because of erroneous data. Landcorp agreed that this was a hugely important issue and said it was continually improving environmental data collection in collaboration with the Ministry for Primary Industries and regional councils. For example, in their Wairakei Estate (acquired for
development by Landcorp in 2004), Landcorp has eight years’ worth of test bore measurements available for analysis; and test bores were being established along the Waikato river in collaboration with regional councils in order to produce valid data such as nitrogen build-up. They warned that requiring a change in land use as a result of environmental data analysis could potentially create the single biggest constraint in New Zealand farming, and argued that farmers must be able to invest money in land-use change without being fettered by planning constraints.

**Farming using different models**

The committee heard that Landcorp trialled various farming systems, and economic and social costs were included in their projections. For example, one farm has been converted to a high-input system, which may prove to have economic advantages, but so far this model has incurred a high social cost. The system requires more staff working longer hours to maintain an effective operation, and they find the work far more stressful. Some of us are concerned that the corporate model pursued by Landcorp is of limited relevance or assistance to the family farm model.

**Supplier contracts**

Supplier contracts for all their farms, such as those for machinery, feed, and fertilisers are now re-appraised regularly but less often than before, to ensure best value for money, and to help maintain and improve relationships with suppliers and clients. Annual contracts are now rarely used except for basic stock items such as fence posts. Sales contracts such as the Silver Fern meat contract with Tesco supermarkets in the UK are also reviewed frequently. Longer-term contracts are preferred if they can be obtained to ensure continuity for farmers, but often the supermarkets prefer short-term contracts.
Appendix

Approach to this financial review
We met on 6 December 2012 and 31 January 2013 to consider the financial review of Landcorp Farming Limited. We heard evidence from Landcorp Farming Limited and received advice from the Office of the Auditor-General.

Committee members
Shane Ardern (Chairperson)
Steffan Browning
Hon Shane Jones
Colin King
Ian McKelvie
Hon Damien O’Connor
Eric Roy

Evidence and advice received
Office of the Auditor-General, Briefing on Landcorp Farming Limited, dated 6 December 2012.

Organisation briefing paper, prepared by committee staff, dated 26 November 2012.

Landcorp Farming Limited, Response to questions, received 6 December 2012.

Landcorp Farming Limited, Response to additional questions, received 13 December 2012.
The Justice and Electoral Committee has conducted the financial review of the 2011/12 performance and current operations of the Law Commission and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Tim Macindoe
Chairperson
2011/12 financial review of Learning Media Limited

Report of the Education and Science Committee

Contents
Recommendation 2
Introduction 2
Relationship with Ministry of Education 2
Online opportunities 2
Future developments 3
Costs of business 3
Appendix 4
Learning Media Limited

Recommendation

The Education and Science Committee has conducted the financial review of the 2011/12 performance and current operations of Learning Media Limited, and recommends that the House take note of its report.

Introduction

Learning Media Limited is a learning services company that provides content for and delivers media products, publishing, professional development, communication, and consultancy services. It provides these services primarily to the Ministry of Education, but also to other New Zealand government agencies and private companies, and overseas customers. Learning Media Limited is a state-owned enterprise, with two objectives: to provide, under contracts with the Secretary of Education, basic material and services to support the national education guidelines, and to be a profitable and efficient business.

Relationship with Ministry of Education

We heard that the relationship between Learning Media and the Ministry of Education has changed over time, which has put pressure on Learning Media’s ability to meet its financial targets. Learning Media was originally a unit within the Ministry of Education, before becoming an external provider. The Ministry of Education has been reducing costs, and as part of this has moved to tendering out. This tendering approach means Learning Media is now on a panel of preferred suppliers, sometimes competing with non-taxpaying, not-for-profit charities. Learning Media suggested these are often small operations with fewer overheads and lower cost structures, making it harder for Learning Media to be competitive and win contracts. In adjusting to this changing marketplace, Learning Media has restructured, and believes it is now in a position to regain a significant number of its previous contracts with the Ministry of Education.

Learning Media acknowledged that engagement with the Ministry of Education remains key to its business, but also noted it has responsibilities under legislation to the ministry. We heard that it has held a series of meetings with the ministry seeking better alignment. Learning Media is still publishing the main curriculum resources, and the School Journal. We will watch with interest how Learning Media’s relationship with the Ministry of Education continues to evolve.

Online opportunities

Learning Media has recognised online resources as a potential area for growth, so it has improved its digital capacity and resources. In the year ended 30 June 2011, it purchased CWA New Media, a company that specialised in multimedia and web services. This purchase allowed Learning Media to expand in the US market, which is a major focus of its digital resources. Learning Media said that if it had not purchased CWA, its revenues would have been 25 percent less.

Learning Media focuses on the primary education sector, and does not compete with tertiary providers, where online provision of resources is increasing rapidly. Learning Media
also said that it has a reputation as a provider of high-quality products, which allows it to charge a premium for its resources. The market for digital resources in the primary sector is growing, though is not currently at the same level as the tertiary sector, which has led the market. Learning Media told us it is focusing on keeping up-to-date with developments in the digital sector, and believes it will be well placed to expand in the digital market.

**Future developments**

During the 2011/12 year, although Learning Media’s revenue increased by 17 percent, it recorded a loss for the year under review. Learning Media points to tightening profit margins, fluctuations in the currency market, and a recent restructuring as contributing factors. In response, Learning Media is diversifying its customer base in New Zealand and overseas. However, overseas business in particular is erratic, and we heard that for now the Ministry of Education remains its major client.

We heard that Learning Media has expanded its engagement with the health sector in New Zealand, particularly the Ministry of Health, and the private sector.

Most of Learning Media’s international business is from North America, where it has a history in the market, and an understanding of local rules and regulations. Learning Media is helping organisations in North America move from print to digital resources. We also heard that it is seeking to expand in the Asian market, particularly Singapore and South Korea. Learning Media is working with Education NZ to open up other markets in the region. It told us it will continue to cultivate these relationships, and to endeavour to expand into new markets, with the goal of becoming a net exporter when these markets mature. We look forward to hearing how these markets mature over time.

**Costs of business**

After the recent restructuring, we asked what proportion of Learning Media’s work is undertaken internally and what by contractors. Learning Media explained that the heart of a publishing company is its design and production, which are undertaken by employees in-house; articles and photographs are often contributed by freelance contractors.

We heard that Learning Media is constantly restructuring to compete with more agile providers in the sector. Learning Media said it estimated the cost-burden of being a state-owned enterprise at between $500,000 and $1 million. We heard that the restructuring has affected staff morale. The cost of redundancies has been about $195,000 for the last financial year, and it has been running at this level for several years. Learning Media told us that improvement in its financial performance will also be impacted by Ministry of Education procurement policy.
Appendix

Approach to this financial review

We met on 27 February and 20 March 2013 to consider the financial review of Learning Media Limited. We heard evidence from Learning Media Limited and received advice from the Office of the Auditor-General.

Committee members

Dr Cam Calder (Chairperson)
Catherine Delahunty
Hon Jo Goodhew
Chris Hipkins
Colin King
Tim Macindoe
Tracey Martin
Sue Moroney
Simon O’Connor
Dr Megan Woods

Evidence and advice received


Organisation briefing paper, prepared by committee staff, dated 26 February 2013.

Learning Media Limited, response to written questions, 1 to 119.

Learning Media Limited, 2011/12 year in brief.
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Mental Health Commission, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2011/12 financial review of Meridian Energy Limited

Report of the Commerce Committee

Contents
Recommendation 2
Introduction 2
Financial performance 2
Tīwai Point negotiations 2
Partial privatisation 3
Hydro generation 3
Wind generation 4
Retail competition 4
New Zealand Labour Party and Green Party minority view 4
Appendix A 5
Appendix B 6
Meridian Energy Limited

**Recommendation**

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of Meridian Energy Limited and recommends that the House take note of its report.

**Introduction**

Meridian is a state enterprise under the State-Owned Enterprises Act 1986. It is monitored by Treasury’s Crown Ownership Monitoring Unit on behalf of the shareholding Ministers, the Minister of Finance and the Minister for State-Owned Enterprises. Mark Binns has been Meridian’s chief executive since February 2012, following the resignation of Tim Lusk. The chairman of the board is Chris Moller.

Meridian is an energy developer, generator, and retailer. It generates 28 percent of New Zealand’s electricity, making it the largest generator in New Zealand, and retails power through the Meridian and Powershop brands. It generates electricity from entirely renewable resources, principally seven hydro stations in the South Island. The Rio Tinto Alcan (New Zealand) aluminium smelter at Tīwai Point is its major industrial customer, and uses about 40 percent of the electricity Meridian produces.

All of Meridian’s planned developments are in hydroelectricity or wind power.

**Financial performance**

In 2011/12 Meridian generated a total of $2.57 billion in revenue, and recorded a net profit after tax of $74.6 million. This latter figure represents a significant decrease from $303.111 million in 2010/11. A large factor in this difference is that the Tekapo hydro-power stations were sold to Genesis Energy on 1 June 2011. Record low rainfall was also a factor in Meridian’s result, but the company performed considerably better than it did in the last severely dry year, 2008. Meridian paid the Crown $69.4 million as a 2011 final dividend and $71.3 million as a 2012 interim dividend.

Meridian told us that its number of domestic customers increased by 5 percent in what is a highly competitive market. A large factor in this was the 83 percent growth in Powershop revenue as it expanded into new areas of New Zealand in its third year of operation. Its total energy sales revenue increased by 12 percent.

We heard that New Zealand’s electricity generation capacity has increased faster than demand over the last five or six years. Transmission constraints have also lessened in the same period. We asked how profitability was continuing to increase in what appeared to be an oversupplied market. Meridian believes oversupply will take a while to work through the market, affecting wholesale prices before flowing on to the retail market.

**Tīwai Point negotiations**

Meridian Energy provides power to the aluminium smelter at Tīwai Point, which uses approximately 40 percent of Meridian’s annual New Zealand generation. Aluminium prices around the world have dropped considerably in the last five years, putting the industry
under pressure. In July 2012 Meridian was approached by Rio Tinto, a majority shareholder of Pacific Aluminium, which owns the Tiwai Point smelter, to renegotiate its existing electricity contract. Negotiations for this existing contract were completed in 2007 and came into effect in January 2013. Negotiations are continuing, but Meridian indicated that the gap between the parties, particularly regarding long-term prices for electricity to the smelter, is such that a new agreement with Pacific Aluminium is unlikely. Confidentiality agreements limited the information Meridian could disclose to the committee.

The Government has also entered negotiations with Rio Tinto, but Meridian has not been privy to their details. We asked to what extent Meridian has discussed with the Government the implications the closure of the smelter for power prices and the company’s value. Meridian said that it had updated Ministers on negotiations with Pacific Aluminium a number of times, but it has not shared its financial modelling. We asked if the negotiations had become a three-way process, but Meridian told us its negotiations with Pacific Aluminium have been separate from the Government’s discussions. The company does not feel that its position in negotiations is disadvantaged as a result of the Government’s involvement.

Rio Tinto has been reviewing its aluminium projects in other jurisdictions, particularly Australia. We asked how these situations have been resolved, and Meridian told us that intervention by state and federal governments, including offers of subsidies, had settled some of the negotiations.

If the Tiwai Point smelter closed, it would have a large effect on the New Zealand electricity market. Meridian told us that the precise impact would depend on how long the closing took and how much notice was given. If contractual provisions for notice are followed, Meridian thinks the market would have time to adjust to the major drop in demand resulting from the smelter’s closure. This fall in demand would almost certainly result in lower power prices for all consumers in New Zealand. Meridian is confident that it is a strong, viable company and will be able to withstand the challenges that may result from closure of the smelter. It expects to be able to handle any transition smoothly, and to remain profitable.

We are concerned about this situation and hope that Meridian and Pacific Aluminium can come to an agreement on Tiwai Point.

**Partial privatisation**

We questioned Meridian about the Government’s role in negotiations with Rio Tinto in light of the proposed partial privatisation of Meridian, but the company felt that it was not appropriate to comment. Meridian is not listed as proceeding towards the mixed-ownership model at this stage, and has not received any further updates from the Government.

**Hydro generation**

As New Zealand’s largest user of fresh water, Meridian told us it faced challenging hydrology conditions in 2011/12. Rainfall into South Island catchments was at its lowest in 79 years. Effective management strategies and more liquidity in the wholesale market allowed Meridian to post a financial result significantly better than that in the previous driest year, 2008.
Wind generation

We asked Meridian about its strategies for increasing its renewable generation, particularly from wind farms. At present 11 percent of Meridian’s electricity output is wind-generated. Since 2010/11 wind generation has increased by 183 gigawatt hours to 1,206 gigawatt hours. The company’s newest wind farm, Te Uku, contributed an additional 132 gigawatt hours in its first full year of operation.

Meridian updated us on recent wind farm projects. Mill Creek wind farm near Wellington is under construction, and is currently on time and on budget. It is expected to be operational in 2014. The Macarthur wind farm project in Australia, a joint venture with AGL, is now also operating. However the proposed Project Hayes wind farm was cancelled following reassessment of the cost and viability of the project. Consents have been issued for other projects, but they are on hold until economic conditions improve. We asked how this is decided, and heard that Meridian based assessments of the viability of wind farm projects on likely demand over the next five years.

Retail competition

Meridian told us that retaining customers in the competitive retail electricity market is difficult. The most recent retail churn figure is 18 percent, but rates have gone as high as 23 percent at times. This is largely because of the Electricity Authority’s “What’s My Number” campaign, which encourages people to calculate the possible benefits of switching power retailers. In response to such market pressure, Meridian is focusing on providing retail customers with high-quality service. In recent consumer surveys Meridian and Powershop topped the retail electricity industry for customers’ satisfaction. The company is also investigating ways to give customers more control over their power usage through new technology, including smartphone applications.

New Zealand Labour Party and Green Party minority view

Labour and Green members remain extremely concerned with the nature and process of negotiations with Pacific Aluminium in respect of the Tiwai Smelter. We note that a failure to conclude an appropriate contract with the smelter’s owners would have a direct impact on the electricity sector, for which the Tiwai Smelter accounts for 15 percent of electricity demand, and if that were to be placed on the open market through a contractual failure, that would create overcapacity, and would impact on the price the Crown would receive for the partial sale of Mighty River Power. We also note with concern the conduct of Ministers in respect of the negotiating process with the smelter’s owners, where Ministers unilaterally intervened in the negotiating process without reference to the board. It surprised us that the Government was willing to intervene in Meridian’s operational matters when it has maintained it could not and would not intervene in matters pertaining to Solid Energy’s financial deterioration. Thus far we have received no explanation from Ministers for this inherent contradiction.
Appendix A

Approach to this financial review
We met on 28 March, and 11 and 17 April 2013 to consider the financial review of Meridian Energy Limited. We heard evidence from Meridian Energy Limited and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received
Meridian Energy Limited, Responses to written questions, dated 8 February and 9 April 2013.


Organisation briefing paper, prepared by committee staff, dated 28 February 2013.
Corrected transcript of hearing evidence 28 March 2013

Members
Jonathan Young (Chairperson)
Dr David Clark
Clare Curran
Julie Anne Genter
Peseta Sam Lotu-Iiga
Todd McClay
Mark Mitchell
Dr Russel Norman
Hon David Parker
Dr Jian Yang

Witnesses
Chris Moller, Chair
Mark Binns, Chief Executive

Young Welcome, Mr Moller and Mr Binns. Good to have you here today. Now, we have an hour with you and we want to invite you to make some opening remarks, but if you could keep those as brief as possible, probably 5 to 7 would be adequate, and then obviously we have got questions to ask. Thank you, sir.

Moller Thank you very much, Mr Chairman. Good morning. It is likely to be about 7 minutes but no more. There are six matters I would like to comment on before we respond to your questions. Firstly, Meridian’s financial performance. The year ending June 2012 was characterised by the company experiencing the lowest ever recorded inflows into our South Island catchments in 79 years of historical records. Despite this challenge, we delivered satisfactory financial results. Our EBITDAR was $102 million up on the previous dry year of 2008, even after the sale of the Tekapō power station, which reduced Meridian’s generation capacity by around 7 percent. During the year we benefited from improved financial risk management, noting that the growth of the ASX futures market is a positive step for the industry. We also benefited from the diversity that wind brings to our 100 percent renewables portfolio, which contributed 11 percent of our total generation for the 2012 financial year. Since then we have announced our interim results for the first 6 months of the financial year. These results demonstrate a return to higher profitability due to improved hydro inflows, higher operating cash costs—sorry, cash flows—stable operating costs, and lower capital expenditure compared to last year.
Secondly, health and safety. With the full commitment of the board and management we take health and safety of our people and contractors very seriously. Our metrics are industry leading. Results follow culture and it is a continuous process to achieve the right behaviours, which ultimately underpins good results. Health and safety will always remain a key focus for our business.

Thirdly, environment and community. We understand the importance of looking after the environment and being a good corporate citizen in the communities in which we operate. Our commitment to the environment starts from our platform of being 100 percent committed to renewable. This is our point of difference and resonates with all of our people. It also goes to the heart of our brand that we are creating a better energy future. We are pleased that our efforts in environmental and community work have been recognised externally with consecutive Green Ribbon and Sustainable 60 awards over the last 2 years.

Fourthly, transmission pricing. Meridian recognises that this has long been a controversial subject. The key issue has always been charging for the HVDC link. The Electricity Authority has concurred with Meridian’s analysis that to charge South Island generators alone for an asset that is used by everyone across New Zealand is inefficient and inequitable. The EA’s proposal corrects this critical problem. While this is clearly a step in the right direction, we believe, like many others, that the EA’s proposal has gone a step too far. Meridian has submitted that their proposal could be greatly simplified while still keeping to the principles necessary for good regulatory decision-making. If the industry takes a constructive approach, then there is a middle ground that we believe is acceptable to most parties. We have taken the time in our submissions to describe what this could look like, and look forward to continued positive engagement on this subject.

Fifthly, New Zealand Aluminium Smelters, or NZAS. Meridian’s new contract with NZAS was signed in 2007 after 3 years of negotiation, and it commenced on 1 January 2013. The new contract is a financial contract, a contract for difference—otherwise known as a CFD—as opposed to a physical supply contract. Meridian was approached by Pacific Aluminium about renegotiation of the contract in July 2012. Negotiations are ongoing and are being conducted in good faith. The aluminium industry, however, is under pressure internationally, and NZAS’s situation is not unique.

Meridian issued a continuous disclosure statement this morning, advising the following key points. One: despite significant effort by both parties, there remains a major gap between us on a number of issues, such that the board of Meridian, which met all day yesterday, believes that it is unlikely that a new agreement can be reached with Pacific Aluminium. Two: various options have been discussed, and Meridian has offered a number of significant changes and concessions to the existing contract. Three: negotiations will continue, but in the event that no agreement can be reached with Pacific Aluminium, Meridian will seek to engage with Rio Tinto and Sumitomo Chemical Company, the shareholders of NZAS, who will ultimately decide on the future of the smelter.
Finally, I want to categorically refute a claim by Fairfax this morning that Meridian’s chief executive, Mark Binns, was paid $1.8 million last year. As published on page 35 of the 2012 annual report, Mr Binns received approximately $471,000. This was for the 6 months ended June 2012, as he commenced employment with the company on 1 January 2012. For completeness, I can also confirm that he received no inducement payment to join the company, and that he is not entitled to any retention bonus.

It is correct that the $1.8 million was paid to both Mr Binns and the former CEO in the 2011-12 financial year. The former CEO received approximately $1.3 million, which was made up of 6 months’ base remuneration, a 6-month short-term incentive to 31 December 2011, a 12-month bonus from the previous year—that is, from 1 July 2010 to 30 June 2011—paid in arrears, so it was paid a year later than the year in question, and that year was actually for a record financial performance by the company, and he also received the conclusion of a 3-year long-term incentive, which accrued over the 3 years but was paid in his final year. And I would also confirm that the former CEO received no exit payment in addition to these contractual amounts. I would like to hand the meeting back to you, Mr Chairman, and we’ll take your questions.

Young

Thank you, Mr Moller. Look, I think that we probably want to get to the heart of some issues. You mentioned about this major gap. I’m not sure how much you can elucidate around that about the significant changes and concessions that Meridian has put forth, but we would probably like some information or dialogue around that.

Moller

Understood. We thought that might be a key issue you wished to probe. I’ll hand over to Mr Binns because he’s been doing all the negotiations and keeping the board advised of how that’s progressed. But I do need to say at the outset that we did sign a confidentiality agreement as part of those negotiations, and we do have confidentiality conditions in the existing contract, which because it is returning a satisfactory price to Meridian—and, of course, one of the reasons why Pacific Aluminium would like to see it renegotiated—we certainly don’t want to breach any terms that could result in any changes or undermining of that contract.

Young

Understood.

Moller

So I will hand over to Mr Binns to answer your question.

Binns

Mr Chairman, in addition to the fact that we have a confidentiality agreement with respect to the contract itself, we also have a confidentiality agreement with respect to the negotiations and the terms. So it is impossible for me to detail for the committee in public what the state of the negotiations actually is. All I will say is that Meridian has tried very hard to put on the table terms that would be acceptable to Pacific Aluminium, and has made concessions relative to its contractual entitlements, which amount to a significant amount of money.
I guess, in short, Mr Chairman, we believe as a board and management that we have tried very hard to bridge the gap, but there is still a gap, and we will continue trying in the best interests of both Meridian and New Zealand.

A follow-up on that, then. You talked about the international aluminium price and what is happening around the world. Is Pacific Aluminium, with their parent company, Rio—are they having similar conversations in other jurisdictions around similar issues?

Yes, they are. They are having similar conversations. I think they’ve concluded most of them in Australia, and they certainly had a similar conversation with the Tasmanians around the Bell Bay smelter. And only recently, over the last month or so, they have completed negotiations with regards to the Gove alumina refinery plant, where the Northern Territory Government and the federal Government have agreed to a range of concessions in favour of Pacific Aluminium.

Yeah, I was going to ask in terms of those three situations whether you could elucidate how those situations were resolved in those negotiations.

We obviously don’t know the detail, but it would appear that with the Gove transaction, that was resolved at the relatively last minute after a strategic review had been announced of the Gove refinery, and the Northern Territory Government agreed to allocate a big chunk of its gas reserves to the plant, and the federal Government agreed to subsidise or pay for a pipeline—around about $900 million.

Well, I would say that we, as my chairman said, hope the aluminium smelter won’t close, and we are still in discussions with Pacific Aluminium. And if we can’t close those, then we’ll turn to Rio Tinto and Sumitomo Chemical, who are the owners. So we are hopeful that one way or another it won’t close. But the impact is really dependent on over what period of time it closes and ramps down, and there is a contractual provision in the contract setting out when notice can be given. And if NZAS left in accordance with the contractual provision, we think probably the market would have sufficient time to largely adjust.

Could I just add, to complete that, if they were to leave—and, as Mark might have said, we are working to make sure that doesn’t happen—it will almost certainly, in fact, I’m sure it will certainly result in lower electricity prices for all consumers in New Zealand.

My understanding is that you can get Manapōuri power to Auckland, even accounting for transmission costs and losses, probably cheaper than they can generate it at Huntly. Is that a fair statement?

That’s a fair statement.

So you could get Manapōuri power into the Auckland market at (inaudible) price (inaudible)?
We can’t get it all in yet, because there are some transmission constraints, but we would get most of it in, and the constraints could be built out in probably a 2 to 3-year period.

Just in terms of the confidentiality issue that you raised, the Government gave a release this morning, disclosing some of the elements of the discussion, where they said that you and the smelter were close on short to medium term prices but much further apart on long-term prices. I mean, were you aware that the Government was planning to release that information about the negotiations?

We had been told that the Government would put out a release following our release, yes.

But were you told that the Government would reveal elements of the negotiations that you have said were covered by confidentiality agreements about the differences between—

I think if you’ve read, the differences between ourselves and Pacific Aluminium, with respect to the short-term period that was referred to, most certainly are less in total dollar terms than the gap we are talking about over the longer term. We are talking about two periods, and so over the short period, the gap that we have with Pacific Aluminium is relatively small—

So you’re saying that it’s significantly less—

The long period is an 18-year contract. Over the longer period, we have a significant difference.

I think I’d also just add that the statement that the Government issued, I don’t think we would believe is in breach of the confidentiality arrangements. I mean, it’s quite broad in its comments. We’re referring to the specific of prices, all of those sort of things that we can’t table with you.

Are you aware of what the Government is putting on the table in negotiations with Rio Tinto? Have they kept you in the loop with those negotiations?

They have given us a very, very brief indication of what was discussed, but given the time frames that we’re working to, we haven’t had a full briefing.

You don’t know is the short answer (inaudible)?

Oh, I know in ambit terms, but not the detail.

This was discussed with the Government yesterday. We were in a board meeting all day in Christchurch, so to that extent, yes, we’ve been briefed by a phone call. But we haven’t had a face-to-face meeting or been able to go right through the details.

It’s a very, very complex contract.

You said in your press release today, and you reinforced it in your opening, that you believe that it’s unlikely a new agreement can be reached with Pacific Aluminium. Do you stand by that?

Yes, I do.
| Binns | Yes, we do, notwithstanding what the other party has said this morning. But, I mean, we’ve put out the release because we trade on the ASX in terms of the hedges that we run. We have an obligation to continuous disclosure. The board met yesterday. I had an extensive discussion with Mark and the management team around this, and the board formed the view that the market needed to be informed and our failure to do so would be inappropriate. So that’s why the statement. We’ve said unlikely, but we hope we’re wrong. |
| Parker | According to the report that you’ve tabled with us today, you—Meridian—have about 28 percent of New Zealand’s electricity generation capacity. What’s the percentage of your total electricity generation (inaudible)? Is it a similar number? Is it about 28 percent, about a quarter? |
| Binns | Well, that varies. I mean, 30 percent is probably a good average. But— |
| Parker | So about—that’s close enough. So about 30 percent of New Zealand’s electricity is produced by you, and, if I am right, about 15 percent of New Zealand’s electricity is utilised at the smelter. Is that about right? |
| Binns | About 14—you’re right. |
| Parker | And is it also true that even without this announcement, the energy margins—both capacity margins and total generation margins—in New Zealand have improved markedly over the last 5 or 6 years? |
| Binns | I couldn’t comment over 5 or 6 years. |
| Parker | Well, is it true that over the last 5 or 6 years, capacity has increased faster than demand? |
| Binns | Yes, capacity has increased faster than demand. |
| Parker | So generation margins in New Zealand are already significantly better than they were 5 years ago, and I think you’ve already indicated that transmission constraints are lower than they were 5 years ago too. |
| Binns | Transmission constraints are being fixed as we speak. I mean, Pole 3, obviously, across the DC link. |
| Parker | So we’ve got the major investments across the Strait and some good upgrades (inaudible) some announcements about the South Island as well. So in New Zealand we’ve got better generation margins, or better electricity margins, better security of supply than we’ve ever had, and even before this announcement we had better margins. I’m just surprised by your initial statement to us that despite all of that, you’re lauding the fact that your profits are up. I find it counterintuitive that in a market that is now if anything oversupplied, we still have (inaudible) increasing the profitability in amongst our electricity market. |
| Moller | It wasn’t up for the year under review—end of June, it was one of our poorest years due to hydrology. And that’s the issue. I mean, we— |
| Parker | Well, I’m well aware that you’ve said that—you said in your opening statement that your underlying profit was up, notwithstanding the fact that |
last year you had a dry year and that impacted on the revenues. Is that correct?

Moller: What I said was that we were $102 million up on the previous most recent dry year of 2008.

Young: Which was your second-worst dry year, wasn’t it?

Moller: That was the second-worst, I think. Am I right about that?

Young: Yeah, 2008.

Moller: So, I mean, the numbers are moving around because of the hydrology.

Parker: I’m pleased that there’s been an acknowledgment that if Tīwai closes, there would be a dramatic decrease in electricity prices, but even without that, I’m surprised that in a country that is increasing capacity, flat demand, that we’re not seeing the benefits of New Zealand’s low-cost electricity flow through to consumers.

Binns: I think that’s because it takes quite a while for oversupply to work through the market. There’s talk about oversupply at the moment, but you’ve got Te Mihi, Ngātamariki, Mill Creek, and I think another couple of small projects that are currently coming on. So it’ll take a while for it actually to flow through the market. You have to see the effect on the wholesale market and then for it to work through in the retail market, because they’re two separate markets.

Parker: When you said that if the smelter was to close, the market would have time to adjust, what did you mean by that?

Binns: I said if it closes, in accordance with the contract, I believe the market would probably have time to adjust. What I mean by that is if you have 5,000 gigawatt hours of power, which Manapōuri produces, brought on to the market, and the short-run marginal cost of hydro is low, then you’re always going to clear that power in the market, and those people who are in the market who have higher costs—thermal plants—are going to find it very uncomfortable. It’s the market working, and probably—I mean, on our estimate—it is likely that some of our competitors might close some of their plants; therefore, you’ll have an adjustment in supply and you’ve got basic economics at work.

Young: Under the current contract, what notice would NZAS have to give if it were to cease operations and what would its obligations be around that?

Binns: Sorry, Mr Chairman, I missed that.

Young: What notice would they have to give if they were to cease operations and what would the obligations be around that?

Binns: I can’t make a comment on that, because that’s covered by confidentiality.

Young: All right, OK. Thank you.

Parker: Over what period do you think we will have—well, how long do you think it’s going to take for you to bring the negotiations one way or another to a head with New Zealand Aluminium Smelters—sorry, Pacific Aluminium?
As soon as possible. I mean, it’s in both our interests to get this resolved as quickly as possible, and we’ll both put the resources in that are needed to try and reach a conclusion. The point, as our chairman said, is we are continuing negotiations where we have disclosure obligations to the NZX and we’ve got to a point where to us, to me, it looks very hard. We have put a substantial amount of value on the table. We’ve got a 2007 contract that was negotiated with NZAS, 80 percent owned by Rio Tinto. Rio Tinto is about 18 times the size of Fletcher Building. We’re not dealing with grandma. They entered into a contract freely. We have that position. We’ve said we’re prepared to back off in the interests of getting a deal. It’s in our interests, it’s in New Zealand’s interests, but there’s only so far we can go. We’ve reached that bottom line, and we don’t know how that deadlock is going to be broken. Friends at Pacific Aluminium say they will. We’re saying that’s fine, come and talk to us. So I give it a couple of weeks.

Sorry—a couple of weeks?

I give it a couple of weeks.

But that’s just a guess.

Absolute guess.

Yeah, no, obviously, you can’t (inaudible). That’s a good indication. Have you done modelling as to what will be the impact on New Zealand’s power prices as a consequence?

We have—have we done modelling?

No, but we have had exceptionally bright people who do nothing but model all day—model all the potential outcomes. But, I mean, a range of outcomes is obviously wide, one of the factors being just what is our competitors’ responses. So we’ve got a range of potential outcomes.

The reason why we have to do that, of course, is that that informs a decision of what we’re prepared to concede to Pacific Aluminium relative to counterfactual alternatives. And our bottom line—

Have you modelled what the impact would be upon your competitors, because the impact upon your competitors would probably be greater than the impact would be upon (inaudible)?

We have an idea on what the impact might be on our competitors, but our competitors have equally brainy people with equally as sophisticated models, and they can work that out themselves. So, I mean, we most certainly have not shared that with anybody. That’s our proprietary information.

So if the more expensive sources of generation dropped off because your power was going north and supplying there, that would be Huntly, presumably, would be retired sooner than is currently forecast, and what else—

I’d rather not comment on our competitors’ positions, but—
2011/12 FINANCIAL REVIEW OF MERIDIAN ENERGY LIMITED

Parker  Well, can I ask it a different way? What are New Zealand’s most expensive current sources of generation?

Binns  You’ve probably named one.

Parker  And what would be the others?

Binns  Well, gas plants, and they obviously have a higher short-run marginal cost than hydro. So some of the gas plants might also be marginalised, in which case I would’ve thought Mr Norman and the Greens would be delighted because New Zealand would be moving a long way towards its renewable target.

Young  Following the press release of your statement, there came a countering press release from—

Parker  The Government?

Young  —no, no—your negotiating partners, who certainly communicated a commitment to a process for negotiations. So even though you are saying, well, you know, the bottom line is poles apart, they are saying that they want to stay at the table.

Binns  That’s right, and as do we, but we have said: “OK, you say we’re close; we think we’re a long way apart. Show me how you’re going to bridge the gap.” At this point, I’ve not had an answer to that question.

Moller  I think it’s also important to say that it’s not just price that’s at issue here. There are some other quite significant matters, which I can’t go into. So, you know, they may think we’re close on some things, but there are other elements that have to be sorted, which I’m not sure they’re necessarily giving a full consideration to, but if I’m wrong and the board’s wrong and the management’s wrong—great.

Young  I mean, this is one of the longest standing companies that’s currently in operation, and from Dow Jones Newswire, it says, you know, that they’re looking at selling two French aluminium plants because they had severe impairments on their assets that tipped the company into its first ever annual loss. I mean, the resources of this company must be huge in terms of, you know—so do you think that there is room for this company to actually meet you at the table?

Binns  Well, could I just say yes, they are closing operations, Mr Chairman, but Rio Tinto in its last 2012 accounts, I think, had operating cash flows of US$16 billion.

Member  $16 billion?

Binns  Billion—that’s a “b”. So, I mean, as I pointed out—I mean, the company or the parent company behind Pacific Aluminium is significantly larger than little old Meridian, with greater financial resources.

Parker  We’ve been told by press release from the Government today that they are now intervening in these negotiations. And I want to inquire how we get our heads round whether the concessions that they might be wanting to make make sense for New Zealand, and I suppose one of the reasons I’m...
interested in that is there is a suspicion that what they’re trying to do is shore up their asset sales programme by taking out uncertainty around the future price of electricity—

Young  Yeah, you probably can’t answer that.

Moller  No. I was going to say that that’s a matter to please address to the Government. We’re certainly not in the position to comment.

Parker  That’s the background to my question. Now, we’ve had in recent history in New Zealand real controversy around the award of UFB contracts to Chorus. We’ve had controversies around the SkyCity deal around the casino, and now we’ve got private negotiations where you tell us we can’t see into them, and I suspect the Government will tell us we can’t see into them. Why can’t we have transparency around this? Presumably, your position in the negotiations has been maximising Meridian’s value, and that will have a market outcome to power prices, which will include consumers’ prices going down, and now we’ve got the Government intervening. Why can’t we—

Binns  Mr Parker, we can’t answer that question. That’s one you have to—

Young  Look, I think you also made some comments—sorry, David—

Parker  I just need confirmation from you that you are unwilling to show us the numbers, and I can understand why that is—

Binns  I don’t know the numbers.

Parker  You don’t know the numbers—

Binns  Mr Moller and I have had a very brief—

Parker  You know the numbers in terms of what you think is the best market outcome for (inaudible) value?

Binns  Yes, I do.

Parker  Well, if there is a variation from those numbers, how do we find out about it?

Binns  I guess you ask Mr Key.

Young  And I think just in context to what David’s been asking, I think that you answered a question before about what negotiations overseas were happening, and the Australian Government has been working with two or three different operations that are under Rio Tinto to improve their viability.

Clark  Given the (inaudible), to what extent has Meridian informed the Minister as to the extent of uncertainty around (inaudible) of the contract and the implications of not going ahead both in terms of power prices and in terms of the underlying value of the company?

Binns  Well, first, on the modelling, we have not shared the modelling with officials. We have kept that to ourselves, but in terms of where negotiations are, I mean, we have kept Treasury up to date with progress right through the negotiating period since August last year.
Clark  My question was about Ministers. To what extent have you had conversations with Ministers in terms of the state of the negotiations—

Binns  Well, through that period we have had probably two or three direct discussions where Ministers have been present where we have updated them on the state of negotiations.

Clark  And so you’ve shared with them your modelling?

Binns  No, we have not shared our modelling with anybody.

Moller  We have discussed, with, Ministers where we’re at in the process.

Clark  You will have discussed no doubt the underlying value of the company and the implications of that, because—

Binns  No.

Clark  The Minister didn’t ask about that?

Binns  No. The Minister’s got a lot of advisers that he can ask that question. We haven’t offered anything in terms of the implications for us, and I make the point again that what we’ve done in terms of our modelling is capable of being replicated by all our competitors. I mean, it is rocket science and they do have rocket scientists.

Clark  If it’s so widely available, why can’t it be released?

Binns  Because that’s our information and we might have better rocket scientists than they have.

Moller  And, clearly, it involves assumptions. And our assumptions may not be consistent with other people’s assumptions, and we could set up a fight over those assumptions.

Lotu-Iiga  Look, I just want to get clear, you’ve done (inaudible) capabilities and resources to negotiate a contract with Pacific Aluminium. Is that—

Binns  Yes, we have.

Moller  But we’re continuing to try.

Lotu-Iiga  And you’re continuing with that process and some of that information is clearly confidential, commercially sensitive, of course. And so, you know, you would, as the Australians have, look at other parties, other forces, other interventions that could bring about an optimal outcome for your organisation. Would that be fair to say?

Moller  Yes.

Norman  Just going back to what Mr Parker said, the reason why I think it’s relevant is that it looks from the outside now that it’s a three-way negotiation, because the Government is starting to intervene in the process, which, of course, (inaudible) if they want to do, then (inaudible) negotiations with now a third party being involved, and I appreciate you can’t tell us the detail, but can you tell us, have you been meeting with the Government as to what role the Government might play in this now three-way negotiation?
Binns  No, we haven’t, and the discussions that the Government has had with Pacific Aluminium we have not been present at, but we do know that Pacific Aluminium has made representations to the Government during the period of the negotiations.

Norman  Does it put Meridian in terms of the negotiating strategy of Meridian in a weaker position not knowing what the Government is telling Rio Tinto?

Binns  I don’t believe so, and, I mean, what we have seen recently with developments with the Government—I mean, we need to get fully briefed and decide how we’re going to take negotiations forward. I mean, as I said, Mr Moller and I only got briefed yesterday in terms of where things were moving.

Norman  How long has the Government been (inaudible)?

Binns  Oh, I think they came and saw us in July last year, and I think at the same time as they saw us they also saw the Government.

Norman  So there’s effectively been a Rio Tinto kind of parallel negotiation strategy, with Meridian on the one hand and the Government on the other?

Moller  Not sure it’s a negotiation. Discussions, but we’re not privy to those. We haven’t been at them; officials have briefed us from time to time. We’ve been very open with officials and Ministers where we’re at. I think these questions really have got to be asked of the Government, because otherwise we’re just speculating.

Norman  That’s fair enough. But it clearly involves you, though, because you’re in the negotiating room. Just one thing, just to finish it—on your announcement this morning, the share price of Contact dropped 3 percent as a result of the announcement, which seems rational. If all this extra cheap power comes on the market, does it seem to you a rational market consequence that companies involved in these businesses, or some of them, are going to be worth less (inaudible) exposed (inaudible)?

Binns  I haven’t looked at the market; I don’t know what the market’s done. Has the market overall gone up or down, and if it’s gone down, I’m talking the whole NZX now, then—you said 3c, did you?

Norman  Oh, sorry, Contact went down 3 percent and—

Binns  Oh, 3 percent—sorry, I thought you said 3c.

Norman  So if it is that sensitive, it seems to be that if there’s going to be a whole bunch—14 percent of the power suddenly goes on the market at a cheap price, then some companies are going to be worth less?

Binns  I think that is probably a rational reaction, but, I mean, again, I would say: remember, we’re not there yet. All we’re saying is it is looking tough.

Young  And it might defer capital investment in the industry as well. Just in the context of what Russel’s asking about, this contract—the contract renegotiated was—you started discussions in 2007?

Binns  No, started discussions in 2005, as I understand it, and signed in 2007.
Young Signed 2007 to commence 1 January 2013?

Binns That’s right

Young So at what point in time was—I presume that there was obviously an agreement around that. At what point in time did the first hand up say, look, we want to renegotiate that?

Binns That was in July last year.

Moller Six months before the new contract kicked in.

Young OK. So you’ve been working pretty hard to keep the smelter viable for them. You’ve talked about a range of changes and concessions. Is there a broad range of concessions and changes, or are you just talking about one particular thing?

Binns No, it’s not just solely price. I mean, there is some variation in the terms on other issues, but again I can’t go into the detail.

Young Sure. OK. Thanks very much

Parker You said you’re going to inquire of the Government what it is they are after in their negotiations. Presumably you’re going to give them advice as to what will be the effect on both Meridian value and power prices of their interventions.

Moller I think we need to have further discussions with them before we decide what actions we’re going to take. I mean—

Parker You’ve already told us that you’ve modelled what will be the effect of outcomes on you in terms of Meridian’s optimal outcome and in respect of the effect on power prices.

Moller There is a range of outcomes

Parker A range, well, I’m sure it’s (inaudible). Will you be sharing that with the Government, and if not, how can your sole shareholder make a rational decision both with their shareholder hat on and also as to their interest in New Zealand consumers as to what they should or shouldn’t do?

Binns Well, that’s a decision that is up for the Government. I mean, the Government is the ultimate shareholder of—

Parker So they could ask for this information and you would have to give it to them as their shareholder?

Binns Well, depending if it’s the modelling, if they asked us for it, yes, we probably would. But confidential information that we have under confidentiality agreements, we can’t.

Parker I’m not asking about the stuff that you’ve got to keep confidential with Rio Tinto, but the modelling that you’ve done on the effect on power prices and Meridian’s value is something that the shareholder would be entitled to know.

Moller But I think if we were to do that and got that question, we would be putting the caveat on it that we were giving it to them in confidence too.
Parker  Well, why?
Moller  Given the serious nature of the negotiation.
Parker  Well, isn’t that for the shareholder to decide?
Moller  Well, we’re entitled to make the request. I mean, OIAs, as we know, I mean, the company concerned can make a request that certain information is not released, and sometimes it is and sometimes it’s not.
Parker  Having said that there’s an enormous parliamentary interest in terms of what’s going to be the effect on power prices. There’s incredible suspicion around New Zealand that we don’t have a properly competitive electricity market anyway—
Moller  We absolutely understand the public’s and everybody’s interest in this matter, but we’re also charged with getting a commercial negotiation complete, to which significant dollars are attached.
Lotu-Iiga  If you released that information, it would seriously undermine the negotiations that were taking place (inaudible).
Binns  Well, we most certainly would not release that information in the public domain—absolutely.
Lotu-Iiga  If you did it, it would seriously impact the relationship (inaudible). It could seriously undermine a deal that could be done in the short term.
Binns  And it would seriously undermine our competitive position with our competitors too.
Yang  I understand Meridian is seeking to grow its renewable generation. What’s the percentage of its renewable generation in its total generation output?
Binns  I think last year we produced around about 11 percent of our generation was from wind, and the balance was from hydro in New Zealand.
Yang  Do you have a strategy to increase renewable generation?
Binns  Yes, when the time is right. I mean, clearly, economic times are difficult at the moment. It might be some time before another power station is built, but when the time is right and we’ve got projects that are in the correct position on the merit order, I mean, we will be looking to build them and they will be renewable.
Yang  I understand that Mill Creek wind farm is under construction, while at the same time cancel some other wind farm projects—
Binns  Yes.
Yang  How do you decide, firstly, on viability of wind farm projects?
Binns  Basically, the ones that we had to cancel, I mean, we made an assessment of likely demand over the next 5 years. We saw that demand looked like it was going to be soft.
Yang  So can you give us an update of these two wind farms.
Binns  In terms of progress, Mill Creek is progressing on programme, on budget, and will be producing power in 2014. And the other one that you wanted comment on? Macarthur. Macarthur is a joint venture with AGL, and it has currently reached practical completion and in full generation.

Yang  It is ready to generate.

Binns  It is. It is generating power now.

Clark  My question is in two parts. The first part relates to the simple proposition that (inaudible) electricity prices will reduce the underlying value of energy companies in New Zealand. You’ve done modelling of the effects of that. Could you—is this likely (inaudible)? Could you give us an indication of the range of value lost to the industry as a whole (inaudible) negotiations are completed.

Binns  No.

Clark  You can’t or you’re not (inaudible) to?

Binns  No, I can’t give you—I don’t have that information here right now.

Clark  Could we request that—

Binns  Well, you could, but we might want to review whether we have to give you that information. But we’re more than happy to look at it.

Clark  You accept that there’s quite an interest in—

Binns  Of course.

Clark  The second part of my question is around whether, given that the value of the SOEs will obviously follow that logic and diminish, but you said you see advantage to you in the market potentially as a result of this (inaudible). Does that then mean that you would prefer the Government to keep out of negotiations, because (inaudible) propping up your competitors ahead of the asset sales programme—

Binns  No, we will accept that if the smelter goes, I mean, there will be implications for all market players. We would prefer that they stayed, but as I said before, there is a point at which we just say we can’t go any further.

Young  So if Rio Tinto made a decision that they were going to sell the smelter, there is a time frame where they give you notice. How long is that?

Moller  I can’t give you the notice period, because that’s also part of the confidentiality.

Young  OK. Thank you.

McClay  Through the course of this morning, we’ve had repeated requests from the Opposition to release information that you think would be detrimental to negotiations—indeed, that it would make it more (inaudible). In October of last year, the then Labour spokesman for economic development, David Cunliffe, was calling on the Government to intervene to save the smelter. Now we’re having suggestions today that the Government shouldn’t be doing its part. The fact that the Opposition is putting politics before jobs— [Interruption]
Moller: I think we would ask you to address that to your colleagues over there.

Clark: Point of order.

Young: There’s a point of order to his question, no doubt.

Clark: Mr Chair, I think the member’s referring to my question, which was asking whether Meridian wished the Government to keep out—

Young: That’s actually a debatable point. It’s not a point of order. Carry on, McClay.

Moller: Well, I think the answer is that we’re not in a position to comment. I mean, address that to your colleagues on the other side of the House.

Norman: Just as much as you’re able to (inaudible) of negotiations, where’s the bottom line? I mean, it’s like one way to think about a bottom line is you can’t reduce—if it were just a price issue, and I accept that (inaudible), but if it were just a price issue, you can’t reduce (inaudible) anything less than (inaudible). But your position’s more complex than that, because you have other options than the smelter, right?

Moller: That’s right.

Norman: Because you’ve got the rest of the grid. So the smelter and you, you’ve both got options. The smelter (inaudible) you can make aluminium somewhere else—or Rio Tinto can if they want to—and you can sell (inaudible) as well. So it seems to me that of the three parties in the negotiations, both of you have quite a lot of options where it feels to me like the Government as the third party in the negotiations is most against the wall because of the asset sales programme. Does that concern you about how they will (inaudible) in the negotiations?

Moller: Again, it’s a matter for the Government. I mean, we’re not even listed at this stage as proceeding through the mixed-ownership situation. It’s been announced, of course, that there were three or four companies. Mighty River is the only one they’ve chosen to proceed with. We’ve had no update at all from the Government on that matter. We don’t know whether we’re likely to proceed and, if so, when, so we have to adopt our approach to this whole thing is around what’s in the best interests of Meridian relative to the counterfactuals we have to look at.

Young: It might be more helpful for our gentlemen here—our visitors—if you didn’t try to get them to agree to your political positions but just ask questions. I think that would be helpful.

Norman: OK. So my question about the asset sales, and why it is relevant to this—and tell me if I’m wrong—is that because if the price of power drops, the value of the assets will drop. The Government’s dealing with Mighty River Power at the moment, then Genesis after that. Genesis owns Huntly, right?

Parker: And e3p.

Norman: Yeah, so if there is a problem with those companies because the smelter goes away, the value of those companies—it’s probably lessened already—could drop. So the Government does have a concern about these
negotiations because of its asset sales programme. It’s not related to your
sale, but that’s my point.

Young

Yeah, it’s a point rather than a question. Look, I think you can ask that
question in the House. It’s probably a better environment for that.

Clark

My question is a question around the Government’s general programme,
and it’s building on Dr Norman’s point (inaudible). When is the best time to
sell assets to maximise shareholder value? Is it when there’s an uncertain
future with dropping prices and returns _____ or is it at a time when there’s
a clearer future and prospects of rising value over time?

Moller

Look, I’m not going to proffer an opinion on that. I mean, the matter of the
whole mixed-ownership process is a matter for the Government. They own
100 percent of us.

Clark

(inaudible) the Government?

Moller

Well, I don’t think I should be speculating on that.

Mitchell

My question is around—any company carries risk, and the board and the
CEO and the management are there to manage that risk. There are a lot of
examples of companies that carry risk around (inaudible). So in terms of
Meridian, and of course any other companies that may be impacted, you
would expect that there’s possibly management going on around if you lose
that contract, if that changes, how do we weather the storm and carry on—
the long-term strategy. With Meridian’s long-term strategy, is the company
still going to be a good, viable company in the future?

Moller

A good, viable company?

Mitchell

Yeah, even with the risk currently around Tīwai?

Binns

I think most certainly it will be. I mean, as I said, if NZAS departs in
accordance with its contract, there’s sufficient period for the market to
adjust, we see some moves in the generation market that are logical, which
will see the supply side sorted out, and we think the transition if it did occur
can be made in a relatively smooth way, with Meridian remaining a vital and
profitable and very desirable company.

Yang

The campaign of the Electricity Authority’s What’s My Number—what
impact has that campaign had on competition in the retail market?

Binns

The last number I saw was that retail churn was around about 18 percent,
but that campaign has led to churn rates that got up to 23 or 24 percent. So
it’s had a marked impact on competition. I mean, it is very, very difficult to
retain customers.

Member

Retail competition?

Binns

Retail competition.

Yang

So you feel the pressure.

Binns

We most certainly feel the pressure.

Young

So what are you doing to retain customers and the challenge of that?
Binns: Well, No. 1 is you’ve got to provide a good service. I mean, service is No. 1. No. 2 is you’ve got to be in the 21st century and bringing smarter energy solutions, better interfacing solutions through smartphones and the internet—is the way of the future—and we’re bringing more and more offers to our clients which allow them to control their own future in terms of their electricity usage. We think we’ve got some very good applications that are going to be highly valued in the market place.

Moller: Pity you weren’t at our board meeting yesterday where we had a demonstration of some of the things that have been done in our retail activity. They really are groundbreaking. We will continue to see real change in the retail electricity market.

Parker: You said that there are some important issues at large other than price, and, you know, obviously, you don’t have to be a rocket scientist to know that probably the three most important areas for you are price, quantity—in terms of including what happens in a dry year—and (inaudible) the contract. My understanding from these negotiations—and it’s a matter of public record—is that, you know, there has to be significant advance notice of material changes to these contractual arrangements. Is one of the issues at large here (inaudible) Rio Tinto wanting to have greater ease of exit from the contract?

Binns: I can’t comment on what the motivations of Rio Tinto, as the owner—

Parker: Not their motivation, what they’re asking for. They want to get out of this contract easier at shorter notice.

Binns: I can’t comment.

Moller: I don’t think we can comment on the specifics, but you’re right. Those three areas are some of the issues that are still being challenging. There are equally significant issues not amongst those three you’ve talked about, but I’m not going to be specific as to what those are.

Young: Right. Any further questions? Right. Thank you very much, gentlemen. Good day to you.

conclusion of evidence
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the MidCentral District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2011/12 financial review of Mighty River Power Limited

Report of the Commerce Committee

Contents

Recommendation 2
Introduction 2
Business strategy 2
Initial public offering 4
Answering of written questions 4
New Zealand Labour Party and Green Party minority view 4
Appendix A 6
Appendix B 7
Mighty River Power Limited

**Recommendation**

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of Mighty River Power Limited and recommends that the House take note of its report.

**Introduction**

Mighty River Power Limited is a state enterprise under the State-Owned Enterprises Act 1986. It is a generator and retailer of electricity, with interests largely in the central and upper North Island. Its generation is primarily from renewable sources, with nine Waikato River hydro-power stations and three geothermal stations. It also operates a gas-fired co-generation plant. It has overseas interests in the United States, Chile, and Germany through its investment in GeoGlobal Energy. Joan Withers is the chairperson of the board and Doug Heffernan is the chief executive.

In 2011/12 Mighty River generated total revenue of $1.52 billion, an increase from $1.16 billion in 2010/11. Its after-tax profit of $67.7 million decreased from the previous year’s $127.07 million. The company attributed this decrease to a significant fall in wholesale interest rates in the first half of the year, which resulted in recognition of an adverse change of $118 million in the non-cash fair value of financial instruments and of associates and joint ventures.

The Government began taking registrations of interest from the public in Mighty River shares on 5 March 2013. We noted that Mighty River was in a pre-prospectus window, which meant that it was restricted by the Securities Act 1978 in what it could say about the proposed initial public offering process.

**Business strategy**

We commended Mighty River on its steady financial performance. We noted Mighty River’s report of lower demand growth conditions in the industry, and its suggestion that it would reduce operating cash flow for new domestic power projects. We asked what that would mean specifically for Mighty River’s domestic development projects. It said that demand in New Zealand had been flat for some time, so it did not see much need to invest in further generation capability. As it did not need the capital for development, it had decided to increase its dividend to shareholders from 75 percent of adjusted net profit after tax to between 90 to 110 percent of adjusted net profit after tax.

We asked whether Mighty River believed electricity supply in New Zealand could become an issue if overseas shareholders wanted a greater return. It responded that it looks to its statement of corporate intent, which states that its “core objective is to perform comparable to a company that is not owned by the Crown”. The company believed the Electricity Authority would monitor security of supply issues. It also noted that of the country’s energy generators, Mighty River had built the largest generation assets in New Zealand over the last four or five years, motivated by economic returns rather than concerns about security of supply. It believed the market worked successfully and was much more secure as regards supply than a centrally planned economy.
Mighty River did not agree with claims by Contact Energy and TrustPower that state enterprises were under-pricing electricity. It said it could not comment on their pricing, but noted that Mighty River had increased its market share.

We asked whether Mighty River had analysed the implications of the possible closure of the Tiwai aluminium smelter, leading to a 14 percent increase in New Zealand’s electricity supply capacity. It said that the company had to make sure it was resilient as possible in a wide range of potential scenarios. It believed its 90-percent-renewable generation, low operating costs, and close proximity of generation to customers helped to make it resilient.

**International geothermal investment**

We asked about the international expansion of geothermal expertise. Mighty River said that there was huge demand for its expertise in this area. It said that a United States partner had been providing management in this area, but in mid-February 2013 Mighty River had restructured this arrangement, taking direct control of its geothermal interests in Chile. It was also an investor in the EnergySource geothermal development in the United States. It said such projects took some time to produce returns, and the Chile project had not yet delivered a return. However, the EnergySource project had produced a return after 29 months, which was much faster than similar investments in New Zealand, which took approximately a decade to produce a return. We asked whether such international projects carried a risk of the loss of intellectual property to overseas companies. Mighty River said that it risked losing intellectual property simply from staff leaving the company, and to retain them it had to make the most of international opportunities for expansion.

**GLO-BUG pre-pay electricity**

We asked about Mighty River’s GLO-BUG product, which allows customers to pre-pay for electricity. Mighty River said it had developed the product in response to engagement with community organisations, particularly budgeting agencies. A staff member continued to engage with these organisations.

We asked how the company measured the resultant benefits to communities, and particularly for those on low incomes, and whether it had seen changes in consumer behaviour. It said that the most pleasing result had been lower electricity costs incurred by households using the product.

**Research**

We noted that Mighty River had research agreements with the universities of Canterbury and Auckland, and asked whether the company undertook its own research with a dedicated team. It believed it was a better arrangement to partner with the universities for long-term research. It invested in the universities’ infrastructure, which in turn improved the universities’ capability to undertake research for the company. It believed the partnerships were also beneficial for the universities, and observed that sometimes graduates would bring their expertise to work for the company.

We asked whether Mighty River believed it was a world leader in technology. It said it had very good scientific capability as a result of its university partnerships. It believed this capability could grow through international expansion of New Zealand’s geothermal expertise.
Initial public offering

In light of the upcoming partial sale of Mighty River, we asked when it believed was the best time to sell shares in a company. The chair said that in her professional experience it was up to shareholders to determine when to sell, taking into account various risk factors.

We asked what had been done to prepare the company for sale, and at what cost. Mighty River said it was constrained in what it could tell us, but a lot of work had been done, at a cost of $6.7 million as at 31 December 2012. It said that public relations, communications, and marketing accounted for less than 0.1 percent ($6,000) of the costs at 31 December 2012, the bulk of which were legal and accounting costs. At 28 February 2013 the total costs had increased to $7.5 million. Mighty River believed that the additional fee being paid to directors for related work was approximately $1,200 per day.

We asked whether Mighty River had undertaken any analysis of Māori water rights following the Supreme Court decision in February 2013. It said it was aware of the need to examine all risks, as it was critical that the board made sure the company’s share offer document clearly described all the risks the company faced.

Listing on the Australian stock exchange

We asked whether Mighty River had been discussing listing on the Australian stock exchange with parties in Australia. It said it had had internal discussions about the possibility, and had discussed the matter with government officials but not with Ministers. It said that any decision to list the company in Australia would have to be made by the Government as shareholder.

The chair of Mighty River said her personal view was that the company should be listed on the Australian stock exchange, and that dual listing had worked well for Auckland Airport, leading to a better price for shares.

Answering of written questions

Some of us observed that Mighty River had not provided full replies to the written questions sent by the committee before the financial review hearing, and were concerned that without full answers it would be difficult to examine the company adequately.

We noted that the written questions had been the same every year for some years. The chief executive said he had seen the answers and took full responsibility for what had been provided. He observed that this was the first time in 14 years as chief executive that the written questions had been referred to in a financial review hearing, and suggested that the questions might usefully be restructured, as many of them referred to Government departments rather than state enterprises. National members believed that the questions could be more specific. Mighty River agreed to reconsider the questions if they were reworded to ask about state-owned enterprises. After the hearing, the committee sent Mighty River revised questions and received more complete responses.

New Zealand Labour Party and Green Party minority view

It was noted in respect of the written questions submitted that these questions were the same questions with the same wording submitted to this state enterprise and others, both in the current financial year and the prior financial year. In the previous reporting period, it was noted that Mighty River Power was fully prepared to answer all the questions submitted to it, as did all other state enterprises. It was further noted that in the current
period all other state enterprises were fully prepared to answer the questions submitted to them. Mighty River was the only state enterprise that objected to the written questions put to them. Further, we noted with concern that the chief executive and chair immediately after the hearing concluded provided answers directly to the media that they were not prepared to provide to the committee. We consider the conduct of Mighty River in this respect inappropriate and disrespectful to the committee and the financial review process.
Appendix A

Approach to this financial review

We met on 7 March and 11 April 2013 to consider the financial review of Mighty River Power Limited. We heard evidence from Mighty River Power Limited and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received

Mighty River Power Limited, responses to questions, received 14 November 2012 and 1 February 2013.

———revised responses to questions, received 14 and 27 March 2013.


Organisation briefing paper, prepared by committee staff, dated 22 February 2013.
Appendix B

Corrected transcript of hearing of evidence 7 March 2013

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Gareth Hughes
Peseta Sam Lotu-Iiga
Mark Mitchell
Dr Jian Yang

Witnesses
Joan Withers, Chair
Doug Heffernan, CEO

Young Can I invite Mighty River Power, please, to come to the table. Thank you. Before you do that I’d like to read out a statement.

? A statement? What on?
Young Regarding the mixed ownership, their pre-prospectus window that they’re operating in at the moment.

? What is it?
? Is that a good idea, Clayton—
Cosgrove A statement from who, about what? What statement? (Inaudible)
Young Sorry?
Cosgrove What statement? Is this Standing Orders or what?
? This is a legal position. They’re in a prospectus window.
Cosgrove Yeah, well, that’s for them to say, not for—
Clark Point of order, Mr Chair. Can I raise a procedural issue, and it relates to the hearing of evidence today. The job of this committee, in my view—and I’ve given this some thought—has been made incredibly difficult by Mighty River Power not really engaging with the questions put forward by the committee. The questions are standard questions that are put every year. The other SOEs that we’re examining have found a way of responding to them, even if they disagree with the minutiae of the way the question’s worded. As I understand it, our job here as a committee is to represent
taxpayers’ interests, to make sure probity issues are covered off, and to have a thorough investigation of these assets, which are currently State-owned.

I contest, Mr Chair, that we cannot do our role effectively if Mighty River Power has not answered the questions that we’ve put them to them, has not engaged with the questions we’ve put to them, and so I seek leave to have this review held over until Mighty River Power have engaged with the questions. If necessary, we can resubmit them in a form that covers off those legal issues, but I don’t think we as a committee can effectively do our job on behalf of taxpayers unless we have had the questions that we have put to Mighty River Power answered. So can I submit that we hold this review over until such time as the questions have been answered?

Cosgrove Speaking to the point of order, the guts of this is, and my colleague can give you examples, that what Mighty River has done is taken the most, I’d call it, work-to-rule interpretation of questions. And where, for instance, Genesis and even Solid Energy, for goodness’ sake, have responded in detail to exactly the same questions, this organisation has decided to simply say it’s not applicable, on the basis of the words “department” and “ministry”. I would point this statistic to you. There was a submission of 133 questions and this SOE has answered 37 of them, and of those 37 there isn’t much detail around that.

Now, if it is good enough for Genesis, every other Government department, and every other SOE that we’re examining to answer those same questions put to them in the same way, rather than being smart alecs and interpreting the question in the strictest possible terms over a hundred times, then I think it’s incumbent on this SOE to do what others have done and answer the questions. We can’t examine them if they refuse to answer written questions.

Lotu-Iiga Speaking to the point of order, I will raise within this point of order about calling our guests smart alecs when an allegation’s been made about answering questions. I have the questions before me, Mr Chairman, and some of them are questions that clearly they cannot answer. I’ll give you an example and I will give the public the example. I’m a bit perturbed that these matters weren’t raised before the committee meeting to actually discuss this, because we have 1 hour with these folk, who have travelled down from Auckland, and this is political grandstanding. There’s no other way of—

Cosgrove Is this a point of order or is this a speech?

Lotu-Iiga Well, I’m just—I’ve given you a chance to speak; I’m responding to his point of order.

Where they’ve answered questions like: “Will the Department/Ministry’s and its associated agencies’ mission statement …”—well, there were no changes in the company’s general statement of purpose. They are clearly answering these questions where they are not applicable. Now, these issues have not been raised—
Clark Speaking to the point of order, the issue raised by Mr Lotu-Iiga, he’s read out question 1. If you follow through questions 2 to 10 you will find that all of those have been effectively refused, and if you follow through, say, for example, Genesis Energy’s submission, you will find that questions 2 to 10 have all been answered in good faith. When one in 10 questions is answered, and that wasn’t a particularly substantive answer you read out, I don’t think that is credible and I don’t think we’re doing the people of New Zealand justice in examining this SOE. I do not think we are doing our job as a committee if we cannot ask the questions and have them answered on behalf of the taxpayer.

Young Order! Thank you. Now, leave has been asked, there’s obviously some disagreement around this. We’ll go to the—

Cosgrove Well, could we seek an explanation from the company as to why they’ve chosen to act this way?

Young You have got time to ask questions, or any questions that you are dissatisfied with. Entities do not compare their answers one with another. So bringing those comparisons to the table here, I think, is futile. Leave has been asked. Any of those opposed, please indicate, or those for.

? Yeah, we oppose.

Young All right, leave has failed.

Clark Can we have the vote recorded please?

Lotu-Iiga Can we have the vote recorded please, Mr Chair?

Young Sure, record the vote. Right, prior to your commencement I’d like to just read out a statement. “With regard to the Government’s mixed-ownership model process, Mighty River Power is currently in a pre-prospectus window. This means that they are restricted in what they can say about the proposed IPO process or what it might mean for the company. If the committee requires a response to particular points, then this could be done in writing, but the committee would need to be cognisant of the restrictions under the Securities Act.” Madam chair, welcome to the table, and your team. If you’d like to introduce your team to us.

Withers Thank you, Chair, and thanks for the opportunity to present to the finance committee this morning. I’m Joan Withers—

Cosgrove It’s the Commerce Committee.

Withers Sorry, Commerce Committee. I’m Joan Withers. I’m chair of Mighty River Power. I have with me our CEO, Doug Heffernan, and our CFO, William Meek. What we’ll be doing this morning is reviewing the period to 30 June 2012, and then we’ll also look at the subsequent period to 30 December 2012, which, of course, we’ve just reported on. The plan is we’re going to talk to a few slides, and then we will welcome questions from committee members. And we’ll do our very best to answer them.

If you turn to slide 2 first, just to give you some background, most of you are aware of our pedigree and we are a leading New Zealand integrated
electricity company. We have, as you know, a strong focus on renewables. In fact, more than 90 percent of our generation comes from renewable sources, about 60 percent from hydro, from nine power stations along the Waikato River, and around 30 percent from geothermal. Obviously, those activities are in collaboration with our Māori land trust partners. We operate four geothermal power stations in the central North Island and then the remainder of our generation comes from a multi-unit gas-fired plant in Southdown, which can respond to peaks in the wholesale market and, thus, gives us significant generation flexibility.

We generate around 17 percent of New Zealand’s electricity and we sell power to just under 20 percent of New Zealand homes and businesses through our retail brands, which you will know well: Mercury, GLO-BUG, Bosco, and Tiny Mighty Power. We have significantly increased our power generation in the last decade, and the next big generation milestone for us is coming up in the middle of this calendar year. It will be the 82-megawatt geothermal plant at Ngātamariki. That will boost the geothermal component of our generation portfolio to around 40 percent.

We have in the last few weeks made some changes to the structure around our international geothermal investments. We have taken direct control of the international geothermal project in the operating subsidiary in Chile, along with minority interests in EnergySource and its related entities. EnergySource is a geothermal development and an operating company that’s based in Southern California. In all of these investments we’ve taken a measured and prudent approach to international geothermal activities, and we’re going to talk about that in more detail very shortly.

So just turning now on slide 3 to the financial results, I would characterise our performance over the last two reporting periods as being very credible. In the financial year to 30 June 2012 our headline net profit after tax reduced by $59 million to $68 million. But that result was distorted by IFRS-required non-cash adjustments to the fair value of financial instruments that was predominantly driven by lower interest rates. Our EBITDAF, which is earnings before interest, tax, depreciation, and financial instruments, was up 4 percent to $461 million. Should note that that follows a $115 million uplift in EBITDAF in the 2011 financial year.

Our underlying earnings, compared to the prior corresponding period, were flat at $163 million. This reflected increased operational earnings offset by increased depreciation and lower reported equity accounted earnings. We achieved increases in both fixed price variable volumes, electricity sales prices, and also volumes to customers of 5 percent on the prior comparable period.

The company’s hydro generation was down about 2 percent, which reflected the lower inflows into the Waikato catchment in the April-June period, but that was still 294 gigawatt hours above the annual average.

In terms of dividend payments at 30 June, we’re still operating on our previous policy of 75 percent of adjusted NPAT, so our total dividend for the full year was $120 million, which was up 9 percent on the year prior. We
have very recently adopted a higher payout ratio of 90 to 100 percent of NPAT adjusted, which was the range applicable to the recently declared dividend of $67.2 million that will be paid to the Crown later this month. And Doug’s going to shortly take us through the most recent interim results.

Slide 4: our business is based fundamentally on the ability to generate electricity from the sustainable use of natural resources. So the long-term partnerships are crucial to our business model and to our success. Those partnerships are held within the operating communities where we operate our hydro assets, and also in our geothermal business we have very meaningful relationships with Māori land trusts, which are designed to deliver intergenerational benefits. The trusts receive financial returns by way of royalties and co-ownership in geothermal assets, which have helped support initiatives to build expertise amongst young people in the community, from apprenticeships through to graduate programmes.

Our relationships with our Māori partners focus on the principle of kaitiakitanga, so we apply our knowledge, our expertise, and technology to manage resources sustainably. This helps provide economic and social benefits to all concerned. So we have longstanding and mutually beneficial relationships with the Tauhara North No. 2 Trust, which supports the management of the Rotokawa, Ngā Awa Purua, and Ngātamariki geothermal developments; have it with Tuaropaki Trust, Mōkai, Ngāti Tūwharetoa, and Pūtauaki Trust at Kawerau; and Ōkūrei and the Ruahine Kuharua over the future development of the Taheke geothermal field.

On to the next slide, slide 5—leadership means really that we need to get things done through other people. So we sit here today representing our 800-odd employees, and helping them to be the best they can possibly be and achieve their full potential is a critical part of our reason for existence. Our people underpin the success of our business, and at the year end the company employed, as I said, about 800 people, but that’s now been expanded by about 50 with our direct involvement in Chile.

In the past couple of years we’ve had increased focus on leadership development, on specialist skill training, and on enhanced frameworks for performance management. We have independently conducted reviews to measure and monitor staff engagement. Through the year we’ve seen shifts in those pre-employment measures with improvements in how we rank against other organisations, how engaged the average employee is, and the proportion of employees who are engaged with the organisation and its goals.

We continue with our programme to unlock employee potential by investing heavily in leadership development across the organisation. Our work with Contact Energy to develop the Electricity Supply Apprentice Programme, the University of Canterbury Source to Surface programme, and our sponsorship of the Auckland University’s chair in geothermal reservoir engineering all demonstrate our commitment to enhancing the technical specialist capabilities across our industry. We are also very proud
of longstanding sponsorship relationships with Rowing New Zealand, the Ironman Volunteer Crew, and the Waikato River Trails Trust.

We’ve raised significant energy through Mercury Energy’s Star Supporters Club and also we’ve been recognised in awards in the last 12 months: Deloitte Energy Excellence Award for innovation for our GLO-BUG product, and that success has built off engagement with the community and understanding how to help customers who are having financial difficulty.

Doug is now going to provide a bit more insight into the operation.

Heffernan

I was just going to say, Mr Chairman, I’m only going to touch on a few of the slides that are in the pack, but I do want to spend a little bit of time just going through health and safety. As Joan has said, people are fundamental to our business. Supporting our approach on health and safety is an absolute priority. It’s our firm belief that better reporting systems are a key part of achieving an improved performance through improved learning, improved awareness, lessening the risk of injury to our people. So we’re pleased to report our near miss reported incident frequency rate was up 45 percent on the previous year. We’ve also achieved zero employee lost-time injury from July 2011 to February 2013, and the Ngātamariki construction site recorded zero lost-time over 18 months and 700,000 man-hours. However, during the half year we were extremely disappointed that a significant near miss incident occurred on the drilling site at Ngātamariki, when a piece of drilling equipment became dislodged. Although no injuries were sustained, this was a serious near miss with a high potential consequence, and is therefore treated very seriously within the organisation and is being investigated by the High Hazards Unit of the Department of Labour.

The focus on achieving zero harm is ongoing—I focus on reporting and learning from these sorts of near misses—is powerful in ensuring that staff and every contractor take health and safety seriously. The electricity industry as a whole has a generally very good record, but there is always room for improvement, and a key focus of the StayLive generation safety group, of which Mighty River is a founding member, along with four other of the large generators, is improvements in contractor safety—in particular, at the subcontractor level—and in their reporting standards, to get improved safety across the entire industry. Despite the near miss incident, the total recordable injury frequency rate was down 46 percent on the prior period, and 73 percent on 2009. So good, steady growth.

Turning to slide 7, you can see the steady increase in our total generation over 5 years, fuelled by the geothermal investments. Annual production of the company’s diversified and flexible portfolio increased by 3 percent in FY12, 92 percent from renewables.

On slide 8, competition has remained strong across the sector, as you heard from the Electricity Authority earlier. In our view, the primary driver of that increased competition has been the significantly increased generation
capacity through the investments that we and others have made over the last 5 years. We’ve continued to achieve sales growth with a customer level over the 5-year period in a flat demand environment, which means we’ve been achieving market share gains at the customer level. And that’s flowed through into the results to the end of December, with volumes increasing over that period by 9 percent on the prior period.

I won’t talk to slide 9 on capital. Slide 10 on market dynamics—this is just touching on something that was a question of interest in the previous session. If you focus on the bottom right-hand slide, what that shows is declining industrial consumption. That’s not a new thing. It’s been happening since the early 2000s, and you can see the effect of efficiency gains being made by large industry, electricity-intensive manufacturing locating closer to customers, in many cases outside of New Zealand, and the continuing use of newsprint, as Norske Skog is testament to, and also global aluminium prices falling. All those things have led to declining industrial consumption. But these are very, very similar trends to what you see in all developed economies around the world. Our trend is not out of step. In fact, it’s rather muted compared to most developed economies.

Residential demand here in New Zealand is actually up on 2007. It does move around a bit year on year with weather, but it’s definitely up. The commercial sector is flat. That’s probably more reflective of the general economic conditions, but it’s a much, much better consumption level than you’re seeing in, say, the eastern seaboard of Australia, where commercial consumption is declining.

I won’t talk about the next one or the one after that, just touch briefly on slide 13 on international. Joan’s already talked about taking direct control. We do have 50 people headquartered in Chile, in Santiago, who are now part of the Mighty River team. And perhaps if there’s any questions, I could come back to that slide. But the only thing I’d stress about that is what we’ve shown here in New Zealand is we’ve now got a very large geothermal business. We’re the 13th largest owner of geothermal anywhere in the world, but it did take a decade from concept to cash flow. And when we look at a market like Chile, we see the same long gestation period should be applied.

I won’t talk about 14, 15, or 16. I would like to touch just on transmission pricing, because it was a topic that flows on from the last session. We do have concerns, as do many, many others within the industry, in the Electricity Authority’s proposed transmission pricing methodology changes. We’ve made submissions on that. We do not believe their proposal is consistent with best regulatory practice on a global basis, and that view has been supported by a number of independent experts that have been part of the submission process. We’re not convinced it will deliver tangible benefits to consumers, and we’re particularly concerned about the application of the proposal being backward-looking, resulting in significant reallocation of sunk costs, which is, to put it kindly, a highly unusual regulatory approach. We believe the best approach for the EA would be to reconsider the draft proposal in light of the submissions, and to distribute a revised approach for consideration.
Young: Right. Thanks for your comments, Mr Heffernan. We’ll come now to questions. Thank you very much for your presentation.

Cosgrove: Can you confirm whether you’ve been in discussions with parties in Australia regarding listing on the ASX?

Withers: I haven’t personally been involved.

Heffernan: Yes, I can. I have met with potential investors in capital markets, equity and debt, along with the CFO.

Withers: Yeah, but not listed. The question is listing on the ASX.

Heffernan: Not related to listing on the ASX, no.

Withers: No, no.

Cosgrove: So Mighty River Power hasn’t had any discussions with any parties regarding listing on the ASX?

Withers: We’ve had internal discussions about that issue, yes.

Cosgrove: Have you had discussions with Ministers in respect of that?

Withers: I’ve had discussions with officials in relation to that.

Cosgrove: But not Ministers?

Withers: Not Ministers.

Cosgrove: And what recommendations have you made or have officials made in respect of listing on the ASX or not?

Withers: The decision as to whether to list the company in advance of the float would be a decision for the Ministers, and I think you probably need to direct the question to Treasury officials.

Cosgrove: And have you made any recommendations to Treasury officials in respect of listing or not?

Withers: I have expressed a personal view, yes.

Cosgrove: And what’s that personal view?

Withers: My personal view is that the company should be listed on the ASX.

Cosgrove: And why is that, given that there is strong demand, as was predictable, for these shares, at least in preregistration? Why do you hold that personal view?
Withers: I don’t want to traverse too far into issues that we’re precluded from talking about. I’ve given you my personal opinion, which I have expressed—

Cosgrove: And I’m asking for the rationale behind your personal opinion. You did offer it.

Withers: A lot of experience.

Cosgrove: In what?

Withers: Govern—

Cosgrove: The point I’m trying to make to you is that certain people are scratching their heads, trying to ascertain why it is, if we wanted mass Kiwi ownership, that the company theoretically—or at least your personal view would be recommending listing on the ASX, so Kath and Kim get a lick of the shares.

Withers: If we pull back from the Mighty River Power situation, I’m chair of Auckland Airport. We are dual listed. There is good pricing tension with having investors in Australia being able to participate. Some of the major institutions in Australia are not able to invest in the stock unless it is dual listed. So that’s the rationale at Auckland Airport. It has worked very well. And that is all I’m prepared to say on that matter.

Cosgrove: So in that respect, the advantage—if I’m getting you; if I’m hearing you correctly—if we use your Auckland Airport example to walk around other issues, is that it is advantageous to ensuring Australian institutions gain shares in that particular entity.

Withers: No, it’s to ensure a healthy aftermarket. And that really is all I’m prepared to say.

Young: Right. Sam Lotu-Iiga.

Cosgrove: Hang on. Hang on.

Young: Sorry. The chair has—

Heffernan: Sorry, I think what Joan’s trying to say, Clayton, is that for New Zealanders who’ve invested in Auckland Airport, having a dual listing means that they will get a better outcome for their shares. They’re more highly—better valued through the dual listing process.

Withers: It’s the aftermarket.

Cosgrove: So that means, presumably, that there will be greater demand within Australia for people to sell them off to Australia, presumably.

Withers: No, I’m not prepared to comment any further on that.

Cosgrove: Excuse me, that’s not a—

Young: Right. Sam Lotu-Iiga—question over this side.

Lotu-Iiga: Thank you. Welcome and good to see you. And I don’t think you’re smart alecs, at all. May I commend you for the financial performance—first and foremost—in terms of EBITDAF. I think, you know, you’re steady there, and your return to, certainly, the Government in terms of dividends has been quite good. I just want to talk about your GLO-BUG product,
because it’s something that, you know, locally for me I’ve seen its performance in terms of how you’re distributing it. Now you’ve got a contract down in, I think, Christchurch. In terms of benefiting consumers, how are you measuring the fact that this device can help consumers regulate their use of electricity and the use of appliances? Can you just sort of talk through that, in terms of the advantages that you’ve seen to, particularly—and I’ve seen it in my local community—those that are on low incomes?

Heffernan Well, perhaps the context for GLO-BUG is where do we get some of the design ideas for GLO-BUG, the product? A lot of that came from spending time with community-based organisations, originally in Auckland, around what sorts of features or needs they thought that the people that come to them—this is typically budgeting agencies looking after people who have difficulty in managing their budget week to week. Talking with them identified the sorts of things that might be helpful for those types of customers, to help them manage, in our case, the electricity part of their expenses. And so a lot of the design features came from that engagement with community-based organisations.

And that’s an ongoing piece of work. We’ve got someone who’s dedicated to doing that. And when Meridian selected GLO-BUG as the best product in the New Zealand market for prepay, we also started to engage with people in the same community-based organisations in Christchurch and taking that experience into Christchurch. So it’s nice to have won an industry recognition for the award; it’s even better that a competitor has said: “You’ve got the best product.” But, ultimately, I guess we get a lot of pleasure in seeing these community-based organisations see that it’s something that’s actually worthwhile.

Lotu-Iiga Have you seen changes of behaviour? And how do you measure those?

Heffernan I think the biggest change in behaviour, I would say—the most pleasing result for those people is because they are able to measure and see how they’re tracking, the vast majority of them have lower electricity costs than they would if they did not have that prepay product. So year on year the amount they’re paying for electricity, the total bill, is lower.

Lotu-Iiga OK. And you’ve measured that and you’ve got the evidence.

Heffernan Exactly. It’s hard to do that at an individual level, but at an aggregate level you would see how that’s trending.

Lotu-Iiga OK.

Clark I’ve got a request. You will have probably picked up from my earlier request to hold over that I’m a little bit frustrated about the way in which you’ve answered the questions. I will just use an example and then have my request. So question 2 says: “Did the Department/Ministry and its associated agencies undertake any restructuring in the last year; if so, what? How much was spent on restructuring costs and what are the estimated savings as a result of restructuring in 2012-13?” That’s question 2 in the survey. It’s a question that goes to the heart of the way the business is being
run—well, you know, asks some serious questions about decisions being taken.

Your SOE is currently owned by all of New Zealanders, who have a stake in it and want the questions asked by this committee that will give us insight into how the business is being run and whether we as a committee, with our parliamentary oversight role, are comfortable with the way the organisation’s being run. Every other State-owned enterprise has seen fit to answer that question, except for yours. These questions haven’t changed for years. The format’s the same. The answer that you’ve supplied is: “This is not applicable to Mighty River Power, as Mighty River Power is not a department, ministry, or associated agency.” You can see how that could be characterised as a kind of smart-arse answer by someone being uncharitable with their language.

Clark Could I request—and it’s a polite request—would you consider answering all of these questions if we reworded them to say “Did your SOE and its associated agencies undertake any restructuring in the last year; if so, what? How much was spent on restructuring costs and what are the estimated savings as a result of restructuring in 2012-13?”, and so on for the other 100 or so questions?

Heffernan At the risk of being called a smart alec, I did review those answers to those questions, so they passed my desk. I’m accountable for the answers that went in. I would say this is the first time in 14 years as a chief executive that I’ve ever had in this committee any question around any of the 130-odd questions that we have to answer every year. One suggestion I would make in a constructive line is that the committee does think about restructuring those questions so that they are relevant for SOEs rather than for Government departments.

Clark And that’s what some agencies have answered. My question is would you be willing to take the same set of questions and answer them if we worded them in that fashion?

Heffernan I’m happy to review the questions that came in and see those that are applicable. There will be some that we will answer, as we have done in other years, that they are commercially sensitive.

Clark Some SOEs have said “This doesn’t apply to us.” or “We haven’t done it.” or “It’s commercially sensitive.” There are answers available like that. The majority of SOEs have found fit to answer the majority of questions. So it’s a simple request as to whether you would be able to take them in the broader sense and actually allow us as a committee to do our job. This feels at the moment like a two-fingered salute to the taxpayer.
Young
Excuse me. Point of order. I think that’s uncalled-for, and can I just say, I think, taking your point, Mr Heffernan, that you’ve addressed this issue to the committee. If we want to have better answers, perhaps better questions are in order. So we’ll take that on board in terms of the quality of those questions and the decisiveness of them.

Cosgrove
I’ll speak to the point of order, please. The issue, I think, Mr Heffernan, is simply this: regardless of whether you take the strictest interpretation of a question because it suits your organisation, Genesis, Solid Energy, and a litany of other SOEs have, as is the norm, taken an appropriate definitional stance to those questions and actually answered them. And I think the point my colleague is making is I suppose you’re acting a bit like a Minister. You’re answering them on a very, very strict interpretation. Why is it that you do that, yet Mrs Shipley’s SOE is quite free to answer the same question about PR costs and other things—exactly the same wording—quite freely? Why is that? You can blame us for our wording, but it’s wording that other SOEs don’t have a problem with.

Heffernan
I’ve got no idea, because we don’t share responses. We never see the responses you get.

Lotu-Iiga
Speaking to the point of order, there is room in these questions for ambiguity, sir, and—[Interruption] No, no, let me finish. You’ve had a go. I have told Opposition members that these types of questions sometimes aren’t framed in the right way. You continued to pursue this line of questioning, which is—

Clark
We approved them as a committee.

Lotu-Iiga
No, it's lazy. I mean, basically, it's lazy. You can reframe these questions to be appropriate for these organisations, and you choose not to. So I don’t know how you can now claim that organisations can’t answer questions, when, you know, we’ve had a discussion in the past and I’ve said: “Make them appropriate for the organisations that they’re relevant to.”

Curran
Speaking to the point of order—

Young
Can I just make a comment before we come to you, Clare, that the committee has spent 15 minutes litigating this issue, where you might want to ask questions.

Curran
Speaking to the point of order, Mr Chair, this is a serious issue that this committee has dealt with before just in recent months, just before Christmas, with a very large ministry—MBIE—which came before this committee not having answered adequately or at all the questions that had been put to it in the financial review. The committee took a very dim view of that matter and demanded that not only did they answer those questions but they reappear before the committee so that the committee could have adequate time to have them address the issues that were raised by the committee. So I’d like you to take that into account.

Young
Well, look, can I say that leave was sought and leave was denied at the beginning of this meeting. I understand Clayton Cosgrove has some more questions, so let’s move on.
Curran  There’s no consistency.

Cosgrove  I’d like to go back before we were sort of truncated to the question that you, Mr Heffernan, I think attempted to answer in respect of ASX listing. Am I to interpret it that the advantage of ASX listing, as alluded to by your chair in respect to another entity, is that those institutions in Australia who can’t participate now in buying shares will be able to participate in buying shares once they are released?

Heffernan  That wasn’t what I said.

Cosgrove  Well, what did you say, then?

Heffernan  I just said that the consideration for the company is much more in the aftermarket performance and the experience of the—I think it’s eight of the 10 largest companies in New Zealand. I’m just going on what I read in the newspapers. What I read in the newspapers is that they see the benefit of that dual listing with the primary listing being in New Zealand on the New Zealand Stock Exchange.

Cosgrove  Being what, in a practical—

Heffernan  Being that it provides better price—the value of the shares is better priced by having that tension. So for those—

Cosgrove  Based on participation, presumably, in part?

Heffernan  Oh, of course, yes. The alternative would be to have less consistent and less accurate pricing of the shares, without that tension.

Cosgrove  So at the present time, if Mighty River was listed only on the NZSE, is it your understanding that certain Australian institutions would not be able to participate in the post-float purchase of shares?

Heffernan  I don’t have a view on that.

Cosgrove  Could you come back to us with—could you try and identify if that is the case?

Heffernan  It’s not something that the company has turned its mind to.

Bakshi  Can you elaborate on the preparatory work that was done before this share offer by the board and the company? Can you elaborate a bit on that?

Withers  Preparatory work?

Bakshi  Yes.

Withers  We are limited in what we can say in relation to the prospectuses the chair has mentioned. What I can tell you is that there’s been a lot of work.

Cosgrove  On that point, can you tell us the total cost of preparatory work to date, please?

Withers  The costs that were declared, I think, was $6.7 million as at 31 December 2012—that’s in our interim accounts.

Cosgrove  And that’s all related directly or indirectly to the IPO?

Withers  Correct.
Cosgrove  Thank you. Could I ask you: have you done any risk analysis of the post Supreme Court decision—the Supreme Court decision in respect of Māori and water rights? There is an interesting legal interpretation that says that there may well be risks ultimately to your profits, given that if, as the court stressed, the issues around water have to be dealt with appropriately by the Crown, that that ultimately might be resolved and result in increased operating costs to you as an entity, which then ultimately would impact on your profit. I understand the court decision; they’ve basically said it can proceed but these issues must be taken seriously by the Crown. Have you done any risk analysis around that?

Withers  We are preparing, obviously, for the process. A critical part of what the board has to do is make sure that there is a comprehensive offer document prepared that clearly describes all of the risks that the company faces. Failure to get that right has very serious consequences, so we are turning our mind very carefully to all of the risks that the company will face in the next few years.

Cosgrove  Would you characterise that as one of them?

Withers  That’s all I’m prepared to say, Clayton, on that, I’m sorry.

Cosgrove  OK, let’s turn to another public issue. You’ll be aware that electricity demand is flat. You’ll be aware that your kindred company, Meridian, is in negotiations with Rio Tinto. You’ll be aware that if that contract falls over it’s likely—the projections are a 14 percent increase in capacity on the market, which would have a direct impact on your company. What risk analysis have you done around that? That pre-dates the float and it’s been around for a long time.

Heffernan  Thanks for asking the question in that way, because usually the question is posed: what’s going to happen? And I wouldn’t have a clue. I don’t have that crystal ball. As a chief executive, my role is to try to make sure the company is as resilient as possible to a whole wide range of unpredictable potential scenarios, whether that’s demand, whether it’s water charges—whatever. And I think what we’ve tried to do is make sure that the business is resilient to those sorts of effects. So the fact that the business is more than 90 percent renewable is a point of resilience to uncertainties in demand going forward. We’ve got very low operating costs. The fuel cost of renewable plants is very low. So that helps make us very resilient. That’s the key piece of what we do. Being based in the North Island, with most of our customer demand close to us, is another point of resilience to those sorts of uncertainties.

Young  I think in your annual report, at page 5, you mention the lower demand growth conditions that the industry is facing at the moment. You say that the impact for the industry as a whole is that less operating cash flow will be allocated to new domestic power projects, with the prospect of stronger balance sheets and higher dividend flows to owners. I’m not sure whether you can comment on that, but what do you see happening for Mighty River Power in that you are pushing back your domestic development projects by 3 or 4 years?
Withers: Yeah, we’ve had a period of heavy investment over the last 5 years. As Clayton has described, the demand profile of New Zealand has been flat for a period of time. So we don’t see any near-term imperative to invest any further in domestic generation. Obviously, we’ve got the Ngātamariki plant, which comes on stream in the middle of 2012. So, as part of our consideration, the point you referred to, Chairman, in terms of looking at the dividend payout ratio for the company, we took that into consideration when we made the decision to lift the payout ratio from 75 percent of adjusted net profit after tax to a range of between 90 to 110 percent of adjusted net profit after tax. In every deliberation that the company will go through and the board will go through in determining dividend payments, obviously you look at your capital requirements at that point in time. We have a triple B+ credit rating, which we are committed to retaining and, obviously, we look at other elements. But the imperative for us, obviously, is if we don’t have value-enhancing projects for the capital, then the right thing to do is to return it to the shareholder.

Clark: Supplementary, Mr Chair, on that. Can I ask a question just about—from a “New Zealand Inc.” perspective more. With the reduced investment and the reduced domestic demand in the short to medium term, until we get some kind of economic growth, and the prospect of dividends flowing offshore, some of us are worried about whether continuity of electricity supply is going to become an issue in future, because there is less of a joined-up thinking incentive, I guess, there in the way that currently with SOEs an SOE Minister looks across the whole scope. Have you done any modelling to look at the likely effects of that, or is that not your concern as an individual player in a future market?

Withers: Well, if I could take your question in isolation, I think what you’re asking, David, is: is there a risk that because we’ve got shareholders in places other than New Zealand, we might have different imperatives in terms of, you know, our ability to or our willingness to invest in more generation? Is that the question?

Clark: Presumably shareholders will want a return—that’s what they’ll be after, rather than security of supply for the country; that would be less their interest. They’ll want a higher return. That’s pretty normal.

Withers: Yeah, well, I guess Auckland Airport, again, is another good parallel. You know, New Zealanders are very concerned about having the pre-eminent gateway into the country, you know, having the appropriate infrastructure for that to continue to happen. So any board worth its salt is going to assess that very carefully. Those projects have to stack up financially when we assess them, and we do this now as an SOE; it won’t be any different for future boards, I’m sure. They’ll look at it, say: “What is this going to return to shareholders? Is it NPV positive?”. If that’s the case, then they will embark on that.

Clark: With respect, the example of an airport is a good one, because it’s often accused of being a price-gouging monopoly asset, and that’s effectively where I’m going with this. It feels uncomfortable to New Zealand
consumers, knowing that it’s likely that there will be a higher dividend flow to somebody who doesn’t have the interests of “New Zealand Inc.” at heart. I guess I’m asking whether you’ve done any modelling as to what you think the likely effect on the market is going to be. I guess maybe that’s not your responsibility.

Heffernan

I think, fundamentally, the Electricity Authority is the monitor for that, so that’s true. But, look, I challenge your proposition, because I find it flawed on a number of levels. Firstly, as an SOE, if you look at our statement of corporate intent, our core objective is to perform comparable to a company that is not owned by the Crown. We don’t have—

Clark

The social responsibility clauses in it.

Heffernan

If I can complete. Where was I? And we’ve probably been the largest builder of generation plant over the last 4 or 5 years. That’s because we could see financial and economic returns out of that, not because we saw that we would be the saviour of security of supply for New Zealand. Security of supply for New Zealand is a combination of a mix of plant. And what you do see is companies making investment or disinvestment decisions based on the opportunities they can see for financial returns out of maintaining security of supply. It’s how a market works. It’s how it has worked extremely successful since deregulation. We’ve got a much more secure market now than, as Dr Layton referred to, in 1992 under a centrally planned economy, and there is no reason that that won’t be sustained.

Lotu-Iiga

I take your point, because we heard in the last financial review how that security of supply has got better under the latest reforms. Just coming back, because you mentioned in your presentation—and this relates to what Joan was saying about as one door sort of closes on domestic development other doors open internationally. We’ve talked, I think, in past financial reviews about the expertise around geothermal production and experience capabilities. How are you seeing that expand internationally? Is there potential growth there for your organisation to—in fact, a reversal of what Dr Clark here is saying?

Withers

I’ll leave Doug to comment substantively, but, obviously, over the past 3 or 4 years, when we’ve had our investment in international geothermal, it’s very clear that there is huge demand in a number of jurisdictions for the sort of expertise that Mighty River Power has. So I’ll let you talk about what’s happening now in terms of the more direct control.

Heffernan

So, I mean, we’ve been involved in this. I should say we have enjoyed shareholder support for international investment for more than 5 years, which means irrespective of which Government was in power at the time. I think that’s because generally our shareholder has also recognised that New Zealand is a world leader in geothermal—it’s one of the most highly recognised and capable countries in the world—and that Mighty River has built up some specific expertise. Until February we were relying on channelling our investment offshore through our US-based entity, who were providing most of the management legs to our international investment.
Since the middle of February we have restructured that arrangement, and we now have direct control of all of the interests in Chile. It’s across—and there’s a slide in the pack—three main jurisdictions: Puchuldiza, Tolhuaca, and Ranquil. There’s 50 people in Santiago. They will be very much dependent on the sorts of knowledge and skills we’ve got here in New Zealand; 100-odd people in Rotorua, who are effectively our geothermal university, and applying those skills into Chile.

In the United States we have, as Joan indicated, an investment in EnergySource. EnergySource last year completed the largest geothermal development in the US for, I think, nearly a decade, at the Hudson Ranch plant. So we’re now an investor in that plant. They have their own geothermal team. But we have—already in the 3 weeks since we’ve established that direct relationship—formed a number of technical committees at operating levels within our organisation interfacing with EnergySource. It so happens that the operational manager at EnergySource used to be my general manager for geothermal.

Lotu-Iiga Just a quick supp. Presumably these operations are making money, and profits from those operations are being repatriated to this country, or are you still building up that investment?

Heffernan I think there’s two parts to that. If you look at our track record here in New Zealand, geothermal is a relatively high-risk development. It’s not the same as wind, because you have to go and prove the resource, which requires drilling wells before you know with confidence the quality of the resource. And so in Chile, at 31 December, we impaired the carrying value of the assets in Chile because the costs of proving up the resource at Tolhuaca were higher than GGE had expected. On the other hand, the investment in EnergySource has been very good, was exactly what we’d expected. The money we put into the development at Hudson Ranch in May 2010, we already got back with a premium 29 months later. In New Zealand, similar investments—payback period of probably a decade.

Hughes Can I have a question, Mr Chair?

Young Have you not had a question?

Hughes No.

Young OK.

Hughes Thank you very much. I guess the supp is on that, because you’ve told us you’re world leading at geothermals, successive Governments have supported you, you’ve taken direct control of some of the companies you’ve coupled with overseas. Can you give a guarantee that none of this New Zealand intellectual property, when it comes to geothermals, is going to go to other electricity companies if they purchase shares in you down the line?

Heffernan Look, we run the risk of losing intellectual property in geothermal every day, and one of the key things there is keeping hold of good staff. It’s got nothing to do with control. You know, it’s a global market for talent, and the important part about having the direct control and the opportunities for growth offshore rather than being constrained, if you will, by a flat
demand—sorry, it’s not a declining demand, David—in New Zealand at the moment is that we can keep that talent and can leverage it into those offshore opportunities.

Hughes Isn’t there a bit of a logical inconsistency here? You’re taking direct control to keep that expertise in-house; New Zealand is losing direct control of this company, and you’ve said you can’t guarantee we’re not going to lose—

Heffernan We had a minority control in the previous involvement with GGE, and we’ve moved to control. My understanding is that the Government’s plans for the IPO is for the Government to maintain control.

Hughes My question is—thank you very much for the presentation. I just need to say how disappointed I was with the answers to the questions. It’s frankly disdainful, I think, to the select committee and this Parliament that questions such as how many credit cards you have, the floor space you’re leasing, you refuse to answer. I think that’s deeply disappointing. But my question is how much more are the board and executive members receiving to handle the privatisation process?

Withers There is an additional fee sum that is being paid to directors, which is being worked out on a daily basis. We have underspent the allocation thus far.

Hughes What’s the daily amount?

Withers I can’t tell you off the top of my head.

Cosgrove Twelve hundred, isn’t it?

Withers You’re probably right.

Cosgrove Pardon?

Withers That’s probably right, yes.

Cosgrove We’re not in the Novopay situation, where people aren’t being paid, I hope.

Withers No, we don’t have a Novopay situation.

Hughes Just responding to claims of Contact and TrustPower over the years that full SOEs are underpricing, do you agree with that statement?

Heffernan Yes.

Hughes So do you anticipate that we could see higher increases in prices for Kiwi consumers, given—

Heffernan My answer was yes, not no.

Hughes You think you’ve been underpricing?

Heffernan No, I said I don’t agree with it.

Hughes So you think they’re overpricing?

Heffernan No, what I’m saying is I don’t agree with them. That was the way your question was phrased, and I was agreeing with you. Sorry.

Hughes Well, what I’m—
Heffernan: So I was agreeing that—we disagree with their statements, OK? So we think that we are pricing fairly to the market, irrespective of the underlying ownership of our entity or theirs.

Hughes: As a corollary to that, do you think they’re overpricing?

Heffernan: We’ve been successful in gaining market share, and ultimately the test of success for a retail company is being able to grow, and maintain and grow market share. I can’t comment on their pricing; all I know is what my outcomes as a company have been.

Young: You’ve got a question, Mark?

Mitchell: I wanted to ask about the US investment, but he’s already answered.

Yang: Given that 92 percent of Mighty River Power’s generation is renewable, I believe that technology is particularly important. I also notice that the company has research co-operation with the University of Canterbury and the University of Auckland. My question is: do you have your own research team, and do you invest in research yourself, and do you think that you are a world leader in terms of technology and renewable resources?

Heffernan: Look, I think the level of investment we put into research is largely through people and through research relationships with the likes of the University of Canterbury and the University of Auckland. The sorts of capabilities they’ve got to do the long-term research that we see as potentially being of value to the company, we see as better channelled through those organisations and working in partnership. So that’s why we write long-term agreements with the universities to support effectively the investment in their infrastructure to help develop our capability. I think it’s a much more efficient way to leverage their skills, and it’s a fruitful way, and I know that they are creating products and services that they can also use in an export sense, rather than just simply helping us. I think from a “New Zealand Inc.” point of view, it’s a much more fruitful collaboration than if we just tried to do it ourselves.

Yang: OK. So your main—basically, you tend to rely on the research partners to provide technology?

Heffernan: Yeah, and, look, we’ve got an interest in doing that with those universities. They’ve got talented people coming through their undergraduate programmes looking for postgrad opportunities, and we see the opportunity in working in collaboration with them that through time some of those people will come and want to work for us through the business relation we have with the university. So it has a, hopefully, self-fulfilling prophecy associated with it.

Yang: Do you believe you are a world leader in terms of technology, using—

Heffernan: Look, young talent, whether it’s in geothermal or everywhere else, want to go with there is growth and new growing opportunities. That’s what makes work more interesting. We have very, very good scientific capability within the engineering—with the university faculties in New Zealand. It withered through the 1980s and 1990s. It is now flourishing, and part of that is because of the investment we’ve made into geothermal in New Zealand,
and we think we can sustain and grow that through time if we can take our geothermal proposition from New Zealand and apply that internationally.

Ms Withers, a simple question. In your experience, when’s the best time to float a company: when demand is high for the product or service that the company is offering, and people are scratching to get it because it’s popular and they want it, and when any major uncertainties are resolved? Or is it preferable to float a company when demand for that product or service is flat and potentially getting flatter, and there are major uncertainties and risks that haven’t been resolved, in your professional experience? That’s question one.

In my professional experience, shareholders determine when they want to sell a company and they take a range of factors into account as they do that.

Maybe I can be precise. In order to maximise the share price and the return of—

I’m not allowed to talk about the MRP IPO.

I’m not asking about the MRP IPO; I’m asking you for your—you’re an eminent and professional director with long experience. I’m asking you, in your professional view, in order to maximise the return to the shareholder, when is the best time to float? When demand is high—

Madam Chair, this may not be a question that you have responsibility for.

No, he’s asking me my professional opinion on those things, and I go back to the point that shareholders will determine that from a range of factors.

Right. Next question is—you’ll be aware that there’s some concern about eventually with MRP shares being onsold into foreign hands, and the only contemporary example we have of what happened in that respect was Contact Energy, which you’ll be aware had 225,000-odd sort of mum and dad investors, and now I think it’s 65 to 70 percent owned by offshore investors. Do you have a view as to the likelihood if there is no share loyalty scheme, or post a share loyalty scheme—do you have a view on how one could guarantee that the majority of the 49 percent remains in New Zealand hands? In your experience, is there any way anyone can guarantee that?

All I would say is that Contact as the example is flawed because you’ve got a cornerstone shareholder who is offshore—

Well, it’s not flawed—

—whereas the Crown is retaining—

—if you accept that—

Point of order.

You’re asking—

Can I finish my question?

Clayton, you’re asking a line of questions that are quite hypothetical. You’re presenting proposals—
Cosgrove  Well, with respect, Mr Chair, I understand the constraints on these folks in terms of the position they’re in, so the only opportunity we have to test certain arguments out—because we can’t get any information on the specific float—is to pose hypothetical questions. Now, if you’re not prepared to entertain those, then we may as well allow these folks to go home early. My question was, to be more precise—putting aside the maintenance of 51 percent by the Crown—is there, in your professional experience, any way, even post the expiry—

Lotu-Iiga  Point of order, Mr Chair. Clearly, she is not disposed to answer this question. The chair can’t talk about the IPO, and we’re talking about operations of Mighty River Power in the last financial year. I mean, this question is out of order, clearly—

Cosgrove  If you don’t think it’s—

?  —about the competence of directors. It’s a hypothetical question.

Lotu-Iiga  It’s out of order.

Cosgrove  If you think it’s not important for Kiwis to know these questions, then that’s a matter for you. I’d like a response from the chair, whatever that may be.

Young  My response is that these are inappropriate questions—

Cosgrove  No, no—

Young  We’ve gone over time—

Clark  Point of order—

Curran  Point of order—

Young  Sorry, we’ve gone over time. Our hearing is complete.

Cosgrove  You’ve got to hear a point of order.

Clark  Point of order, Mr Chair. We’ve had a pretty tight time frame for this, and there’s huge public interest. There’s a significant line of questioning—

Young  Thank you very much.

Curran  Point of order, Mr Chair. I seek leave to extend the amount of time that Mighty River Power—

Young  Sorry, we’re closed for this hearing.

Curran  Point of order, Mr Chair.

Cosgrove  You’re a bunch of toadies. Can we ask for some information? Are we allowed to do that, like we normally do, procedurally?

Young  We can—

Cosgrove  Well, can we ask, then? You made reference to the cost of the IPO. I don’t expect you to provide that to us now, but would you be prepared to detail for us those costs, particularly money spent on PR, communications, marketing, to whom, what contractors, what they did, and how much?

Withers  If you submit questions, we’ll have a look at them.
Young Thank you. We'll do that.
Cosgrove Yes. Thank you for your accountability.

conclusion of evidence
2011/12 financial review of the National Institute of Water and Atmospheric Research Limited

Report of the Education and Science Committee

Contents

Recommendation 2
Introduction 2
Staffing changes 2
Aquaculture 2
Tangaroa 3
Biosecurity and biodiversity 3
Changing climate 3
Appendix 4
Recommendation

The Education and Science Committee has conducted the financial review of the 2011/12 performance and current operations of the National Institute of Water and Atmospheric Research Limited and recommends that the House take note of its report.

Introduction

The National Institute of Water and Atmospheric Research Limited (NIWA) is a Crown research institute. In the year under review, NIWA employed 627 staff at 16 sites in New Zealand and Australia. It is New Zealand’s principal provider of environmental research in the areas of atmosphere and climate, coast and oceans, fresh water, fisheries, and aquaculture.

Staffing changes

We learned that NIWA had 18 redundancies during the 2011/12 financial year, including 2.8 full-time-equivalent positions at the Lauder Atmospheric Research station, and asked about the impact on NIWA’s research. We heard that these redundancies were driven by a shift in emphasis; NIWA will now focus on researching a narrower range of issues in greater depth. NIWA previously undertook extensive research into the ozone layer and ultraviolet light, much of it conducted at the Lauder Atmospheric Research station. We were told that NIWA’s advisory panel had decided that research in this area had largely answered the questions it had set out to answer, so the resources could be put to better use elsewhere. By shifting its resources into new research areas, NIWA feels that it has strengthened its research capacity.

We were also interested to learn about the work NIWA was doing in partnership with other research institutions. We heard that NIWA has increased its interaction with universities, strengthening its relationship with Auckland University in particular. NIWA staff were teaching at the university, and some of its students were working with NIWA on research projects.

Aquaculture

We are aware that the Government is seeking to increase the economic output of the New Zealand aquaculture sector, with a goal of its contributing $1 billion to the economy by 2025, and we asked about NIWA’s contribution to this end. We heard that NIWA was working on improving the marine space available for aquaculture, and improving the science for determining what constitutes a sustainable level of fishing. There is a tension between sustainability and economic growth, and NIWA said that its role was that of science provider, leaving decision-makers to apply the information when determining whether to expand aquaculture in a particular area. We also heard that NIWA is focusing on research into ocean acidity, and is contributing to international research projects on climate change and its impact on aquaculture.
Tangaroa

NIWA owns and operates a number of purpose-built research vessels which provide the principal platforms for marine research and surveying in New Zealand. The largest is the RV Tangaroa, a deep-water research vessel with an ice-strengthened hull. The high-end Tangaroa is a key source of revenue for NIWA. It has recently been equipped with an internationally certified dynamic positioning system, allowing the vessel to win international contracts. We heard that NIWA is promoting this capability to global researchers, and the private sector, to improve its revenues, and it is confident of success. NIWA aims for the vessel to be at sea on average 300 days a year; we heard that last year it was at sea for 297 days. This financial year NIWA confirmed the Tangaroa has spent between 260 and 270 days at sea, and it is confident of achieving more than 300 days by the end of the financial year. We are pleased that the upgrades to the Tangaroa have enabled NIWA to increase its research capacity and revenue.

Biosecurity and biodiversity

We asked what NIWA is doing in the area of biosecurity. NIWA is the principal marine collection point for physical specimens, which are kept at Greta Point, in Wellington. We heard that NIWA publishes a register documenting all the living species in New Zealand, and that New Zealand is the first country in the world to maintain such a register. NIWA told us it is highly connected and engaged internationally, and collaborates with other nations in this area. For example last year NIWA hosted an international conference on marine biodiversity, where it met with a number of international organisations.

Changing climate

We asked what NIWA does to help local government prepare local infrastructure for the consequences of climate changes, particularly fluctuations in the frequency of flooding, and a shifting coastline. NIWA explained that this is a core part of its applied science work, which its board sees as an absolute priority. It is working with the new Auckland council in this area, and we heard that the local councils are happy to collaborate with NIWA in this area.
Appendix

Approach to this financial review
We met on 20 February and 20 March 2013 to consider the financial review of the National Institute of Water and Atmospheric Research Limited. We heard evidence from NIWA and received advice from the Office of the Auditor-General.

Committee members
Dr Cam Calder (Chairperson)
Catherine Delahunty
Hon Jo Goodhew
Chris Hipkins
Colin King
Tim Macindoe
Tracey Martin
Sue Moroney
Simon O’Connor
Dr Megan Woods

Evidence and advice received
National Institute of Water and Atmospheric Research Limited response to written questions 1 to 115.
National Institute of Water and Atmospheric Research Limited response to written questions 116 to 125.
National Institute of Water and Atmospheric Research Limited presentation.
Organisation briefing paper, prepared by committee staff, dated 19 February 2013.
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Nelson Marlborough District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Jackie Blue
Deputy Chairperson
Contents

Recommendation 2
Introduction 2
Cost savings and productivity 2
New Zealand leadership 2
Antarctic environment 3
Energy management 3
ANDRILL 4
Sovereignty 4
Ross Sea marine protected area 4
Appendix 5
Recommendation

The Foreign Affairs, Defence and Trade Committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Antarctic Institute and recommends that the House take note of its report.

Introduction

The New Zealand Antarctic Institute is responsible for New Zealand’s activities in Antarctica and the Southern Ocean, particularly the Ross Sea region. Its activities include supporting scientific research, conservation, and raising public awareness of the importance of the continent. It is responsible for the year-round management of Scott Base, New Zealand’s permanent base in Antarctica.

The New Zealand Antarctic Institute has 28 permanent staff in Christchurch, and a team of temporary staff, including some seconded from the New Zealand Defence Force, at Scott Base. Its chief executive is Lou Sanson and its chair is Rob Fenwick. Antarctica New Zealand receives the bulk of its funding by way of a non-departmental appropriation within Vote Foreign Affairs and Trade. In 2011/12 the institute’s total revenue was $13.916 million, its total expenses were $13.516 million, and it had a net operating surplus of $400,000 for the year.

The Office of the Auditor-General assessed Antarctica New Zealand’s management control environment and its financial information systems and controls as “very good”, and its performance information and associated systems and controls as “good”.

Cost savings and productivity

We asked Antarctica New Zealand how it had achieved planned cost savings of 30 percent. Antarctica New Zealand told us it made savings on fuel and helicopter operations, and by using sea rather than air transport, minimising workplace harm, improving the efficiency of its planning system, and reducing staff at its head office. It has consolidated its space in Christchurch, sub-leasing some of it to other government agencies.

Antarctica New Zealand believes it has met its board’s target for productivity, diverting funds from operations to science logistics, by reducing waste, and being efficient. It expects to make savings over the next several years primarily in fuel, transport and choosing logistics suppliers more effectively. It aims to get the best out of the science community, and ultimately benefit New Zealand’s standing in Antarctic science.

New Zealand leadership

We believe there is an opportunity for New Zealand to show leadership in the Antarctic region, primarily because of proximity. There is scope to build a centre of excellence in Christchurch, creating a gateway for coordination and collaboration in tourism, science, and education, and providing Canterbury with much-needed income.

Antarctica New Zealand told us it agrees with this vision, but believes the only way for New Zealand to retain credibility and status is by maintaining a strong presence in
Antarctica, driven by good science. It is funding this presence by collaboration with the private sector to resource the New Zealand Antarctic Research Institute. We heard that New Zealand's capacity for leadership, presence, and effective international relationships is strong. A recent survey of the 28 consultative parties to the Antarctic Treaty showed New Zealand to be the third most influential party.

Antarctica New Zealand gave us examples of ways it is working towards this vision. It has very recently convened a workshop of New Zealand specialists in polar science, and some Australian and American scientists, to consider the value of Antarctic science to the New Zealand economy. It plans to continue to have the New Zealand Defence Force operating in and out of Antarctica, and possibly Air New Zealand. It had 97,000 visitors to the recent Ice Fest in Christchurch, where it has a well-established business network. It is also seeking ways to collaborate with countries with a presence in Antarctica in transportation.

Antarctic environment

We asked for comment about climate change and the Antarctic environment, and heard that the west of Antarctica is warming, and the east is cooling. The Ross Dependency sits between the two. Ross Island is now approximately 1.5 degrees above the previous normal temperature. The warming on the surface is measurable, but changes in the ocean are unknown, and could be more significant, for example affecting New Zealand via ocean currents.

Since the Ross Dependency had the warmest summer on record, the ice runway suffered problems with dust and sticky snow, and no jets could land for two months. Antarctica New Zealand may have to prohibit landings by any craft in December and January except United States ski-equipped planes. We asked how much it would cost to equip a C130 with skis, and we told it would be approximately $250 million.

We asked for comment on the Intergovernmental Panel on Climate Change’s most recent report. We heard that the most recent report did not include any Antarctic data, and predicted a 34-centimetre increase in global mean sea level over a hundred years. With Antarctic science factored in, the increase over this time is likely to be greater, possibly a metre or more. A new report will be issued in 2014.

Energy management

There is potential for an energy management agreement with the USA, as it is discussing the management of energy and transport on Ross Island with the USA National Science Foundation. If an agreement is reached, Scott Base and McMurdo Station would share energy, and air and sea transport resources. This could result in savings on fuel and transport for Antarctica New Zealand, potentially at little or no cost to New Zealand; New Zealand’s contribution would be to give the USA energy from the wind farm. There would also be an agreement that the Scott Base generators could top up the much larger McMurdo generators.

Antarctica New Zealand is discussing with the New Zealand Refining Company the potential for New Zealand to manufacture diesel for the Antarctic operations of the USA and Korea as well as New Zealand’s own use. New Zealand cannot currently produce the small quantities Korea needs, but it is now talking to the United States about producing their fuel as well, and if it can pool the needs of all three nations, there is potential for extending a business proposal to the New Zealand Refining Company. We have asked to
be kept informed of Antarctica New Zealand’s progress towards establishing this arrangement.

**ANDRILL**

We asked for an update on the partners in ANDRILL, as we were concerned about the potential withdrawal of funding from the USA. ANDRILL is an international collaborative project that collects ice core samples for research. We heard that currently the partners are Germany, Italy, New Zealand, and the USA, with the USA providing fifty percent of the funding.

A new structure was proposed, to include Korea, Brazil, and Britain, with the USA retaining the same funding share. The USA was reluctant to remain the major partner, and asked scientists from the other countries involved to consider the possibility of spreading the cost more evenly. There will be a meeting in September 2013 of the United States ANDRILL community, with a new proposal expected for 2015. ANDRILL is currently on hold.

**Sovereignty**

The Governor-General of New Zealand is the governor of the Ross Dependency, and three officers based there run the jurisdiction under his supervision. We asked about the relationship between Antarctica New Zealand and the governance structure. The Ministry of Foreign Affairs and Trade said it takes responsibility for any sovereignty issues that arise.

We heard that New Zealand’s claim in Antarctica is recognised by a number of nations. Members challenged this and asked for evidence of official recognition. We have since been told that the development of the Antarctic Treaty system has provided a mechanism for international cooperation regardless of treaty parties’ recognition or non-recognition of territorial claims.

**Ross Sea marine protected area**

We asked whether Antarctica New Zealand had considered joining forces with the USA before the Commission for the Conservation of Antarctic Marine Living Resources (CCAMLR) convention, to create the proposed marine protected area, to maximise its chance of success. The ministry replied that they did put considerable effort into a joint proposal, but the two countries’ perspectives were too different. New Zealand fishes in the area, and the USA does not. Antarctica New Zealand believes the two countries are now in a different position, and it has a solid joint proposal it feels balances sustainability, commercial interests and science.

We questioned the strategy involved in getting agreement on this proposal, asking whether New Zealand should have been prepared to compromise on fishing, and reduce its quota. One of the measures applied by the CCAMLR convention, to which New Zealand is a signatory, is rational use. The convention aims to balance competing interests to maintain sustainability. The commission has agreed to a special meeting in July, and New Zealand and the USA will lobby to get its proposal adopted.
Appendix

Approach to financial review
We met on 14 March and 21 March 2013 to consider the financial review of the New Zealand Antarctic Institute. We heard evidence from the New Zealand Antarctic Institute and the Ministry of Foreign Affairs and Trade. We received advice from the Office of the Auditor-General.

Committee members
John Hayes (Chairperson)
Hon Phil Goff
Dr Kennedy Graham
Hon Tau Henare
Dr Paul Hutchison
Su’a William Sio
Lindsay Tisch

Evidence and advice received
Office of the Auditor-General, Briefing on the New Zealand Antarctic Institute, dated 14 March 2013

New Zealand Antarctic Institute, Responses to written questions, received 19 February and 19 March 2013.
2011/12 financial review of the New Zealand Artificial Limb Board

Report of the Social Services Committee

The Social Services Committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Artificial Limb Board, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Peseta Sam Lotu-Iiga
Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of New Zealand Blood Service and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2011/12 financial review of the New Zealand Historic Places Trust (Pouhere Taonga), the New Zealand Lotteries Commission, the Office of Film and Literature Classification, and Sport and Recreation New Zealand

Report of the Government Administration Committee

The Government Administration Committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Historic Places Trust (Pouhere Taonga), the New Zealand Lotteries Commission, the Office of Film and Literature Classification, and Sport and Recreation New Zealand, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Hon Ruth Dyson
Chairperson
2011/12 financial review of New Zealand Post Limited

Report of the Commerce Committee

Contents

Recommendation 2
Introduction 2
Financial performance 2
Rural post delivery 3
Bank fees 3
Digital services 3
Canterbury earthquakes 3
Appendix A 5
Appendix B 6
New Zealand Post Limited

Recommendation
The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of New Zealand Post Limited and recommends that the House take note of its report.

Introduction
New Zealand Post Limited operates postal services nation wide, and is the parent company of several subsidiaries including Kiwibank, Datam Limited, New Zealand Post Group Finance Limited, and Express Couriers. It operates in New Zealand and Australia, in the postal, banking, payments, courier, logistics, and customer communications management markets. In the 2011/12 financial year, New Zealand Post’s total operating revenue was $1,309.373 million and its total operating expenses were $1,223.526 million, resulting in an operating profit of $85.847 million.

Financial performance
In 2011/12, New Zealand Post’s balance sheet was boosted by a one-off non-cash gain of $96.2 million from the repurchase of shares in Express Couriers and Couriers Please Holding Pty Limited, whereas in the 2010/11 financial year write-downs had negatively affected its financial result. We asked about how New Zealand Post manages its financial ups and downs, and heard that it has been conservative, particularly in writing-down provisions. It has also increased its capital by selling and leasing back its headquarters, but does not envisage more such transactions at present. It might make purchases through Kiwibank to help build the bank’s financial portfolio.

In general, we consider New Zealand Post is performing well, despite the declining demand for core postal services. It recognises that these services, and specifically rural delivery, are its fundamental responsibility as a state enterprise, which limits its flexibility to minimise costs. We also note that New Zealand Post acknowledges the need to drive down Kiwibank’s high cost ratios. It hopes to reduce them over the next five years, despite rising regulatory costs and the need for major system upgrades during this period.

New Zealand Post’s environment is defined by the general decline in the use of postal services and a transition to providing digital services. It is important that New Zealand Post ensures that its products and services remain accessible and financially viable. The repurchase of shares in Express Couriers has given New Zealand Post an opportunity to consider the organisation’s bottom line as a whole. These initiatives should provide New Zealand Post with the basis to plan with more freedom and react to external change.

Relationship with Ministers
The shareholding ministers for New Zealand Post are the Minister of Finance and the Minister for State-Owned Enterprises. We asked New Zealand Post to outline the nature of its relationship with its shareholding Ministers, and heard that they communicate variously through different parts of the organisation. New Zealand Post consults with the shareholding Ministers regarding its statement of intent. It communicates with the
Ministers regarding specific issues, such as the purchase of Gareth Morgan Investments. Recently, there have been communications with the Ministers over the process to change New Zealand Post’s deed of understanding with the Crown, to allow it to react more quickly to the changing environment; public submissions on the deed have recently closed. Finally, through formal letters, such as New Zealand Post’s strategic issues letter, it keeps the shareholding Ministers informed of potential issues.

We are aware of a 2009 letter from the former Minister for State-Owned Enterprises that requested that State enterprises increase their proportion of debt to equity, or “gearing ratio”, and asked how New Zealand Post responded. New Zealand Post told us that there is an understanding that when the shareholding Ministers set target gearing ratios, there is flexibility as to how State enterprises go about achieving them, depending on the nature of their business. As an owner of a bank, New Zealand Post is in a unique position because the gearing ratio can affect an organisation’s credit rating, which is a serious matter for a bank.

**Rural post delivery**

New Zealand Post is seeking more flexibility to change its practices in response to the changing environment. Concern has been expressed over the potential for the frequency of rural post delivery to be reduced. We asked whether the rollout of an ultra-fast broadband network was likely to coincide with such a reduction. We heard that New Zealand Post has not made any specific assumptions along these lines, but it said that the arrival of ultra-fast broadband in rural areas was likely to increase parcel deliveries. New Zealand Post stressed that it has not made specific plans to change the configuration of its letter and parcel delivery services, but that it will need to consider this eventually. We intend to monitor this issue with interest.

**Bank fees**

We asked New Zealand Post to respond to the claim that banks in New Zealand charge higher fees than those in Australia. It told us that in New Zealand banks charge more directly for individual services, while in Australia they build costs into their interest rates. It said penalties are charged as a necessary incentive to pay back debts and avoid defaults on loans. New Zealand Post said it is important to understand that banks need to charge fees so that they can deliver services; however, Kiwibank has accepted the Commerce Commission’s suggestion that bank fees should be regulated.

**Digital services**

We asked about New Zealand Post’s plans to develop a digital network for the delivery of postal and financial services. It will be delivered through YouPost, a secure digital mailbox that customers could use to access financial services or receive mail electronically. Customers will still have the option to receive mail physically. We asked how it would differ from email, for example, and heard that the secure network would eliminate junk mail. To date, New Zealand Post has invested approximately $6 million in the initiative, which it expects to launch by the end of 2013. We look forward to its release.

**Canterbury earthquakes**

We asked how New Zealand Post was affected by the Canterbury earthquakes, and heard that it suffered the loss of one Kiwibank staff member. It also lost some New Zealand Post buildings, and is seeking to upgrade its remaining postal buildings in Canterbury. New
Zealand Post is considering what it will be providing in Christchurch, and we will monitor its decision with interest.

**Bad debt profile**

We asked how New Zealand Post has managed its bad debt profile in the wake of the Canterbury earthquakes. We heard that its primary risk was in the ability for customers to meet their mortgage obligations. However, provisions already made have proven adequate. We were pleased to hear that Kiwibank has started to pay more attention to its risk and credit profiles, and in this respect its system is now stronger and better managed than in the past.
Appendix A

Approach to this financial review

We met on 14 March and 28 March 2013 to consider the financial review of New Zealand Post Limited. We heard evidence from New Zealand Post Limited and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received

New Zealand Post Limited, Responses to written questions, dated 15 February and 26 March 2013.

New Zealand Post Limited, Responses to questions, dated 15 February 2013.

Appendix B

Corrected transcript of hearing of evidence 14 March 2013

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Peseta Sam Lotu-Iiga
Mark Mitchell
Hon Damien O’Connor
Dr Rajen Prasad
Denise Roche
Dr Jian Yang

Witnesses
Hon Sir Michael Cullen, Chairman of New Zealand Post Group Board
Brian Roche, Chief Executive, New Zealand Post
Mark Yeoman, Chief Financial Officer, New Zealand Post

Young Welcome, and thanks very much Sir Michael, and we’ll open to you to bring your presentation, and then we’ll follow up with some questions from the committee. Thank you.

Cullen Well, Mr Young, to be honest we’re well behind schedule, and we’re only the warm-up act today in terms of SOEs. I’ll be as brief as I can.

Clearly, in the year under review, 2011-12, we posted a reasonably good final result, particularly compared with the previous year. That was largely driven by a substantial one-off gain in relation to the repurchase of 50 percent of Express Couriers Ltd, which meant that certain matters even from 2004 then came into the balance sheet; and secondly, through improved performance by the bank.

The underlying picture in terms of the core postal system seems to be one of declining usage of the postal system matched to some extent by reductions in expenses through New Zealand Post, but the trend continued. That has continued through to the first half of the current year. So again we have a further improvement in the net position compared with the first half of the previous year, driven simply by two factors: one, increased net interest income, largely because of the number of people remaining on floating rate mortgages compared with forecasts, which tends to lead to higher net interest income overall; and, secondly, because of the write-back of some of the provisions that we’d made for bad debts. I think that’s a fairly typical story with banks over the last year, including Kiwibank, that
conservative positions have been taken through 2010-11, and some of these provisions are now being written back for a variety of reasons.

Obviously, the main thing which is going on at the moment is that we have been in the process of the Government considering our submissions for more flexibility around the deed of understanding. Submissions on that process closed this week. Those submissions are now with MB, MoBIE, whatever one chooses to call it, the ministry of business, etc. Our understanding from their indications are that there are some hundreds of submissions; we don’t have the exact number.

The great majority of those are around the issue of rural post delivery. Very few people seem to say no to more flexibility, but the major concern is if there is reduction in frequency of delivery in rural areas, how will this impact upon the other services that our rural contractors provide, and will they become non-viable. So that ranges from all kinds of people, particularly, actually, newspapers—a big concern around that because we deliver a lot of the newspapers in rural areas, and clearly they don’t want to go necessarily for 3-day-a-week delivery for that purpose.

I would emphasise that we have no specific plan at this stage around changes to delivery. What we are seeking is flexibility in comparison with the current Deed, so that we can develop a specific plan. Both Mr Roche and I are concerned that we do that in a way which gives some high level of certainty and also enables us to plan any transition in terms of staff over the next 2 or 3 years. I think we can probably say, Brian, that at this stage we think it quite unlikely that we’d be going to move within the next couple of years in terms of changes of delivery. This is something that is a bit further out than that, but we want to be able to plan that properly and carry that through.

The other thing that we’ve been engaged in is a quite significant capital reorganisation, if you like. We’ve been divesting ourselves of some of our assets in order to focus more upon our core business and in particular having gone through a credit rating downgrade, because we own a bank we are very sensitive to the prospects of any further downgrades, so that in comparison with other SOEs we need to have a stronger balance sheet in terms of things like our debt-equity ratios, etc. We have to maintain a credit rating, really, with an A in front of it if at all possible, rather than a B. That is less important for energy companies and so on. So we are different in that regard. The other obvious point to make is that we are different because we are a much more varied business. I mean, it’s (inaudible) we’re not just a bank; we’re an express courier business, and even within the traditional postal part of it, there is a whole range of businesses. We have sold out of our shareholding in Datacom. We realised a significant gain on that compared with the book value, and that’s put us in a better position to look at paying down some debt and to consider our other options in terms of supporting the growth of the bank.

The final point I’d make is that we were in our last visit, I think, talking in terms of the approach to the Government around seeking more capital to
support the bank, both in terms of its regulatory requirements, change in systems and growth. While we have not had any specific answer from the Government I think we have drawn the impression that we are unlikely to get a positive response for a request for money. Not surprising in the current situation. We have looked at where we are going. We believe that we can certainly manage it over the next couple of years without any further capital injection, but that assumes that Post is in a position to put about another $100 million into Kiwibank over that 2-year period, because there are systems issues. There are regulatory issues, resulting from the actions of the Reserve Bank, and, of course, even with some growth in the retail side that still has to be supported by capital, tier 1 capital etc, within the bank itself. Brian, is there anything you want to add?

Roche No, I don’t have anything to add.

Young Very good. Thank you very much, Sir Michael. I was very interested to hear your comments about the need for a strong balance sheet to maintain that credit rating. I’m assuming that if there was any shift in that, in the cost of borrowing, implications for Kiwibank would be affecting New Zealand mortgage holders. So you’re actually managing a very broad portfolio, and so it’s important to manage that for the benefit of the mortgage holders of New Zealand, as well.

Cullen But also because, of course, it puts us in a less competitive position with the Australian-owned banks, who are in a better position to maintain that credit ratings in their situation.

Young So in terms of the last couple of years, because, you know, as banks have moved through the global financial crisis and the Canterbury earthquake, which has affected some of your branches, how has Kiwibank fared in that regard?

Cullen In Christchurch in particular, or Canterbury in particular, or more generally?

Young In Christchurch in particular.

Cullen In Christchurch in particular we obviously suffered—well, the most immediate thing for us was we suffered one staff member’s death in the February earthquake. It was a Wellington staff member visiting Christchurch on that day. We lost 2 or 3 Post buildings, which were severely damaged. Of course, we then have the flow-on effects, like everybody else, looking at the requirements for upgrading of existing postal buildings.

We are now considering, particularly on the bank side, what our provision is going to be in Christchurch, how we can, in effect, restore our position and move forward and support the redevelopment of Christchurch. As with the other banks, there was a degree of activity designed to underpin the confidence within Christchurch, and that seems, I think, to have been reasonably successful. What we have, I think, found is that the provisioning that we made, which was on the methodology used by all the banks—in order to allow, I think, for a reasonable comparison between them, and consistency—so far looks as though it’s certainly sufficient. I don’t anticipate us having to make any provisioning, barring further major
activity, any earthquake activity. Any major provision above that, indeed, we’re probably looking by the end of this financial year for some write-back on those provisions.

O’Connor Thank you very much. You raised the issue of gearing, I guess, and you said that you needed perhaps a stronger balance sheet than many other SOEs. I guess the question would be: have you received at any stage instructions from Ministers to in fact gear up and raise the level of borrowing for your company?

Cullen No, we received no instructions. The issue of the nature of the balance sheet, dividend payments, etc., is always an ongoing debate between shareholding Ministers and SOE boards. In our case in terms of the dividend we have an agreement which we initiated with the Government. We will guarantee a minimum dividend of $5 million a year. In relation to the total size and the EBIT of the company, that appears to be excessive, I think one can say. But the other side of the equation is that in effect we’re saying to the Government: “Well, that enables us to fund the growth of the bank for the next couple of years without us coming to you for capital injections.”, because banks are capital-hungry beasts.

O’Connor So you’ve not received an instruction to change?

Cullen No.

O’Connor OK. Thank you. On the rural mail issue, you spoke—and I apologise for being out for the first part of your presentation. You explained your understanding of the need for ongoing rural communication. I guess you appreciate the productive side of the economy. Given the promises of rural ultra-fast broadband roll-out don’t seem to be eventuating in delivery, are you considering the roll-out of broadband with the match of your postal services, either from a positive or negative perspective? That is, it could potentially give you more parcel delivery, but on the other side, of course, they may rely more on the broadband. The question is: does the timing of that roll-out affect any decisions around reduction or possible reduction of services?

Cullen I don’t think we made any specific assumptions around that. The decline in rural mail I don’t think is any significantly different from the decline in urban mail. It’s the phenomenon across the board. Certainly, we need to think about the configuration of our letter delivery and our parcel delivery services in the context not just of the core postal system but also Express Couriers Ltd. Part of the reason for buying back the 50 percent share that DHL held was to give us the full freedom to consider the options across the entire business around our delivery networks and to look for synergies across that.

O’Connor Do you think, as some have claimed, that if broadband is indeed rolled out, if it does reach, you know, most of rural, that there’ll be the potential to pick up more business through online purchase?

Cullen Yes. I mean, certainly that would tend to increase the amount of parcel delivery, and how that would impact upon Post again depends on some of
these other issues that I just alluded to. But it would certainly be helpful rather than unhelpful.

O’Connor  Last question. We’ve had indications from Ministers that they are concerned with your proposals. Are you aware of any ministerial connection around that one of ultra-fast broadband roll-out and service delivery through New Zealand Post?

Cullen  Well, the Minister’s another context at all. No, I think the concern remains primarily around the impact upon the other services that rural contractors provide because, as you’ll be aware, our rural contractors are different from all the other people who work with or for New Zealand Post in that they’re allowed to do other things. Posties and so on don’t deliver other things; they just deliver New Zealand Post stuff or stuff that DX and others have fed into the New Zealand Post delivery network. But they deliver all kinds of things, from tractor parts through to the Otago Daily Times through to, you know, birthday cards and whatever else it may be. So if it was down to 3 days a week, that might affect some of those other businesses. It might not, because the question of whether it reflects the viability of those rural contractors. So that is the bit that we are most sensitive to. We identified it ourselves. It’s one of the reasons that we began talking with Federated Farmers and Rural Women New Zealand in advance of any further discussion, and we’ll continue to maintain those links and think through very carefully before any final decisions are made. I should also add that probably 2 or 3 days a week delivery, if we get to that point, and I emphasise “if”, that’ll be primarily in the suburban areas in any case. Central city areas would not be expected to cut frequency of delivery. That would simply open up opportunities to our competitors.

Bakshi  Touching from where Damien just mentioned with the ultra-fast broadband, how New Zealand Post is geared up with the digital world which is coming up.

Cullen  Well, given my extraordinarily limited ability to understand the digital world, I’ll hand it over to Brian, who can certainly tell you. He leads me through it slowly every so often.

B. Roche  Look, I think the company has been trying to develop a digital network, which we’re still in the process of doing. We would hope that we can bring that to the market this year. In thinking about our digital strategy, we are looking at what other postal businesses are doing worldwide, and I think it’s fair to say all postal businesses are trying to have a digital network alongside a physical network. We still remain committed to that.

Bakshi  In your report you mentioned about YouPost, so can you please elaborate on that? What’s—

B. Roche  Well, YouPost is what we hope to become our digital network. We’ve been working on that for about 6 months, and that’s what we would hope to bring to the market this year, and that would allow an individual to have a digital mailbox that they would receive stuff electronically. The issue for us is, you know, how do we position that to compete with email and other,
sort of, technology, so it’s a pretty cluttered marketplace, but we believe
with our brand and what we’ve historically done that we can actually create
a commercial business.

Bakshi

What’s your target date on this—the launch of it?

B. Roche

Well, we’ve missed our previous target date, but by the end of this calendar
year.

D. Roche

Thanks, Brian. I guess I should state for the record that we’re not related.

Cullen

That’s very good for both of you!

D. Roche

I just wanted to ask a bit more about the digital services. How much has
been invested so far and how much are you looking to invest in that to roll
it out?

Yeoman

I don’t have the exact number off the top of my head, but it’s in the region
of about $6 million has been put into the YouPost initiative to date.

D. Roche

And you’re budgeting for that for the future as well?

Yeoman

We see that’s an important part of the overall portfolio of services that we’ll
offer in the postal business, and, obviously, until we launch that product we
don’t have a line of sight of what the future costs and revenues will be
associated with it. But we do have a budget in place to get it to market.

Cosgrove

Forgive me. I was out of the room attending to far less important matters.
Dr Cullen, I know my colleague asked you about gearing ratios. You’ll know
they’ve got a particular moment at the present time. Sorry, is it correct that
the Government did not at any time instruct Solid Energy to increase its
gearing?

Cullen

Oh. Us?

Cosgrove

Sorry! Sorry!

Lotu-Iiga

Solid Energy? Come on, mate! [Interruption, laughter] You’d better go out and
make some more phone calls!

Cosgrove

As you said, you don’t have a biofuel plant. [Interruption] At any time were
you instructed to increase, New Zealand Post, its gearing ratio?

Cullen

No.

Cosgrove

Because you’d be aware of the 2009 letter which asked for a uniform
gearing ratio of, I think, 40 percent across all SOEs, so how did you guys
sort of wriggle out of that one?

Cullen

Well, I think there’s always been understanding that when Ministers set a
target ratio or credit rating, as was done in about 2004, as I recollect, that
those have some degree of flexibility around individual SOEs. And I think
there’s a relatively clear understanding that because New Zealand Post owns
a bank, it is in a quite different position around the credit rating, and the
gearing ratio has quite some impact in relation to the credit rating.

Cosgrove

So is your point that the prudent and more conservative and therefore less
risky approach is to have a specific but un-uniform, if you like, gearing ratio,
depending on the nature of the business—say, a mine to a bank to a whatever?

Cullen Yeah.

Cosgrove Rather than a—

Cullen I think it’s propositional to argue for a higher gearing ratio, not sure which way you look at it, a high-debt-to-equity ratio for, say, an energy company compared with a company that owns a bank. BBB and BBB+ rating has quite different connotations if you’re a bank or—

Cosgrove So the counterfactual of your point, it would be a high-risk proposition, therefore, in your view to require a standardised, or the same level of gearing ratio across a diverse range of businesses, regardless of the differing risks and differing nature of those businesses, banks to energy?

Cullen I don’t want to get, sort of, in the middle of what could well be an argument at question time today, but—

Cosgrove Why would you think that?

Cullen —what I would say is that New Zealand Post is different from almost any of the other SOEs both in the complexity and the range of its business in the fact that its core business is in decline and in the fact that it owns a bank, and I think those differences are reasonably well understood. Clearly, Governments are always likely looking to us or to any other SOE for more money. Ministers hence have this sort of in-built tendency to do that. But nevertheless, it has to be judged against the feasibility of extracting that money, and the consequences of over-extraction—

Cosgrove So presumably you were able to convince through logical argument the shareholder that a different gearing ratio was more appropriate for your business?

Cullen I think if I answered yes, that would imply there’d been a long debate around that. I think it would be fairer to say that there is a degree of understanding, which has been going on for a long time around the position of New Zealand Post in that regard. I mean, we are in a—dare I say it—somewhat chivalrous position on dividends in any case in that the dividends which flow from, if you like, the bank, or the profit flows from the bank, does not automatically translate back into a dividend flow to the Government. We don’t have, sort of, 60-odd percent of our net cash flow has gone into dividends, as has been the norm for other SOEs. Obviously, every now then we have a discussion with COMU and the Ministers about whether we should, but then, I wouldn’t expect any other conversation to occur.

Young I think we understand very clearly the distinction you’ve made there between New Zealand Post and the other SOEs in terms of the banking.

Lotu-Iiga Well done. Thank you for turning up today and well done on your result. But I note when you drill down today and well done on your result. But I note when you drill down into the financial result and you look at the different lines of business, which you’ve alluded to, it’s probably a more complex business than other SOEs. And you see that you’ve got a one-off
non-cash gain of $96.2 million from the transaction that you did, and then last year, I think, you had some write-downs that affect your result, so it’s bumpy. It can be bumpy over time. You know, I think you’ve talked about your interest margin, which I think, you know, is something which you look at when you’re a financial services business. I mean, I’m just looking at the 5-year trend summary, which I think is a really good page to look at over time. Those write-downs last year and then this one-off transaction this year—I mean, when you take those sorts of extraordinary-type transactions out, I mean, you’re tracking well. Would that be fair to say? I mean, obviously—and how do you mitigate those sorts of bumps? Because it is difficult when you—you’re not going to have that one-off transaction next year.

Cullen No, that’s right.

Lotu-Iiga And just can you talk us through in terms of the risks that are there and how you’re navigating through it as an organisation?

Cullen I think we’ve been through more bumps in the last 2 or 3 years than would be normal for us. Some of that’s obviously the ongoing effect of the global financial crisis, as I think I said last year. In Kiwibank’s case, we were probably rather late to take enough provisioning and were slower than the other banks in taking sufficient provisioning, so that impacted quite significantly in one financial year. We’ve remained relatively conservative. We’re slightly more conservative than most of the other banks on writing down those provisions. If you’re in the current financial year so far, which means we have to meet appropriate accounting standards in that regard at the end of the financial year. We have been engaged in other property transactions now on the market that we have sold the headquarters down the road and are leasing that back, so it’s further capital for the organisation. There’s not a huge amount more that’s going. We’re looking at the current frame of the business and I can’t see a lot more that’s going to be sold or bought. There is more likely to be some level of purchasing—maybe at the wealth side of the Kiwibank business because that’s almost a no-brainer in terms of building up that side of Kiwibank for the future. If you take that out, I mean, compared with, again, the energy companies with much more underlying volatility around energy pricing and energy supply, we’re actually more constant. Am I happy about where we are? I think Brian has done, and Mark and others have done, a great job in trying as hard as we can to reduce cost in the core post business, trying to manage that decline in the letter business as best we can. I think over the next 5 years we can do quite a lot better in driving down cost ratios in the bank. Our expenditure cost ratios are still high by banking standards. Now, some of that’s the legacy of being new and growing, but we’re sort of moving out of that new and growing phase into a more mature phase, and we would expect to see therefore some improvement in those ratios, but against that we have the regulatory cost and we have quite major systems upgrades that we have to engage in for the next 2 to 3 years, which will be a stretch for the bank and Post to fund during that period. But certainly we want to position ourselves to be looking to improvements in that regard.
So there is always work to be done, I think, is all I can conclude—it’s a bit of a cliché, really—around that in respect of New Zealand Post. If changes that need more flexibility are improved, then clearly there is the potential for more significant proficiency gains in that regard, but we have to be aware of our responsibilities as an SOE, and particularly these issues around rural delivery are quite important because it relates back to our universal obligation—universal service obligation—as well.

Lotu-Iiga Yes, that’s well answered.

Young I note in your report that the number of customers through your doors are at over 40 million, and 58 million transactions. You mentioned just before that in terms of the buying and selling of assets, you’ve pretty much done that, and stabilising. All the time there’s this challenge about the technical transition that you’re going through. Obviously it’s important to ensure that your services and products are remaining accessible while financially viable. How are you managing the tension around these sorts of issues?

Cullen Well, that’s part of what the commissioners and debate is about. Can we have the flexibility to react to a rapidly changing environment? We’ve taken some moves ourselves. As I said, the repurchase, or the buying out of DHL’s shareholding in Express Couriers Ltd was to give us more flexibility, to consider what our options were in that regard, because as long as DHL was in there then it was hard to make changes that might impact negatively on ECL’s bottom line but positively on the group’s bottom line, because their interest was only in the ECL bottom line, whereas our interest was as a group bottom line.

The reality is that that core business is in a longer-term decline that at this stage shows no sign of levelling out. It doesn’t show any great signs of rapidly accelerating. We don’t see the cliff scenario yet, but we need to think about what happens if suddenly everybody switches off traditional mail. We don’t see that yet, but we don’t see, either, the bottoming out of the business. So we’re not in a position to plan for a 50 years’ heavy state of so many letters. We can plan out, say, 10 years, what we can do in that regard. What we want to do is to have the freedom to be able to plan in such a way that we don’t have rapid change forced upon us by any sector collapsing the financial position within the company.

Young I understand that. So one of those transitions, of course, we talked about before was YouPost, your digital network. What’s the defining—I’m not sure whether you can answer this at this point in time, it might be just a bit too commercially sensitive, but the defining difference that that might offer compared with email?

B. Roche The key point is it puts the person in more control. It’s a secure network, so, basically, you don’t get junk.

Young That’s going to be a big help for a lot of people.

B. Roche So, from a customer’s perspective that would be good.

Young All right, so a secure network—no spam, junk.
B. Roche  No spam. It also allows you to determine whether you want to receive something in a digital form or in a physical form, and that’s why we see the two networks as being complementary.

Yang  I have a few questions relating to the stamps of animals representing the Chinese Year. First of all I thank you, and I think the Chinese community and all the Asian communities really appreciate your effort. But I notice that the physical mail share of the communications market has plummeted to 1 percent, as you have stated here. So is it financially challenging for you to do this—that is, for you to do the stamps of the animals?

Cullen  No, not really. Actually, changing the stamps every so often is probably a positive of the business. Also, international collectors we see—

Yang  OK, so how much—

Cullen  —buy nothing except the New Zealand Post stamps.

Yang  I was going to ask what is the percentage for collections and what is the percentage for later use as postage, do you know?

Cullen  We could—

Yang  OK, it’s too detailed, maybe.

Cullen  We could follow up—we’ll come back with an answer on that.

Yang  OK. How many years have you done this?

Cullen  New issues?

Yang  Yes, yes.

Cullen  Well, for as long as I can remember. I mean, it’s fair to say that—

Yang  Have you done a circle?

Cullen  —traditionally it was putting on a stamp and—

Yang  Have you finished at least one circle, is there 12 years?

Cullen  But I think back about 1992 it really started, lots of these sorts of things. New Zealand has produced lots of special stamps over that period.

Roche  We do 14 or 15 issues. You know, we do one of Anzac, we do one for the Chinese New Year, we do one for Matariki, and other events when we’re approached, so if there’s a special event like the Rugby World Cup. We’ll probably do one for the Cricket World Cup.

Yang  Your stamps are well designed, for example, the Year of the Snake—difficult, but it looks good.

Mitchell  Yes, thank you, Michael, gentlemen, for your presentation today. Sir Michael, in your presentation you were talking about the exposure to—or your bad debt profile. I was just wondering if you could tell the committee a little bit how you’re managing that and also especially in relation to Christchurch because we see with such a big event that that is still unrolling in many ways and we’re starting to see maybe additional costs arising from the rebuild and things like that. I’m just wondering in relation to Kiwibank...
is there much risk and exposure there in terms of the losses that Kiwibank are facing due to the earthquake, and could you just talk to that a little?

Cullen Well, proportionately we would have had a slightly higher risk in Christchurch than our average across the country because Kiwibank had a bigger market share in Christchurch than the average across the rest of the country. The risk for us obviously was inability for people to meet their mortgage obligations and that’s the primary risk that we were exposed to. In general terms I think that the way that’s turning out is that that’s not been a massive impact upon the banks at all and the provision that we made, as I said before, has been more than adequate in that regard. The first part of the question, I’m sorry, I missed that.

Mitchell Oh, just around your exposure to debt—how you’re managing that bad debt.

Cullen The bank—Kiwibank—has paid a lot more attention to its risk and credit profiles. There have been major changes in the senior executive team in that regard. We now have a much stronger system in place in that regard. And whereas I think it would be fair to say when I first became a member of the Kiwibank board in 2009 that there was some degree of looseness around the granting of credit, and we ended up with quite a few bad risks in that respect, particularly in the property development area rather than the individual home purchase area, that is now under much, much better control, and certainly the Kiwibank board and the Post board, and I think both can say that they are satisfied—that that’s an area which is very much better managed now than it was 3 or 4 years ago.

Lotu-Iiga In terms of these macro-prudential tools that have been talked about by the Reserve Bank—and you don’t have to answer this if you don’t want to—do you have a view on how that have an impact on the financial services.

Cullen Well, certainly it’s helpful from the Reserve Bank’s perspective to have additional tools to the interest rate mechanism, which is a very crude and somewhat perverse mechanism in many respects in terms of its outcomes—not least because most interest is simply the transfer of money from one person to another in New Zealand anyway, so it’s the net effect which has got to be counted. I suppose—not with the New Zealand Post hat on, but another one—my only concern would be that if the levers get pulled too hard, what impact does this have upon the ability of first-home buyers to get into the market. I’m not worrying in the least if people who are buying more properties—

Lotu-Iiga Talking about LVRs.

Cullen —are a bit affected, but I’m really quite worried about suddenly young families see things moving out of range for another year, 2 years, and not knowing how long. That could be quite destabilising. But I think that does come back, however, to saying that in the end the real answer is we’ve got to do something on the supply side and (inaudible) the demand side, depending on what you tend to concentrate on in housing.
O’Connor Thank you. We’ve just in the last week or so had an accusation, I guess, or a class action initiated against all the banks, yours included. Have you received any advice from Kiwibank over the claims that have been laid out in public?

Cullen The advice so far is that Kiwibank is considering what the impact of that might be. The only bit of advice is very, very tentative and preliminary is the same as has been in the public arena, which is it’s much harder to take a class action in New Zealand than it is in Australia. Beyond that we are simply considering the position at this point and I expect we’ll get an update at the Kiwibank board meeting the week after next.

O’Connor Given the legal interim advice, what about the moral one, and that is the claim that we are paying a lot more in New Zealand for bank fees and charges than they are in Australia?

Cullen Well, one of the issues there is the extent to which they may be building fees into their basic interest rates. One of the things that has happened in New Zealand is because there’s been much more competition in interest rates in the banks over a quite extended number of years now compared with what used to be the case, banks have therefore had to remove what has been in effect in turn subsidisation on the system and to charge more directly for the individual activities that the banks undertake. Clearly if people are defaulting on mortgages or on other issues, or failing to pay their credit card on time, etc., there is a relatively significant moral hazard if there is no penalty for engaging in that behaviour. Why would anybody pay on time if there was no reason to do so? So one can argue about the individual fees and the Commerce Commission has come down with a set of regulations around quite a large range of banking fees, and we obviously accept that regulation. Nevertheless, I think it is important to understand that the banks need to charge fees for a range of services. We have not ever been a charity in that regard. (Inaudible) ever accuse banks of being charitable organisations.

Mitchell I am sorry, Sir Michael, can I just clarify at the beginning of your answer you said that when making a comparison against the fees that Australian banks charge and New Zealand banks is that actually Australian banks can maybe recover some of the costs through—

Cullen I’m saying there’s an issue, but I don’t know it’s an answer or not. But I know in New Zealand one of the reasons why a whole of range of banking fees emerged more clearly in the public picture was that there had previously been a degree to which fees had been subsumed within just general mortgage interest rates. Once that part of the banking system became much more competitive as it did when we competed in it day by day, hour by hour, across the banking system on mortgage rates, then in theory those costs have to be reflected in charges within somewhere else within the system and basic law knows the charges fall where they lie so to speak. But nevertheless, I think we would still claim at Kiwibank that Kiwibank’s entry into the system has fined up the fees anyway and then the Commerce Commission’s obviously taken further action.

Mitchell Yeah, thank you.
Lotu-Iiga Two years ago you came in here and we talked about the board’s commitment to expanding Kiwibank to a sustainable physical network in delivering customer experience. You’ve done that physically in your stores. I’m pleased, locally, we’ve got some stores that reflect that change in focus towards customers. Growing Kiwibank, you’ve purchased Gareth Morgan Investments, which was an interesting—that increases your product range. First, how is that going in terms of your acquisition? Second, are there other intentions to have a product offering that has a bit of breadth when you look at your competitors, the insurance products, there’s a whole range of products that you can offer, not just as a bank but as a financial services provider. Can you just talk about that area of your—

Cullen The GMI purchase has certainly gone pretty well. We always knew there’d be some issues in terms of integrating GMI and the Kiwibank KiwiSaver product, but those have not been untoward. Pretty much all the predictor benchmarks, etc., have reset. It’s certainly profitable already, which is why that kind of investment is particularly attractive, because it’s not a long payback time, and, indeed, obviously, as you’ve seen in the whole KiwiSaver market place. Bulking up is the essence because it enables you to reduce the fees, return a greater net return to the final end customer and build a profitable business. When you haven’t got bulk, you can’t be profitable in KiwiSaver and small niche players are tending to sell up.

Would Kiwibank be interested in purchasing others? Yes. Will it do so? That depends on whether we can afford to do so. We can certainly expect to discuss any significant move in that direction with our shareholding Ministers. We regard that beyond a certain point as being an issue of significance. There certainly was debate over the GMI purchase. Certainly interested in insurance; we are doing some work in that area already, but looking to expand that, because it’s part of the Kiwibank offering, which has been rather small compared with our competitors.

I think probably the current state given the messages about lack of capital are that the despatch of the wealth and insurance sides of the business make good sense, but we’re rather more cautious in expanding on the business and agricultural side of banking. There is probably not a lot of activity in that regard over the next couple of years because that’s a much bigger area, longer payback times, certainly significant capital requirements, and so on. It’s been a process—Kiwibank—of building stage by stage, anyway and when it was first set up the then Minister of Finance insisted it was going to be a retail bank, they didn’t try to get into the business area quickly, it’s been moving down the number of stages progressively. I think one of the interesting things is what is the long-term strategic value of Kiwibank to New Zealand and to the New Zealand Government and (inaudible) once we are through the current fiscal pressures.

Cosgrove Dr Cullen, just for the record, could you outline for us the frequency and specific ways you keep shareholding Ministers informed of your activities and—

Cullen It’ll be a long answer.
Cosgrove: I’m very happy for a long answer. I’d like some detail around it. Any risks in your business, any potential movements in forecast profits, etc. etc.

Cullen: Well, I’ll start off and Brian—

Cosgrove: Sorry, one other supplementary to that. Could you also outline for us what, going the other way, you do to facilitate input from shareholding Ministers in respect of your entity?

Cullen: Well, we operate quite a significant number of layers and a significant number of parts. There is the full process around the statement of corporate intent, which is an annual process, and, in one sense, that’s the most important part of the interaction, where, in effect their process to interaction—to agree what that statement of corporate of intent is—then guides the action of the group over the coming period. That interaction occurs both directly and indirectly if need be. The indirect interaction is with COMU and that is intense and frequent. Brian saw COMU this week—yesterday. I’m seeing COMU next Wednesday—

Cosgrove: So by intense and frequent—

Cullen: Well, quarterly—quarterly as a minimum but there will be other interaction often on an ongoing and frequent basis if there are issues. For example, there was frequent interaction around Gareth Morgan Investments purchasing. The Ministers wanted to be satisfied that we hadn’t gone mad and were wasting lots of Government money on buying something that wasn’t going to be a good purchase from the perspective of both the business and the Government.

Obviously interaction again, around the Deed, primarily with Minister Adams, because she is the regulatory Minister for New Zealand Post. Brian maintains informal contacts—I think it would probably be fair to say—with many lines of Government, rather than be too specific around that, as one would expect a chief executive with enormous background in Government relations to do. That is very helpful from the business’s perspective and Mark would interact with (inaudible) on occasions on financial matters.

So we will occasionally have a formal letter. For example, Minister Ryall wrote to us formally about the issue in Queenstown and what we were doing to address the issues that had arisen out of the theft of mail, which occurred in Queenstown. Brian and I were booked in for a meeting late January with the Minister and his advisers. At that meeting we had a reasonable exchange. I think we were able to satisfy the Minister that we were addressing the issues which had arisen. So there is nothing at all unusual. As I say, it’s multifaceted and multi-layered and multi-personnel.

Cosgrove: And of course you have a no surprises policy.

Cullen: Absolutely.

Cosgrove: And just for the record, could you just give us a wee bit of definition around that policy and its practical application?

Cullen: Well, I take a fairly broad definition as chair of New Zealand Post. In other words, what would I expect to know about and—
Cosgrove From a previous life.

Cullen So for examples, Gareth Morgan Investments—clearly we notified the Government about our intentions in that regard. The repurchasing of ECL shares, because that’s significant anyway. So all those kinds of matters are issues that we would initiate and it would be quite damaging to a relationship if the Government learnt about these things from other sources—you can’t go saying: “What the hell is going on here?”.

Cosgrove So is it fair to say that, one, you’re diligent in providing shareholding Ministers with appropriate information—that there’s a free exchange and flow of information through no surprises and the formal and informal procedures you have. So Ministers would be fully—and Ministers are, I presume, free to, as with your example in respect of Minister Ryall with Queenstown, bring issues to your table that they feel are of risk or critical. And Ministers would be very comfortable presumably that they’ve got a very clear grip on information regarding New Zealand Post and Kiwibank?

Cullen Yes.

Cosgrove Thank you.

Cullen (Inaudible) we also have a thing called the strategic issues letter, where we have to indicate to the Ministers what we see as the strategic issues facing the company.

Cosgrove Without breaching confidentiality, on matters in your experience as chair of New Zealand Post, are Ministers quite active in seeking out areas of potential risk with your SOE—seeking information around risk?

Cullen I think Ministers are always aware of what the main risks are in our business. I’d be surprised if they’re not. It’s not particularly hard to identify in this case.

Cosgrove Thank you.

Young Well, thank you very much, Sir Michael and your team.

**conclusion of evidence**
2011/12 financial review of the New Zealand Productivity Commission

Report of the Commerce Committee

Contents
Recommendation 2
Introduction 2
Staffing and recruitment 2
Collaboration 2
Inquiry topics and follow-up 3
Performance measurement 3
Inquiry reports 4
Appendix A 5
Appendix B 6
New Zealand Productivity Commission

Recommendation

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Productivity Commission and recommends that the House take note of its report.

Introduction

The Productivity Commission is an independent Crown entity established in April 2011 under the New Zealand Productivity Commission Act 2010. The commission’s board comprises three commissioners, including chair Murray Sherwin CNZM, with the option of an additional member at the discretion of the Minister of Finance. Peter Alsop is the commission’s general manager.

The commission’s total revenue for 2011/12 was $4.762 million, with expenses totalling $4.754 million.

Staffing and recruitment

We congratulated the commission on a good first year, and on inquiries that were robust and thorough.

We asked how the commission recruits and constitutes its staff in terms of capability and inquiries. The commission said that because it is small, it looks for high-quality staff who can cover a wide range of issues. As its work is diverse, it sometimes needs to bring in sector experts. Economics is the core discipline, but analytical, communication, and writing skills are also important. It has a small team with deep technical and quantitative skills, who often engage with the wider public. It is constantly looking for opportunities to hire the best, has a mix of permanent staff and contractors, and is flexible enough to make best use of the talents of its staff.

Asked if it considered staffing and the maintenance of a skill base to be an issue, the commission said it is always seeking to hire high-quality staff, as it believes they are crucial to a successful organisation. The commission has a good office culture, and engages staff in decision-making and policy; it is conscious that in an organisation with a flat structure every staff member needs to be involved and engaged.

Collaboration

We heard that the commission collaborates with many agencies, including the New Zealand Institute, Motu Economic and Public Policy Research, the Institute of Economic Research, universities, the business community, and the local government sector.

Productivity hub

The commission has initiated the establishment of a “productivity hub” for consolidating and coordinating productivity-related work in government and other agencies. It is working with Treasury, Statistics New Zealand, the Ministry of Business, Innovation and Employment, the Ministry for Primary Industries, and a number of other agencies, and considers it has made a productive start. The hub is running a symposium in mid-2013, to
bring such groups together to work on productivity challenges. Feedback from the agencies involved has been positive.

At this stage there are no plans to extend the hub into the private sector.

**Australian Productivity Commission**

We asked especially about collaboration with the Australian Productivity Commission, on which the commission is modelled. It undertook with the APC a joint inquiry into future directions for the trans-Tasman economic relationship. It found the APC’s 15 years’ worth of experience valuable, and noted that the APC had been very supportive. Potential for joint initiatives emerged during the trans-Tasman study, in relation to international freight services and competition exemptions.

**Inquiry topics and follow-up**

We asked how the commission decided which topics to investigate for its inquiries. The commission said that the inquiry topics are set by referring Ministers, who canvass widely for suggestions. The commission is consulted on the topics and on the precise terms of reference; but once the terms of reference are set, the New Zealand Productivity Act requires the commission to act independently in forming its views, judgements, and recommendations.

We suggested to the commission that it might consider the ageing population and the “digital divide” as topics for inquiries, as current issues affecting New Zealand’s productivity. The commission identified this and the ICT area as potential topics to look at. However, it believes it is important for Ministers to choose the topics for examination, to ensure they remain engaged in the investigations and their results.

We asked to what extent the commission followed up its recommendations. We were told that its funding is for specific inquiries; once an inquiry is done and the recommendations are made, and the commission’s report is tabled, it has very little capacity to do any further work. It is not resourced to maintain a watching brief. The commission tracks and reports in its annual reports how many of its recommendations are agreed to.

**Performance measurement**

We asked how the commission measured its success, which we felt might be difficult. We heard that it considers it has an obligation to make a difference to the New Zealand economy. The two inquiries undertaken in the last financial year were scored using objective performance measures set out in the previous annual report. The commission expects the next annual report to be even more positive about recommendations adopted, as the previous annual report was issued before the Government had responded to either the housing affordability inquiry or the international freight inquiry. It has considered other measures of its impact— for example the APC reports the number of mentions of itself in Hansard or editorials—but the commission does not believe these measures to be useful for the purposes of its own performance reporting.

We suggested the commission set a target minimum percentage of recommendations adopted by the Government. It pointed out, however, that some recommendations are slow to be adopted, so this might not be an accurate indication in practice within reporting timeframes.
Inquiry reports

The commission has completed three inquiries: the trans-Tasman joint study, one on housing affordability, and another on international freight services. It considers the feedback from industry to have been positive.

The commission, once it has received the terms of reference, publishes an issues document setting out the scope of the inquiry and asking for submissions. It then analyses the submissions and produces a draft report, asking for further submissions on the draft before the final report is formulated.

Trans-Tasman study

The trans-Tasman study raised the possibility for potential joint initiatives with Australia, in relation to international freight services and removing competition exemptions.

Housing affordability

The commission told us that housing affordability involves complex issues and will not be solved with easy or quick policy decisions. It considered international responses to housing affordability issues in the context of capital gains taxes and the international housing boom.

The Government’s response was comprehensive, dealing with each recommendation individually. We heard that around 90 percent of the recommendations were adopted.

International freight transport services

We asked about the recommendations that came from this report, and how they were received. The commission said that the main recommendation was the removal of the exemption under the Commerce Act 1986 that exempts contracts for carriage of goods by sea from the full application of anti-competition laws. The recommendation was accepted by the Government in principle.
Appendix A

Approach to this financial review

We met on 21 February and 20 March 2013 to consider the financial review of the New Zealand Productivity Commission. We heard evidence from the New Zealand Productivity Commission and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received


——— Responses to written questions, received 11 February and 8 March 2013.


Organisation briefing paper, prepared by committee staff.
Corrected transcript of hearing of evidence 21 February 2013

Members
Jonathan Young (Chair)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Hon David Cunliffe
Clare Curran
Gareth Hughes
Peseta Sam Lotu-Iiga
Mark Mitchell
Dr Jian Young

Witnesses
Murray Sherwin, Chair
Peter Alsop, General Manager
Geoff Lewis, Inquiry Director
Steven Bailey, Inquiry Director

Young Welcome to your first appearance before the Commerce Committee—the committee that obviously worked on the bill that put you into place, so we’re very thrilled to have you here. I think you see all of our names. I think we have an hour with you, so what we’d like you to do is give us a brief and then the committee will ask questions. All right? So welcome, and way you go.

Sherwin Thank you, and can I introduce my colleagues Peter Alsop, who is general manager of the commission and, behind me, Geoff Lewis, who is the director who ran our inquiries on international freight services and on the trans-Tasman inquiry just finished, and Steven Bayley, who has run our studies on housing affordability and is currently working on local government regulatory functions.

Well, as you noted, the Productivity Commission is a new organisation. It’s an independent Crown entity. It came into being 1 April 2011 and, as you noted, our first appearance before this committee. The Act passed in 2010 establishes our purpose as “providing advice to the Government on improving productivity in a way that is directed to supporting the overall well-being of New Zealanders, having regard to a wide range of communities of interest and population groups in New Zealand society.” And that’s a fine purpose statement as far as we’re concerned. The Act also spells out that we should undertake this by doing in-depth inquiries on
topics referred to us by the Government, carrying out productivity-related
research, and promoting understanding of productivity-related subjects.

The work to date has included the four inquiries: housing affordability,
international freight services, future directions for the trans-Tasman
economic relationship, which we did jointly with the Australian Productivity
Commission, and local government regulatory functions, and that’s work in
progress. We expect to get our next topic very soon, within the next week
or two, I hope, and we’re looking forward to that.

We’ve also initiated the establishment of a cross-agency productivity hub,
we’re calling it, and that’s aimed at consolidating and coordinating a wide
range of productivity-related work across government and other parties that
are interested in this thing. So it covers the Productivity Commission—
we’re convening along with Treasury—Statistics New Zealand, MBIE,
Ministry for Primary Industries, and a number of other agencies inside and
out, and that looks to be getting off to a very good, strong and productive
start, and it’s really aimed at trying to make sure we understand who’s doing
what, that we’ve got the priorities sorted out, and we’re covering the gaps
that need to be covered on productivity-related research.

We’ve got a budget of around $5 million a year, which I don’t imagine is
going to change any time soon—certainly not upwards. The commission is
governed by the three commissioners: me as chair, Graham Scott, and Sally
Davenport. We’re all part time. I’m on a sort of 3½ to 4 days a week basis;
Sally and Graham—2 to 2½ days. Commissioners lead the inquiries. We
also constitute the governance board of the commission. The staff of the
commission at any time numbers anywhere between 15 and 20. It moves
around a bit. That includes support staff. At any time we’re likely to have
quite a range of consultants, contractors, secondees, student interns, and
others working with us, depending on the particular skills and experiences
we require at the time and the nature of the inquiries we’re working on. We
also have an arrangement with Inland Revenue under which it provides our
core corporate support services, particularly payroll, finance, and accounting
services, and that’s done on a for fee basis.

The commission’s modelled very closely on the Australian Productivity
Commission, and my then counterpart Gary Banks, as chair of the APC,
spent quite a lot of time, I think, with the select committee when this one
was being put together—

Young That’s right.

Sherwin So we do a similar set of tasks. Our approach to the work is similar—the
same very heavy emphasis on engagement and participation of interested
parties in our work. We draw very heavily on input from public submissions
and on consultation processes, and we generally publish submissions and
try to be quite open about the material that’s come in, and we draw heavily
also on expert review processes. I’d have to say that the Australian
Productivity Commission has been extraordinary supportive of our
establishment. I tell them that I intend to plagiarise absolutely everything we
can, and they’re very open with that, and, indeed, we have a staff member
that we share at present, which is quite a useful arrangement as well. Working on the trans-Tasman inquiry was a really great opportunity to get a look under the hood and see how it works, and get a sense of what they’ve achieved over the 15 or so years that they’ve been in place in their current form.

The inquiry topics are set for us by referring Ministers, although we’re very appreciative of the efforts that Ministers have gone to to canvass widely for suggestions, and that’s been, I think, a useful attribute. The commission is consulted on the topics and on the precise terms of reference—and, indeed, we’re required to be consulted on the terms of reference—but once the terms of reference are set, we take very seriously the provision in our Act that requires us to act independently in forming our views and our judgments and recommendations.

To earn our right to our continued funding and continued existence, we’re very clear that we need to make a difference to the performance of the New Zealand economy, so we don’t dodge that obligation at all. A key concept underpinning the way we work is that progress is made step by step. Our work is quite deliberately focused on specific inquiry topics and generating quite specific recommendations that can be actioned. So it’s not just the high-level macro analysis; it’s given us some recommendations that it can work on.

We’re also very clear that good analysis and ideas and insights isn’t enough; the stuff has to be accessible. So we work very hard on plain language and on trying to make our analysis as widely accessible and compelling as possible to the audience.

We’re very pleased with the way the commission has come together from a dead start on 1 April 2011, with wet paint on the walls and computers in boxes on the floors. It’s been really heartening to see it come together as quickly as it has and the work that we’ve been able to generate, and we’re looking to build on that, obviously. We have provided you with written responses to your questions and can, of course, provide any further elaboration of that. In the course of preparations, we’ve spotted a couple of errors, and I apologise for that, and we’ll correct them and provide corrected responses.

Young That’d be good for the record.
Sherwin OK. Well, we’re pleased to be here and we look forward to your review.
Young Thank you very much and, yes, congratulations, I think, on a very good—probably even better than good—first year. The inquiries that you’ve done, I think, have been very robust and in-depth, and added a lot to, you know, the focus that the country’s taking in terms of some of these areas. In terms of your capability and inquiries, how do you recruit and constitute your staff?
Sherwin Well, we’re looking for high quality people who can turn their hands, because we’re small, to a wide range of issues, and recognising that, given the quite diverse nature of the work we do, we’ll need to bring in sector
experts to supplement one way or another. So, you know, it’s a bit of learning by doing. I think, you know, we’ve got a team that’s pretty experienced, although I suspect that we might have pitched a little too low in a couple of areas, but it moves on, it’s fairly fluid, and we’re always on the lookout for high quality people.

Economics is the core discipline, but others also need to be on hand, and again it’s just a question of keeping the networks open and wide, and looking for people who we think are going to be able to contribute. Analytical qualities matter a lot. We’ve got a small team with quite deep technical and quantitative skills, but you need to be able to write in this game. You need to be able to communicate. You need to be able to conduct engagement processes with the wider public, so it’s a broad span of skills.

Alsop I’ll just add quickly that we’ve structured the commission into three teams. We have two inquiry teams led by Steven and Geoff that Murray introduced, then we have a shared service team, which is called research and analysis. They provide input into the inquiries, but they also take a leadership role on our research function, so it’s quite a nice flexible team that allows us to go where the need is on our work pressures.

Lotu-Iiga Presumably you also contract skills in and out and, given your small scale, that’s the nature of being able to be flexible—to bring the right skills in. Obviously, you collaborate with the APC. What about other research/thinktanks? Do you collaborate with them—the New Zealand Institute, for example?

Sherwin Yes, quite close collaboration. Motu is another one, which has not only some good skills on board but some great networks. So you’re always sort of ruffling the networks to see if you need a particular set of skills. Institute of Economic Research, the universities—we’re trying quite hard to keep in touch and maintain relationships there, and be aware of what sort of skills are available if we need them, and internationally as well.

Lotu-Iiga And businesses as well? You have those types of relationships with them?

Sherwin Yeah. The relationships with the business community, I think, have been good, and actually the relationships that are with the local government sector have been working out really well this time around as well.

Alsop Murray mentioned the productivity hub earlier, and it’s running a symposium in late June or early July, and one of the key purposes of that symposium is to bring these sorts of groups together to work collaboratively over a day on some of the productivity challenges.

Young So working with these different networks, which is absolutely essential—probably a difficult question to answer, but how are they regarding your engagement with them and what you’re producing? Any feedback from them?

Sherwin Well, the hub, which is probably the primary focus for that sort of engagement across the wider professional community, is going very, very well and is getting some really good raps from those who’re participating in
it. You know, we’ve gone out on the back of our inquiry reports and sought sort of peer review from people in organisations such as that, and, you know, we look for critical response, feedback, so that we can improve on it. Those are published in our reports and I think by and large they’re pretty good.

Mitchell Actually, most of the questions have been answered. It’s just about the hub, because I think it’s a great initiative, and it sounds to me like you’re looking at maybe even extending it into the private sector, or you are dealing with the private sector now. Are you looking at expanding their role, in terms of how the hub is currently made up?

Sherwin Yeah, in the first instance, it’s around the small group of professionals who are generating the data, generating the analysis, have the technical skills, applying the analysis in different ways. The outreach is to academics who are in that field. It’s unlikely, I think, that we will go in the first instance to the private sector or wider than that. It tends not to be a lot of sort of in-depth professional and technical skill or interest in the private sector around those issues. They’re much more interested in application of managerial techniques and other techniques in driving shop floor productivity, if you like, and that’s a different beast, which is not the core work of the hub.

Alsop Also I think when we were starting out with the hub, it was a case of starting with the smaller nucleus group and proving its worth and getting some traction, and then, being open-minded to different directions, it can move beyond that. So, you know, the slow start—well, not the slow start but the contained start is going really, really, really well, and the symposium is coming up to take it to another level.

Hughes Thank you very much for your submission. My question is around your annual report and the objective performance measures. There’s quite a big difference between the two inquiries you’ve undertaken. Why was the housing inquiry report scored lower compared to the other?

Sherwin Oh, I’d have to think back to—I mean it’s a very wide constituency and, I think, some very wide expectations. I’m sort of struggling a bit for the right answer here right now. I think the freight inquiry was a narrower constituency of professionals around the logistics field and we were able to have a sort of much tighter engagement with them. I suspect that that’s where the answers lie. I can’t actually recall the numbers.

Alsop Did your observation about the difference relate to a particular aspect, because—

Hughes I guess I’m quite interested because one of the measures is policies adopted by the Government. There are some pretty big gaps, I think, in that Productivity Commission report around capital gains tax, around rental accommodation, in terms of housing affordability. Given we’ve seen public Government statements on these issues, was their omission in part to try and up your performance standards? I guess I’m asking—

Sherwin No, I mean—
Hughes: You know, the Government was going to rule them out, that’s why you didn’t look at them?

Sherwin: Oh, absolutely not—absolutely not.

Hughes: If you’ve got the savings working group advocating for that—

Sherwin: Absolutely not. There is a whole chapter on taxation, and the point in that chapter is that taxation is a complex beast and we have a tax base, which is around income—and with GST consumption, largely, you can shift it to a capital base, but there’s a lot that needs to change to make that happen—and that we didn’t see the tax issues as the principal driver of the housing issue. You can look to countries that do have capital gains taxes of various sorts and see very similar house price appreciations. So that analysis was all there. We didn’t rule out a capital gains tax, but said you wouldn’t do it for housing alone. You’d want to do it as part of a much more comprehensive thing, otherwise you end up screwing your tax system around and getting all sorts of unintended outcomes. So that—there is certainly not an omission there at all.

One of the challenges with the housing report was just trying to keep the damn thing to a manageable scale, given that we were also starting from dead scratch, and we ended up extending much further into social housing than we had originally intended, because it just looked to us like we were identifying some substantial issues there that had to be touched on, and a couple of other areas where we ended up going a lot deeper into than we might have expected, as well. So, you know, you make your judgments on the way through about what you can cope with in the time frame available, but certainly no wish at all to avoid anything that looked hard, and certainly no influence from Government about what—

Young: So, following that, where you made the comment about making a judgment as, through the process, what you can do, you felt that the report in the end was comprehensive, balanced, good advice to the Government, obviously?

Sherwin: Oh well, I am very comfortable that it was comprehensive. In fact, it was far more comprehensive than I think we intended when we went into it. Housing affordability is a subject that’s got tentacles that runs in all sorts of directions and, as we’ve seen with the sort of discussion that’s taken place on the back of that report and other input subsequently, it’s a critical issue.

Bakshi: Comparing the two reports, you score very high on the shipping and transport report. How was it taken by the industry and the Government? Can you just elaborate a little bit on that?

Sherwin: Industry was generally pretty happy with it. And the stuff that I really appreciate when we get feedback from some of the stakeholders, and it was particularly the case in the shipping area, was when people come back and say “Ah, I actually learned something about my industry in the course of reading your report.” That’s a very positive sign, for me. As I said before, the freight one was a sort of a narrower focus, if you like, and a narrower, more defined group of stakeholders with a particular immediate interest. So we were able to engage quite closely with them, and by and large, I think,
that was reflected in the quality of the responses and what they saw in that report. Sorry, was there a second part to your question?

Bakshi: Government and—

Sherwin: Oh, yeah, for Government—well, the response was quite comprehensive. It’s a little harder to get your hands around some elements of what we were looking at, to the extent that it went to the nature of the processes around infrastructure planning and issues such as that, but the Government response was a formal written response, recommendation by recommendation, and quite comprehensive, and picked up on a number of issues. And we know that there’s quite a lot of work under way, even still, on pushing through the issues that we brought to the fore.

Bakshi: Did you get any response from the Australian side also of your report?

Sherwin: Well, the Australians have covered this territory on a number of occasions, and when we were doing the trans-Tasman study, two or three issues came back up and reappeared in the trans-Tasman study as potentials for joint work, or joint initiatives, between the two Governments, particularly around international freight services and removing the competition exemptions. So that was part of the recommendation in the trans-Tasman report. And also the Australians were keen to pick up on some of the coastal shipping arrangements that we have in New Zealand.

Alsop: Can I just make a comment on the numbers, that obviously we pay close attention to the exact levels of the percentages, but probably the main benefit for us in those surveys is to chuck the data through a bit of a sieve and identify some do-betters for the organisation. On page 21 of our report we set out a list of things that we feel we can further lift on in our performance going forward, which derives from those survey results. So that’s sort of a more general assessment across both inquiries.

Bakshi: Thank you.

Cunliffe: Nice to see you in here, and it’s obviously the first time we’ve had an opportunity to review the commission, and the committee was keen to have you in to track progress. If I can just note that on the systems area obviously it reflects the fact it’s in your first year, and the nature of the work to a certain extent. Putting in place performance indicators is a little challenging when the direct outputs are your reports and the indirect ones are the consequences of those reports. How do you think about measuring success in terms of the impacts of your reports? Just assume that the work is of high quality in and of itself—how do you measure that?

Sherwin: You touch on a very tricky area of work, and I’ll ask Peter to elaborate on some of the processes and work we’ve done to try and elaborate that. It’s outcomes that matter, and ultimately the outcome is improved productivity performance in the New Zealand economy. But there’s lots of different influences on that, and we hope that we can contribute positively to that outcome—but then how do you track it and how do you do the attribution and all the rest of it. So you’re always looking for proxies and other indicators that will give you a few pointers at least. So we’ve been going
through a process developing whatever mechanisms we can to try and get a handle on that, but it ain’t straightforward, as you can imagine.

Alsop  Well, I think the lucky tangible one for us is recommendations adopted, and at the time of the annual report the Government hadn’t responded to either inquiry, but in our next report I think we have quite a good story to tell around the proportion of recommendations that have been adopted. We looked at other models, like the APC looks at number of mentions of the APC in *Hansard* or editorials. We’re kind of a bit so-so on the long-term value of those sorts of measures. They don’t necessarily determine good-quality work. So it’s tricky, and we’ve taken an approach with our survey, our independent expert valuation, and a focus group to sort of triangulate around our performance and get feedback from different dimensions, and then put that into a blender and take some learnings.

Young  Just following up on David’s question, in terms of the initiation of inquiry, what are the points along that journey to the completion of that report? Are you getting feedback from stakeholders, perhaps even from Ministers, if at all, so that you are certain that you’re actually heading down the right track?

Sherwin  The first step, once the terms of reference is agreed and handed to us, is to publish an issues document, which is really: “This is what we’ve been asked to do, here’s a bit of context as to why we’ve been asked to do this, this is how we’re thinking about going about it. We’d love to have your input, and if you’re an interested person, you know, let’s start connecting.” So that’s the first stage of that process. Submissions come in. We do our analysis. The next stage is a draft report, which would typically include the analysis we’ve been able to do. It would typically include a lot of feedback from submitters, so we’re quite deliberately trying to highlight that and focus on it, and publish it in the report to use it to support various conclusions. And with the draft report we would expect to get feedback as well, and the draft report also goes through another round of submissions. And we’ve been getting pretty high feedback, pretty high submission numbers, for a report like this. So that’s an opportunity to get input as to what people are thinking about where we’re going and how this process is evolving before we nail our final view. And at various stages through there, there’s the peer review process and other sort of customer survey processes.

Alsop  I think a couple of other important dimensions, Murray, are the use of focus groups, which we used in the freight inquiry, bringing different stakeholders together on an issue. In trans-Tasman we held a trans-Tasman, very in-depth, tax workshop—one of the best technical workshops that Murray said he’s ever attended. Then in the local government inquiry we put together a reference group of people that have longstanding credibility in the local government sector, with Steven’s team to bounce off and for commissioners to engage with. So there’s a large number of touch points right through the process.

Cunliffe  So if we look, for example, at your performance report, quite a lot of use is made of qualitative feedback statements, and, of course, the reader has no
visibility to the selection process of those. We could probably all find positive ones or negative ones if we chose to.

Sherwin Yeah, and that’s one of the risks with those processes.

Cunliffe Likewise, if the sense of how many of your recommendations were accepted by the Government of the day was your overriding—I mean, it does go to impact to a certain extent, but it doesn’t go to independence.

Sherwin That’s right.

Cunliffe Because you could set very modest outcome goals and have them all implemented, or you could set more stretch goals and have less implemented but have more impact.

Sherwin Which is absolutely the case.

Cunliffe How do you think about that?

Sherwin Well, we worry about it.

Alsop We haven’t set a target for that, for that reason, though.

Sherwin Yeah. You’re absolutely right. I mean you could set up—

Cunliffe I’d like to see you set a target of a minimum percentage recommendations that were not accepted by the Government of the day—because otherwise you’re not trying hard enough. You’re shifting the debate.

Sherwin Precisely, you need to be able to shift the debate. You need to be able to push things along. Talking with the Australians, who have been worrying about this for a lot longer than us, you know, they’ll say in terms of recommendations, some of the recommendations will sit there gestating for quite a period of time. It might be through an electoral cycle where the Opposition is mulling on this stuff and works it into their policy prescription.

Cunliffe And you’re—coming, then; shifting the questions a little bit to your mandate. First—because you’ve just mentioned it—the term of that mandate. The commission exists precisely to take a strategic as opposed to a tactical perspective. You’d agree?

Sherwin Yes, absolutely.

Cunliffe So therefore, how is that—I’m trying to make a question out of this. How is that reflected in the way you think about your work, and the time horizon of your recommendations?

Sherwin Well, time horizon of recommendations—well, something like housing, you know isn’t going to be fixed immediately and so you try to steer away, I think, from some little quick-fix type stuff, because it isn’t going to be that sort of issue. So you’ll find quite a lot of our stuff ends up talking about the nature of the relationships, the nature of the structures in place that will drive behaviours and incentives and so forth over the longer term.

Cosgrove Sorry, were you referring to housing?

Sherwin Housing is one of those, yeah.
Cosgrove What do you mean by a quick fix?

Sherwin Well, it’s a complex set of issues and it’s not one that is sort of open to one or two very quick, easy policy decisions that will suddenly make the problem go away.

Cosgrove Like what?

Sherwin Well, that’s what I’m saying. It’s not open to those sorts of things, which is why—

Cosgrove How do you define a quick fix? You see, you could argue that there’s no fix being propagated by this Government and there are policies being put by others, so I just want to get from you what you define as a quick fix as opposed to a substantive policy.

Sherwin All I’m saying is that it’s a deep-seated problem and unlikely to be—well, it’s not going to be amenable to a quick policy change that will solve it in the course of the next 2 years, 1 year, whatever.

Cosgrove You might want to choose your words carefully.

Sherwin I’m sure I do, and I’ve got no particular wish to get drawn into a political debate about that. But the point I’m making is that many of the issues—well, the productivity issue in itself is a deep-seated problem which has been evolving over the last three or four decades. What we’re doing is taking bite-sized pieces at it, inquiry by inquiry. But to go back to your point, David, we absolutely have to be thinking about the impact of the recommendations over the longer haul.

Mitchell It was pretty clear to me what you were saying is that with complex issues around housing, it’s going to take maybe a bit longer and an in-depth analysis in terms of generating some recommendations back to the Government.

Sherwin Well, the recommendations are already there and—

Mitchell But if there were more complex issues like that arising.

Sherwin Yeah, I mean you try and frame your recommendations in a way that they will provide a way forward, but they won’t all have immediate outcomes, you know, within a 1 or 2-year time frame.

Cosgrove In terms of your recommendations have you had any indication from the Government as to whether they’ll adopt them or when they’ll adopt them, and if they’ll implement them?

Sherwin There was a written—

Alsop There’s a full Government response on both housing and freight, recommendation by recommendation. It came up earlier when you weren’t in the room, Clayton. So the Government has responded.

Cosgrove Forgive me, forget about whether I was in the room. So how many recommendations have been adopted?

Young Where’s it available from?
Alsop I think it’s—
?
We might seek to get copies, actually.

Cosgrove Well, no, the question is simple. How many of your recommendations, say in housing, is the Government going to adopt?

Sherwin Well, they’ve published in intention, which goes through, recommendation by recommendation. That’s available—

Cosgrove So my question is how many of your recommendations has the Government stated, to use your words, an intention to adopt or progress?

Sherwin I’d have to go back and look through the response. It’s there; it’s published.

Cosgrove If you’d provide copies of the responses to the committee (inaudible)

Alsop The very large majority would be in the order of 90 percent of our recommendations, but that’s not an exact percentage. I don’t have an exact, absolute number, but it’s in that order.

Sherwin And there’ll no doubt be some variations as to how they pick them up, because there’s quite a lot of policy work still going on, I think, across the system.

Young You mentioned that in terms of your recommendations that there could be a time lag as that policy work is being done. You mentioned—what was it, 1 to 2 or 3 years?

Sherwin Yes, well, in the housing area one of the things that came clear as we were working through that is that there was a relative dearth of capability within the public sector looking at housing policy overall. There were various silos looking at elements of it, and I think you’ll find that there’s been quite a flurry of activity subsequent to that report, as agencies are pulling together teams to try and sort of cover off some of the issues that were identified.

Yang So do you think that your report of housing affordability will have an impact on, like, the Auckland District Plan; this kind of argument?

Sherwin Yes.

Yang So you have to follow up, basically; observe, assess the impact.

Sherwin We don’t follow up ourselves. I mean, our funding is very much around specific inquiries. Once the inquiry is done, the recommendations are made, it’s tabled. We have very little capacity to do any further work on those issues, but it’s clear from the sorts of discussion we’ve had with the Auckland Council that they have taken that seriously and so have Ministers taken that seriously in their discussions with the council about their evolving plans.

Cosgrove Just on your housing recommendations—I mean, forgive my ignorance, I’ve been concentrating on a couple of other things. Do your housing recommendations, or informing those recommendations, did they, for instance, canvas wider issues such as housing affordability and, leading to that, propositions that have been put in place by other countries? For instance, (inaudible) MPS issues, capital gains tax issues, where you’re
steering people away from unproductive to productive investment, issues around the monetary policy and the formation of monetary policy and its influence, obviously, on interest rates and its flow through to housing. Did you look at any of those?

Sherwin  There’s a chapter which deals with the international context, and that’s the international monetary impact, which was obviously important in shaping the shape of the house price boom internationally through 2000, including in New Zealand. There’s another chapter on taxation issues.

Cosgrove  And did you make any recommendations about some of the settings around those issues domestically that Government might want to follow?

Sherwin  We did not make particular recommendations around changes to either monetary policy or to taxation policy.

Cosgrove  Don’t you think they’re inherently linked to housing affordability?

Sherwin  Not in the way that I think some people are arguing. There’s no evidence from countries that have a capital gains tax, for instance, that their behaviour on pricing was any different than ours. What the tax chapter does quite explicitly is identify the conceptual basis for the existing tax basis, tax regime. It makes it clear that you could have a capital or assets base to that if you wished, but that would be a substantial change and it wouldn’t be just on housing alone.

Lotu-Iiga  The Reserve Bank is going out for consultation around some of these macro-prudential tools. Are you going to make a submission?

Sherwin  No, we won’t be making submissions. One of the points I would make, though, and it goes back to both these points, is that I think the conclusion we came to was that the housing affordability issues are fundamentally around supply.

Lotu-Iiga  So that’s land.

Sherwin  Land is a part of that, and land both inner-city and greenfields. But it is fundamentally an issue of supply, and it’s fundamentally, apart from the specific issues around Christchurch, fundamentally an issue around Auckland and the upper North Island. There are ways—

Cunliffe  Sorry, Mr Chairman; (inaudible) touch on two other reports if I can. A couple of specific questions around the freight report, and then trans-Tasman integration, which is a very important report, I think. On freight you’ve been, as my colleague has noted, rated more highly on that than the housing one in the feedbacks. So the relativities of that feedback are of interest to the committee. I think one of the reasons the freight one has been helpful is that it was quite grunty in its recommendations around the removal of the Commerce Act exemption, and that that sparked quite a wide and vigorous public and commercial debate, because it went to some real interests. Can you tell the committee from your point of view—again it goes to the issue of measurement of impacts—how that’s been received, what the next steps are, and how you anticipate that to play out, and
therefore how that flowed and any implications for the way that you handled that. (inaudible)

Sherwin That recommendation flowed out of really just reviewing what is going on in our international freight services, what is the regulatory regime, recognising that that exemption is unusual across commerce in New Zealand, recognising that in a number of other jurisdictions internationally they have moved in recent times to remove that sort of exemption, and a judgment, having done the analysis and sought the advice that we could from different places—and a very strong submission also from the EU, which was interesting on that one—that there was no particular reason to sustain that exemption. The exemption has its origins in the move from sailing to steamships, and about managing capacity on very expensive capital equipment—being steamships. So, you know, it’s odd how history sort of echoes on.

Cunliffe (Inaudible) that recommendation up?

Alsop I’m pretty sure, Geoff, they—

Sherwin What have they done with that?

Alsop I think the response accepted the recommendation in principle.

Lewis? It was passed—a letter was written by the Minister to the select committee that was considering the bill about—

Sherwin That’s right.

Lewis —yeah, competition and collusion.

Cunliffe So to what extent is the commission tracking the follow-up action in respect of one of your principal recommendations on that report?

Sherwin We don’t do a lot of actual tracking.

Cunliffe So can I just then bring that back to—and it’s an area, without going into detail, that our Auditor-General’s office has raised with us. It’s only your first year. We’re not beating up on you, but the opportunity for improvement in the measurement and interaction of the downstream impacts and the implementation—you know, as an ex-consultant you’re more and more fussed about implementation. So here’s a nice example. It’s a principal recommendation, it’s highly controversial, looks the Government is going to act and there’s counter-pressure where you may have a role in the further debate. But you’re quite vague as to, with respect, where that’s got to.

Sherwin Yes, and we’re not resourced to carry on the ongoing follow-up. We do our work, we do our recommendations. We do the best job we can, but we’re not resourced to maintain an ongoing role and interest in those.

Young Just a supplementary to that, David. Would that be part of your position of independence—that you produce a report, make recommendations, and then you have to cut free from the decision-making process around those recommendations?
Cunliffe: Oh, look, I don’t think it’s quite that issue, with respect, Chair, because it’s (inaudible)

Young: Well, I asked the question, not for you to answer but for Mr Sherwin.

Sherwin: Well, it really is just a capacity issue. To try to maintain a watching brief, particularly as the portfolio of recommendations begins to build up, is quite a burden, and, you know, we’re fairly tightly strung in terms of getting out the ongoing inquiries. The Australians don’t do a hell of a lot of this either.

Cunliffe: I’m just pushing back, respectfully here. You’ve only done three reports, and this was one of your key recommendations. It’s a matter of substantial commercial interest and some public debate. I am surprised that you haven’t taken a close personal interest in its implementation.

Sherwin: We do the analysis to the best standard we can, put the recommendations out, we deliver them to the Government, and our work is in trying to be as compelling and as persuasive, and bringing the best body of evidence, that we can.

Cunliffe: But your statement of intent talks about impact, not only report quality.

Alsop: David, could I just make a point of clarity?

Cunliffe: Here’s the question. How can you be sure that you are maximising your impact if you are not tracking the downstream issues, to some extent?

Alsop: What we do—

Cunliffe: To some extent.

Alsop: What we will track, as a point of clarification, is in our annual reports. It’ll say 19 out of 20 recommendations have been agreed to, or whatever the number is. So that’s where the 90 percent came for the housing. It’s in that broad magnitude. So we will report the number that are adopted, but that’s quite different to following in detail an interdepartmental process around a particular issue.

Cunliffe: This is a question of degree, but, for example, if there’s a public debate about the Commerce Act exemption, you might have an opportunity to do an op-ed in the New Zealand Herald on it, because, sure as hell, there’ll be some shipping interests that will try to preserve some monopoly rents, and there will be a public debate and you’re on one side of it. So, anyway, look, let’s move on—

Young: No, no. Before you move on, in terms of what you were talking about there before, David, in terms of this issue of independence—

Cunliffe: Doesn’t compromise—

Young: Obviously you consult on the terms of reference and then, as an independent entity, you proceed, deliver your report. So in terms of, obviously, the Government not influencing your work, in terms of you having a parameter where you influence the Government’s work by your report, when your report is delivered, do you see at that point in time that
you have completed your mandate? And then what David is talking about—
op-eds and things like that—how do you manage that sort of opportunity?

Sherwin  
By and large we manage that sort of opportunity around the release of our
drafts, around the release of our finals, and while the inquiry is in play, once
we deliver our recommendations, basically we stay out of the way of the
Government and don’t want to engage in the political debate which is
subsequent to that. That’s partly about protecting our independence, as well
as about just the resourcing elements. I mean, I could be—

Cunliffe  
Just to be clear, I’m not asking—well, do you think that any downstream
engagement would necessarily imply a compromise of your independence?
(Inaudible) is different from resourcing, that vigorously pursuing an
independent perspective in a public debate, which might be different from
the Government of the day, actually enhances your independence.

Sherwin  
Ah, it could, but it puts us into a political play. You know, if you’ve released
a report, the recommendations are out there and the political process is
working its way around that. I would prefer not to have us in the midst of
that.

Young  
OK, we’ve covered all this. Clare, a new question line, and then Mark.

Mitchell  
I’ve got a supplementary on that. I can’t see the point in downstream
engagement (inaudible) your impact is going to be, what sort of uptake
there’s going to be on your recommendations. I would have thought that
would be a pretty good measure in terms of what impact they’re making.

Young  
OK, thanks. Clare. Then we’ll come back to you on a fresh question.

Curran  
I think myself, and Sam over here, are the only ones who sat on the
previous select committee in the last term in which there—

Young  
And myself.

Curran  
—and you, excuse me—in which there was a lot of discussion around how
you would form the role. One of those discussions was around how, in the
context—and we had this discussion with the Australian Productivity
Commission when they came to speak to us—you chose issues to
investigate and study, and whether that was your choosing or whether it was
essentially on the recommendation or (inaudible) of the Government, etc.

So I’m interested in your views around that now, given that you’ve been
there for a year, and how you’re making those decisions, in particular in
relation to what you’re going to do next. I note that you do have a period of
business, you know, that you’re working on. But when you look at the big
issues of the day, and the big issues that have impact on productivity, there
are some things that kind of leap out, and I’m going to name two of them
and ask you whether you are doing any thinking in this area. The first one is
the economic effect of the ageing population, which the Australian
Productivity Commission did a lot of work on, 3 or 4 years ago, and the
other one is essentially looking forward in another way—I suppose,
perhaps, at the other end of the spectrum—and that is the economic impact
of a growing digital divide in New Zealand. Given the basis on which our
economy is going to be focusing more and more on technology and innovation, are there any concerns and, if so, what is that impact, down the track?

Sherwin Well, as you’re probably aware—you met with Gary Banks when he was here supporting the progress of the bill through the House, through the committee—he argued very strongly that the selection of topics should remain with Ministers and should remain with Ministers in order to ensure that Ministers have skin in the game. It’s too easy, if the commission is picking its own topics, for the results to be basically ignored and walked away from. I think that was a sound judgment, and that’s certainly the way it works.

Bill English, as the relevant Minister, the primary referring Minister, has been quite open in terms of seeking input from others about what topics would be of interest, so he’s been openly canvassing. In fact, I there was even an ad, wasn’t there?

Alsop Yeah, they went public on this second round of inquiries—a media release and contacting, like, Business New Zealand, CTU, and other organisations.

Sherwin So they’ve canvassed quite broadly to try to identify topics which would be of relevance. We are invited to put in our own suggestions as well, and we typically put in three or four options, with a bit of scoping around what they might look like and what they might be trying to achieve.

The issue of Asian population has not been one that’s been on the agenda, although I notice the Aussies, not through the Productivity Commission, but through Ken Henry, who will be across here shortly, have done that major piece of work on Australian connections with Australia and there’s been briefings provided to New Zealand for that. But that’s a different issue from the changing demographic—

Curran Ageing.

Sherwin Ageing, sorry. I thought you said Asians.

Curran Sorry, I didn’t say Asians. This is the ageing population—

Sherwin The ageing population.

Curran —which is a very large piece of work.

Sherwin Yes, sorry. They have done that work on aged care and ageing populations, and it is one of the areas that we’ve identified as potentially productive to have a good look at, because I think it does have significant implications for the way this economy behaves, the way the society evolves.

The digital divide—well, we’re still waiting for the next topic to come our way, but something in the ICT space, I think, has an awful lot to recommend it as territory for us to be working in. You could take a lot of different cuts of that, and I suspect that over time you would expect a commission like this to come back to that subject.

Curran Can I, I guess, take the opportunity, seeing as you’re here before the select committee, to actually put that on the agenda for you to have a think about,
given that there’s just been another select committee inquiry into 21st century learning, in which the digital divide was identified as a key issue? But the issue that we have in New Zealand is that there’s no research. There’s virtually no research that’s being done at this point in time on these issues. Given we’re a country that is transforming, as many other countries are, into new technology, where children that are starting school and going through school now are the workers of the future and will be working in the technology space, there is a big question mark around those who have access and those who don’t and what the impacts will be in the workforce of the future. So that’s a very big—

Sherwin I agree, and a very exciting one. You’ll be familiar with that Point England experience, are you?

Curran But we use that experience constantly, because we don’t have any others.

Mitchell Just coming back to the question at the beginning of the briefing, which was around staff and the skill base, so is this going to be an issue? Do you see this as an issue or something that needs a fair bit of attention, in terms of being able to recruit and get the skill base that you need?

Sherwin Quality staff is the core of a successful organisation.

Mitchell Yeah, absolutely.

Sherwin We need to be on our toes all the time, looking for opportunities to hire the best, get access to the best, and we’ll get access to them in different ways. Some of them will come on to the staff permanently; for others that won’t work for them. You know, there are a lot of Kiwis abroad, as well, who have extraordinarily strong CVs and experience and insights to offer. We try to position ourselves to be sufficiently flexible and open, that we could make use of those sorts of talents as well in different ways, and that goes to how we engage with them, how we structure topics so that we can get input which works for people, but yeah, we’re after the best.

Young In terms of Mark’s question, just as a follow-up on that, morale on the staff in terms of engagement in these projects, enthusiasm, how is that work going?

Alsop I think you should talk to these guys. I think in a small organisation you know pretty quickly whether something is awry, and my assessment with the leadership team, which includes Steven and Geoff, is that we’ve got a fairly good office vibe. We’ve taken our culture formation really seriously around values and engaging our staff in some of the decision making and policy settings, etc.; regular staff updates, internal comms is important. So we feel we’ve got our finger on the pulse, and we place a high premium on that because in a small organisation everyone needs to click for the whole ship to move well.

Sherwin It’s a small structure. It’s a flat structure. It’s a very collegial and engaging atmosphere, which is what we aim for.

Young One more supplementary question from Sam; then we’ll go to David Cunliffe.
Lotu-Iiga  When we were considering the bill we looked at the structures and looked at how yourself, you’re the executive chair, which I think an atypical structure is what we’ve got, in terms of having someone who is in the governance role but also part of the operations of the organisation. I mean, how has that panned out in terms of your sort of dual involvement in governing the organisation and also being part of it?

Sherwin  I think it’s OK. I mean, I try to focus on the outputs. I do a lot of the external stuff and the inquiries. Peter runs the shop, and that’s fine. Again, it’s an APC-type model. Gary Banks has been sort of chair there, with his finger on the pulse. You can make other structures work, but this one, I think, is fine.

Young  I think we’ve got, probably, a final question from David Cunliffe.

Cunliffe  In your purpose statement you have a broad well-being orientation, but in the trans-Tasman paper, productivity is defined as the positive net benefits of integration, and then that’s interpreted as the lowering of barriers, so it takes a fairly narrow and cost-based approach. There are two questions, really. This is the general one. As you move into the local government report, that becomes a very important issue, because local government can play an empowering role in developing communities and economies, but if you take a deregulatory cost-based approach you would be likely to be recommending a shrinking of their role, and that goes to the heart of the debate a year ago about your mandate.

Do you agree, or disagree, that a broad-based approach to productivity, which includes both the building of capabilities as well as the reduction of costs, is important, and how is that informing your view of the local government report?

Sherwin  We take that well-being concept very seriously. It’s broader than just straight dollars and cents and costs, and so on, and that’s an important part of the way we’re set up. It’s kind of interesting, given the way the well-beings are being written out of the local government legislation right now—

Cunliffe  That’s exactly (inaudible)

Sherwin  Yeah, yeah. I think there’s some—I mean, a key part of this inquiry is around how you make judgments about what regulatory functions go to local government and what goes to central government. What are the principles and characteristics that you would bring to bear on that, which is not an easily resolved issue. I think in there is a sense that part of this is about empowering local communities to take ownership of their own issues, their own challenges, and their own successes. It’s trying to find the principles that allow that to occur but also reflect the periods where there are strong drivers for national consistency.

Cunliffe  I think what you’re saying, but I’m checking, too—yes, it’s almost yes or no—that from the point of view of your interpretation of your mandate in the broader well-being construct, you think it is in scope to look at both the bottom line advantages of reducing costs through deregulatory activities, and also the top line advantages, where they exist, of proactive development
that might expand opportunities and capabilities. Are they both in scope, or is the latter not in scope?

Sherwin We’re interested in effective outcomes for strong communities. But that can come in all sorts of ways. This is not primarily driven by “can we do regulation cheaper”, or whatever. It’s about what constitutes effective regulation for the better outcomes for those communities.

Cunliffe But it’s not just regulation, is it?

Sherwin Our focus is very much on regulation.

Cunliffe Why?

Sherwin Because that’s what the terms of reference are.

Cunliffe Who sets the terms of reference?

Sherwin Ministers.

Young But you are consulted on that, and discuss that, don’t you?

Sherwin The terms of reference for the local government inquiry are around the regulatory functions of local government.

Cunliffe So would you therefore feel unable to look at the capability-driven productivity gains for local government and restrict yourself only to the cost-based regulatory (inaudible)

Sherwin No, no.

Cunliffe I’m glad to hear that. A final question in the trans-Tasman case, and it goes to the same issue of upside, downside. The mutual recognition of imputation credits—New Zealand is being screwed. There’s a 60 percent effective tax rate on investment in New Zealand companies and a 40 percent on Australian companies. But you kick for touch in the final report, saying that it’s a matter for Governments to consider and it may cost the Aussies something. It only costs the Aussies something because they’ve been screwing us blind for years. Why don’t you muscle up?

Sherwin The tax bill for the Australian revenue system is around $500 million a year for mutual recognition.

Cunliffe They should be refunding us 10 years’ worth of back tax.

Sherwin For the New Zealand inland revenue system it’s probably of the order of $200 million a year. There’s a published set of papers from a very intensive workshop that was held in Australia, and that’s all available. It was an interesting and intensive debate to get to where we got to.

Cunliffe Doesn’t it go to the heart of—

Sherwin This was a joint—

Cunliffe I know it was a joint study, and I appreciate that makes it difficult, but it goes to the heart of whether you are making recommendations that are in the New Zealand national interest, which addressing that issue surely is, or the net trans-Tasman interest, where the Australians could argue that the detriment to them is significant.
The argument about what constitutes a net trans-Tasman benefit got a lot of airplay, as you can imagine, through the course of this, because it’s really easy if there’s a proposition where both sides can see a benefit for each country—real easy. It gets a little harder if it’s sort of break-even for one and a benefit for the other, but you would probably end up running with that, given a bit of interest in pursuing further integration. Where one side sees itself losing and the other side sees itself gaining, then you get to where we ended up on mutual recognition, which was: is there a compensation arrangement which would give both sides an outcome. You can spend a lot of time arguing, as we did, the models.

Cunliffe The analysis is where the politics is a complex thing.

Sherwin Yeah, and it was a joint study.

Young There’s a variance of view coming from both sides, obviously.

Cunliffe Keep on it.

Sherwin It was a pretty robust session.

Cunliffe I can imagine.

Sherwin I think it would be a net gain, but you have to be able to make some strong assumptions about—

Cunliffe That it’s trade-creating—

Sherwin Well, it’s about the trade creation, it’s about the dynamic effects which come down the track as companies begin to behave differently and structure themselves differently, and that’s very hard to capture in a model.

Young Well, Mr Sherwin, Mr Alsop, I would like to thank you very much for appearing today. Congratulations on a very good—well, you’ve been going for nearly 2 years, but a very good first return to us. Well done, and all the best for the future.
New Zealand Railways Corporation

Recommendation

The Transport and Industrial Relations Committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Railways Corporation, and recommends that the House take note of its report.

Introduction

The New Zealand Railways Corporation was established in 1987. From 1 October 2008 (following the Government’s 1 July 2008 repurchase of rail and ferry operations from Toll New Zealand) it was wholly responsible for rail and ferry services and rail infrastructure, trading as KiwiRail. During the year under review, it was a statutory corporation, commonly referred to as a state-owned enterprise, operating as a single entity with multiple business units.

From 1 January 2013, the business has a new structure. The New Zealand Railways Corporation continues to hold 18,000 hectares of rail network land, from which it is not expected to provide a financial return. KiwiRail’s freight, passenger, infrastructure, and ferry businesses, together with rolling stock, rail infrastructure and plant and equipment, have been transferred to a new state-owned enterprise, KiwiRail Holdings Limited.

Turnaround plan

We note that KiwiRail’s 2011/12 operating surplus of $77.6 million was down from $102.6 million in 2010/11, and did not meet the 2011/12 target of $139.5 million. While the freight business performed well, the passenger and Interislander business units did not perform as expected, and EBITDA¹ targets have not been met for two years. In view of these results, we asked whether KiwiRail would still meet the capital investment targets in its turnaround plan, and whether it would require Government funding in addition to that already proposed. We were told that lack of growth in the economy has meant that the corporation has already had to make adjustments and modify the plan, and that assumptions will need regular updating. Nevertheless, the corporation expects the plan to be achieved, within currently-planned funding, no more than a year or two later than the initial 10-year target.

We asked if the maintenance deferred over the past year in adjusting the plan would make it harder to carry out the plan in subsequent years. We were assured that all necessary work will be done each year, because the corporation prioritises ensuring that assets meet safety requirements and customers’ needs. The corporation pointed out that up to 50 years’ worth of maintenance has been deferred; the aim of the turnaround plan is for the corporation to reach a position where it can fund such work itself rather than rely on continued investment from the Government.

¹ EBITDA refers to earnings before interest, tax, depreciation, and amortisation.
Napier to Gisborne line

The corporation reported that it had intended to replace 71 culverts on the national rail network in the year under review, but only 49 had actually been replaced, as a result of adjusted priorities. The corporation acknowledged that damaged culverts were a contributing factor to washouts on the Napier–Gisborne line after very high rainfall, but pointed out that there had been doubt over the economic viability of the line well before the washouts, so as little as possible had been spent on the line for some years. The corporation has engaged with the Gisborne community over this time; it believes that its estimation of the cost of reopening the line is robust.

Clifford Bay

We asked the corporation if it had planned for and estimated the financial impact on its business if the Cook Strait ferry terminal were to be moved from Picton to Clifford Bay. We were told that KiwiRail would not be involved in operating such a facility, and would sign up as a user of the port only if the business model, which is yet to be developed, was financially viable. A Clifford Bay terminal would mean shorter journeys for both ferry and rail services.

Local procurement

We noted KiwiRail’s preference for a particular overseas procurement tender bid, and were told that the cost differential between the tender for having rail wagons built in Dunedin and the successful tender from China was around 30 percent. The corporation told us that its main job was to make correct commercial decisions, and that it was not mandated to make decisions based purely on the societal outcome. We were also told that building a highly technical and complex train that had never before been built in New Zealand would not fit the corporation’s risk profile.

Repair work to new wagons sourced from overseas has incurred no cost to KiwiRail; the manufacturer had undertaken or paid for all necessary work, and had not increased the price of the product for future orders. KiwiRail could not answer our question about the length of warranties on the wagons as this is covered by a confidentiality agreement with the supplier, but told us that various components have different liability periods and it considers the warranties in place to be appropriate.

Freight business

KiwiRail’s freight business has grown by 25 percent in the last two years. We congratulate the corporation on this achievement. KiwiRail is seeking to grow further by prioritising capital investment to increase freight capacity and preparing for new sources of freight (for example, by constructing a branch line to Fonterra’s new Darfield plant).

KiwiRail does not expect planned reductions in track renewal work to affect the freight business. Any temporary speed restrictions will be within service tolerances so will not be appreciable to freight customers. We heard that there is a limit to how quickly money can be spent on track-work without disrupting services, but the corporation acknowledged that its current priorities were not close to that limit.

The corporation told us that market share is very hard to measure in the freight business as KiwiRail can carry freight for only part of most journeys. A particular freight company can therefore be a competitor of, a customer of, or a service provider for, KiwiRail for different parts of the journey of a particular piece of freight.
Passenger services

New, locally-built rolling stock has been added to each of the three main long-haul passenger services, and the corporation reported that passenger feedback has been very favourable. There are challenges to the profitable running of the passenger services; for example, two of them (the Tranz Alpine and the Tranz Coastal) are based in Christchurch, where tourist numbers are constrained by the availability of hotel beds since the Canterbury earthquakes. The Overlander service was losing money, but it has now been reconfigured as the Northern Explorer, to be more squarely aimed at the tourist market. It is expected to carry fewer passengers, but at higher fares.

Auckland electrification

KiwiRail is involved with three major projects in Auckland at a combined cost of about $1.6 billion. Project DART (Developing Auckland's Rail Transport) is almost complete, on time and on budget. The Auckland Electrification Project is due to be complete late this year. The first of the new electric trains will arrive once the electrification is complete.

Capital Connection

We noted that KiwiRail has stated that it would require about $550,000 per year to continue to operate the Capital Connection between Palmerston North and Wellington; we asked if cutting the service would therefore make KiwiRail better off by that amount each year. We were told that it would not, as some of the costs would not cease immediately, and other costs would be redistributed to remaining services. The Capital Connection is unusual in that it travels a longer distance than other commuter services in New Zealand, and is the only commuter service without significant support from local or central Government. The critical factor for the viability of the service is the number of passengers the service attracts in the section of the route not covered by other commuter rail services. We note that a proposal for its future has been made by the two regional councils through whose areas the service runs; and that whether and how it will continue to run is now to be decided by the Ministry of Transport rather than the New Zealand Transport Agency.
Appendix A

Approach to this financial review

We met on 14 February and 21 March 2013 to consider the financial review of the New Zealand Railways Corporation. We heard evidence from the New Zealand Railways Corporation and received advice from the Office of the Auditor-General.

Committee members

David Bennett (Chairperson)
Chris Auchinvole
Dr Cam Calder
Darien Fenton
Iain Lees-Galloway
Sue Moroney
Simon O’Connor
Denise Roche
Mike Sabin

Evidence and advice received

New Zealand Railways Corporation, responses to written questions, received 3 December 2012 and 15 March 2013.

Bennett Welcome John and Jim, and David. Thank you very much for coming along to the select committee for this financial review of New Zealand Railways Corporation. We’ve got about an hour, so we’ll probably go until about a quarter to 1, if that’s OK. Members will have quite a few questions, so feel free to give us an introduction now and then we will open up for questions, OK?

Spencer Thank you very much, David. The business plan that KiwiRail operates to is aimed at one thing, and that is creating a sustainable business. Just to make it clear what sustainable means, it means that hopefully by the next 10 years KiwiRail will be able pay its own way, from a cash point of view—i.e., generate enough cash to meet its capital needs, replacement needs, as well as its operating needs.

Sustainability is based on a three-pronged approach: volume growth, improving price points, and lifting productivity. That will be underpinned through world-class customer service and engagement of our people. We are now 3 years into the plan, and what that has seen is sustained revenue growth. Also we’ve been knocked about by significant events such as the Christchurch earthquakes, flooding, and the global financial crisis. We’ve had great engagement with our customers. We’ve delivered on the tough calls that the plan outlined. We’ve closed the Stratford line, the Napier-Gisborne line, Hillside workshops, we’ve restructured some of our businesses, and of course we have had a major balance sheet restructure.

We’ve faced a number of challenges. The process to design and build new carriages, locomotives, wagons, log bolsters, and ship extensions has been demanding. I think it needs to be remembered that it was 35 years between the new locomotives we received in 2010 and the previous ones. We’ve had...
the renewal of the Wellington and Auckland networks, the introduction of the Matangi trains, and the Aratere stretch project.

The financial year just gone has seen strong financial growth. We’ve had a 12 percent freight growth. We’ve been challenged by the Interislander and Scenic performance, and tough market conditions. The year we are in now, we’ve seen the continuation of growth. However, in December and January we have been hit with the threatened Interislander strike action, which affected freight as well the Interislander. South Island floods have affected coal shipments through January, and the warm summer, particularly in the North Island, has slowed milk shipments.

Looking forward, we’re very pleased with volume and revenue growth. We’ve stayed within the funding envelope. We’re disappointed that earnings have not come as fast as planned, but pleased that we can identify the reasons for this. We’re now through the highest risk period of the plan, which is the design and build of each of the new asset items. We can now order products with a bit more confidence. We’re under way with commissioning further locomotives and continue to get greater engagement and support from our customers. Thank you.

Bennett Thank you very much John. I appreciate the brevity.

Twyford First question is around how realistic the Turnaround Plan is, given that you’ve missed financial targets in the first 2 out of 3 years under the plan. I suppose my question is what are the prospects based on your current projections of KiwiRail meeting its own capital investment targets under the plan, and are you going to need more Government money over and above the $750 million?

Spencer Going back to the Turnaround Plan, the $750 million was for the first 3 years. The total amount required from the Government according to the plan was close to a billion dollars. As far as will we reach the targets within the 10-year period? Some economic growth would help. Things are slow. We’ve had to already readjust. If it’s not 10 years, then certainly it will be a couple of years after that. I don’t see it being 15 or 20 years. It is sustainable, but we have to continue where we are, the way we are going now, and try to get more volume on that rail.

Twyford Are you going to need more Government money than is foreshadowed in the plan?

Spencer No, as far as I am concerned we’re staying within that plan.

Twyford Will you meet KiwiRail’s own capital investment targets?

Quinn Can I just go back to the question asked before that. I think we’re very resolved to try and deliver the plan, to do everything we can within what we’ve asked for. So that’s the first step. At no stage, given that’s a mantra, will we allow ourselves to breach or get near unsafe, because it’s a very strong part of our responsibilities. And then we would only ask for more money if there was a really—you know, if we’re at the point where we’ve exhausted all approaches to that. We’ve done our very best to modify the plan and review it based on the economic events that John talked about.
before, the incidents around us, but also how the clients are reacting. You
know, there’s nobody realistically who thinks that the 10-year plan is going
to stay static. Wouldn’t it be nice if the world was as calm as that?

So we’ll continue to do that. We’ll continue to engage with shareholders,
we’ve got to, and we’ll continue to challenge ourselves. We know so much
more about the business today than we did when we wrote the plan. We’ve
tried things, we’ve challenged things, we’ve implemented the new rolling
stock. So the assumptions need to be challenged and updated as we go
through.

Twyford

Given that $168 million of the $200 million that you cut last year from asset
maintenance, track renewals, and so on was deferred rather than not done,
that creates a bow wave of future maintenance that is going to need to
happen. So what does that mean for the organisation’s ability to—are you
going to be able to do, in the coming year, what you had intended to do,
and catch up on the $168 million that you deferred from last year?

Quinn

We did not defer $168 million from last year, so we’re moving through —
we have deferred some stuff. That was a deliberate call to keep the plan in
tune. I think the mistake we can make, all of us, is to think of this as like
some sort of 10-year drop-dead window. We’ve got 30, 40, 50 years of
reinvestment to make. The 10 years is about getting the cash above the
investment requirement.

Will we deliver all that has got to be done? Yes, we will. Will we continue to
look at what absolutely needs to be done in any given year, every year? Yes,
we will, and the decisions around that and the priorities we’ve put around
are absolutely underpinned by what has to be done because we have to keep
it safe, what must be done because we need the assets to be in a shape so
that our customers get what they want—the customers we’ve got—and the
customers who are emerging, we are able to deliver what they want. So we
have a very clear view on how we prioritise that, and we will continue to
review the plan every year for every 3-year window out and continue to
update. And, yes, we will deliver.

Twyford

In the written answers that you provided, you attribute the Napier to
Gisborne line washouts to both high rains and the failure to properly
maintain the culverts. The damage to the culverts—blocked, old, and
damaged culverts—combined with high rain are what caused the huge slips
that took the line out, and you say that KiwiRail has been actively upgrading
the long-neglected national rail network.

You go on to talk about the fact that there are 12,197 rail line culverts
across the country. You’ve identified 53 high-priority culverts, and you’re
doing kind of a risk assessment of those culverts. But in the annual report,
you say, under your KPIs, that you cut the planned culvert replacement
programme, where you missed the set target of 71 culverts and only
replaced 49. So we’ve got lack of maintenance on culverts the main reason
for the washout of the Gisborne-Napier line, which has been a disaster that
region, and as part of your cutbacks on maintenance you’ve substantially
missed the target of culvert replacement.
Quinn: And that goes to what I just said. We run a detailed asset management plan. We review our priorities every year based on what is in front of us, what we’ve learnt, and what we know needs to be done. We set some views based on what we assume, and we have our people inspect and check, and those priorities are grounded around the realities of that year.

The Gisborne line, we were very clear 3 years ago for the Gisborne line that we would do the absolute minimum on that line to keep the capital down on it while the discussion was being had around where it would go. We were very clear at that time that we thought it was unlikely it would be a commercial and viable line. Nothing we’ve learnt on the way through would change that. It’s unfortunate that the washout occurred, but look, that topography and geography has had major washouts on it for decades. That’s not an uncommon event. We do our best to keep these things as clean as we can, and there is no doubt that the age of the culvert didn’t assist. A bigger culvert would have helped, but we weren’t going to invest in that at that time. So I understand what you’re trying to link, but I think they’re quite different situations.

Spencer: I just want to make a point. Remember we are living within limited fiscal resources. We have to prioritise, when we’re looking at things like culverts, and looking at maintenance versus replacement. So do we prioritise? Of course we do.

Twyford: But you’ve acknowledged that the Gisborne to Napier washout was largely a result of lack of maintenance of culverts, and—

Quinn: No, no, so what we’ve acknowledged is that the culvert was an old and tired culvert, and that was one of the factors. But, look, at the end of the day, that was a very large amount of water. There was debris that came down with that. So it’s a combination of events, and I understand that. I just don’t think I would go as far as to say that we think the only thing that caused it was that. Maintenance would have improved it, and a bigger culvert would have improved it.

Twyford: Jim, your own words are that heavy rain combined with blocked, old, and damaged culverts are what caused these huge slips, and I put it to you that it’s cause for alarm for the public when you put that information alongside the fact that you have dramatically missed the maintenance targets for culverts across the whole network, that that should ring alarm bells.

Quinn: I would agree if they were the same thing. I think all I would say to you is that we have a clear asset management plan, we grade the different parts of the network according to the demand on them, and we look at all of the asset pieces, whether that’s bridges, viaducts, culverts, or traction, and we make sure we put our money into where it needs to be. We start with some assumptions, and we finish with what needs to be done; that’s managing our demand.

Twyford: I wanted to ask you about Clifford Bay. Does KiwiRail have the funds available and have you done any planning on what the financial impact on KiwiRail would be of having to adjust to—
Quinn: There is no—

Spencer: I'll offer to answer that question. Clifford Bay, we're not going to [inaudible] We own the land, all right? It's not for KiwiRail to run ports.

Twyford: No, but presumably there would be significant changes to your operation if the Government made a decision to shift the port to Clifford Bay. There would be substantial investment needed by KiwiRail to adjust your—

Quinn: No, we don't accept that. We're assuming and know that the Government is working through a business case for whether that will be built, which will include all the inputs. It will engage with us when an economic model is assumed. We will, like our competitor I am sure, sit down and assess whether that economic model, which would require us to sign up as a user of that port, is one that would make us go there. So—

Twyford: So you'd expect it to be fiscally neutral?

Quinn: Sorry?

Twyford: You expect it'll be fiscally neutral for KiwiRail?

Quinn: We know what we can afford, Phil. It's a very simple thing. Given what we're speaking about, we clearly don't have the luxury of money, so we will only sign up to something that we can afford, but it does depend on what the whole package is. There will be benefits and, obviously, therefore, you may be prepared to pay some of it and save us money somewhere else. But the model is not clear yet. At the moment, there's an exercise going on which will soon, and is about to, engage us, I think. But we don't know what the assumed investment model is, and, therefore, what will be expected of it.

Twyford: This process of decision making around Clifford Bay and the time frame, is that having any impact on your own planning and contingency around replacing the two ferries and the long-term investments?

Quinn: We're comfortable at the moment because the Kaitaki is a leased ship and we're working through the process of extending that lease as we speak, and we would have done that under any scenario. We're working through evaluating the models for how we use ships, because the bigger issue for us by far is whether we have rail-deck ships or not, because they are a very expensive ship and they're becoming a rarer ship around the world. We will over the next decade or so have to replace all three of them, so it's important for us in that context to decide how we're going to operate, and we're doing some trials with some intermodal options which would enable a more standard ro-ro ship. That would ameliorate quite a significant capital bow wave, so we're working through those issues. Clifford Bay, for us, if you put it crudely, just changes where we park and certainly gives us a shorter journey to get there.

Twyford: So you don't see it as any impact on the ro-ro option?

Quinn: No, because whatever we decide there, we could do anywhere.
Calder You mentioned quite obviously that you need to increase freight volumes to attain sustainability. How are freight volumes tracking and what steps are you taking to encourage use of rail for moving freight?

Quinn Firstly, we’re thrilled with the growth, especially given how the economic climate has been through the same time frame. Our customers have committed really well. Our customers are very pleased with what we’re doing for them, and they are signalling that both in the freight growth, and our freight business has grown 25 percent in the last 2 years, so we’re very pleased about that. The endorsement we get is that people are pleased not only with our capability but with the way we serve and attitudes. I think we’ve done a lot to enhance that. I think the material thing we’ve done, though, is we have gone back to the client base and said we’re only a railroad, and previous iterations of rail and trucks, which meant we were competing with some of our customers. That’s made those strategic, long-term conversations easier to have with them.

We’ve also said we want them to be attached to rail if they have volume to justify that. So we’re seeing massive change. You know, the Mainfreight building down the road here, Toll are on our sites, and pretty much on every site Mainfreight are constructing two or three more. Peter Baker Group has constructed one and is talking to us about more. Any of you who go to the new Darfield Fonterra site will see three brand new roads of rail there. We’re connected into that, and that will become a very large dairy factory. So, look, our customers are committing. My description of our customers would be pleased with the progress, frustrated that pixie dust doesn’t exist to enable us to do more in a faster way.

Calder So an actively collaborative model with people who hitherto have been your competitors?

Quinn Absolutely. And, you know, they welcome that. You know, the key thing with rail is to be able to engage in strategic conversations as they plan, because Fonterra building in Darfield and then coming to us afterwards and saying “Wouldn’t it be good if rail was there?”—we’ve just missed the boat. So they need to trust us to be involved with them early, and some of the things we’re doing will benefit management and New Zealand generations past my time and John’s time here.

O’Connor You’re actively engaging with the likes of Fonterra rather than them coming to you?

Quinn Absolutely.

Spencer For example, when we have our own strategic planning days, we have some of our major customers along talking to us about their plans, and Jim and his team attend some of theirs as well. It’s very important; you’re talking about long-term planning. I mean, you think about if you’re sitting on the board of Fonterra, and you’re looking at a lot of new milk tankers versus putting it on rail. We’re not talking about a 5-minute decision or a $10 decision; we’re talking about big money, big impacts. You need to know rail can deliver.
Quinn: And our customers are defined as the key domestic groups who ship up and down NZ, and the producers shipping to the ports. The ports themselves are customers, because they use rail as part of their growth strategy, and, of course, the importers too, from ports. And we’re getting terrific engagement. I think the key for KiwiRail is to make sure that we continue to sell to the customers who really want us, as opposed to trying to get into spaces where we’re not suited particularly. We’re not the answer to all things, and we need to partner with the road industry, the port industry, and the air industry to deliver the combined supply chain that the client wants.

Calder: Your 25 percent growth rate in the current economic climate over 2 years is an outstanding indication of the success of your strategy.

Curran: As you can imagine, my questions are around the Hillside workshops. In 2010 BERL Economics found that building the rolling stock for the Auckland rail network in New Zealand would have added an additional $250 million to GDP and create up to 1,270 jobs. Now, we can quibble over the exact numbers there, and I don’t want to do that, but it is clear that there is an economic multiplier effect by local procurement. So my question is why does KiwiRail not take full account of the economic multiplier effect when considering local procurement tender bids?

Quinn: Our job is extremely clear. Our job is to take the right commercial calls and to gather other information to allow those agencies who have other accountability—that wider societal one—and I think this is a very good and clear line. So our job is to recommend and to make our calls based on the commercials. We certainly gather and provide any other information, but local government, local businesses, and national government are all able to change those calls. It only costs them money. So it isn’t our job, and it’s not in my mandate, to make our call on the pure societal outcome.

Secondly, I would add to that, I think, while everything you’ve just said about the Auckland trains is interesting, us thinking we’re going to suddenly leap into building a train that has never been built in New Zealand before, that is very high-tech and very complex, you only have to look at the challenges with the Sydney build to realise how high-risk it is. Now, given the huge focus on the turn-round we’ve got to achieve, we simply should not, must not, have that sort of risk profile. We have to use our money really well and deliver what we said we’d do.

Curran: I used that as an example, because BERL did that report, and that was the figures they came up with as the economic multiplier. Can you tell me what was the actual cost differential between the Hillside bid for the 300 rail wagons and the Chinese wagon bid?

Quinn: Around 30 percent. Sorry, it’s a 30 percent thing. We can get, again, into the detail as to whether it’s a bit less or a bit more than that, but it’s a 30 percent-type gap.

Curran: Did the Chinese bid include the cost of freight to New Zealand, assembly, and testing of the rail wagons?

Quinn: The comparison was done with all costs, yes.
2011/12 FINANCIAL REVIEW OF THE NEW ZEALAND RAILWAYS CORPORATION

Curran How much has the repairs to the Chinese rail wagons cost? Now, I understand that that cost is being met by CNR, but you must have an idea of how much that has actually cost?

Quinn Sorry, look, I don’t have that on me, and to be honest with you I don’t actually know the answer—

Curran So you haven’t done any work on looking how much that actually has cost?

Spencer It hasn’t cost us anything.

Quinn No, no, I know what you’re asking.

Curran In terms of a cost.

Quinn I have not done that work, and I haven’t had the need to. The manufacturer, as I would expect, has stood behind this. Some of the work is being done by them, some of it done by us or agents of ours and billed back to them. I could probably find out the latter piece. I just haven’t, because it is only a part of the picture.

Curran So, just so that I am clear with this, if there was, you know, ongoing problems with those rail wagons for the next 5 to 10 years that required constant repairs, KiwiRail would do no assessment of the cost that that created?

Quinn No, no, no. Sorry. Just to be clear, the question asked was do I know the cost. The answer’s no. Do I know the issues, the incidence of them, and whether they’ve gone away? Absolutely, and from my perspective that’s the important information.

Curran Well, wouldn’t it be prudent to include a cost figure in that as well, so that when you make, in future, procurement decisions with potentially that company, you can be deciding on whether it’s false economy to be buying faulty products that have—

Quinn No, I don’t agree with you, because that has no bearing at all. What the manufacturer has done, in a terrific way, is stand behind the product and sort it out. Our job is to make sure we’re aware of issues, that they’re mitigated and put to bed once and for all, which we’ve done. If the consequence of that was that my price suddenly spiked because they’ve absorbed this and I get it back, then that would drive my next call. The manufacturer has not done that. We are still paying for the second batch, which we’ve just ordered a similar amount, and, you know, as I say, the manufacturer has stood behind the product.

Auchinvole I live on the West Coast, Lake Brunner, and we are very familiar with your freight services for gold ore, coal, dairy products, and so on, but also the passenger services, with the sort of signature TranzAlpine. How are your passenger services, from that sort of long-haul perspective, going, and how do you measure the passenger satisfaction?

Quinn How they’re going first. We have three main ones, which is the TranzAlpine over to your world; Christchurch to Picton, which is called the Tranz Coastal; and the recently relaunched Overlander, which is now called the
Northern Explorer, which does the length of the North Island. Over the last year we’ve put new rolling stock on all of those, which Hillside built, and they are a fabulous bit of rolling stock. How do I measure that? We have a lot of interactions with the clients on that, through our staff and through surveying. We build relationships with them through Facebook, and Twitter, and all those things. I have to say, I was literally walking past a hotel in town here on Monday night, and this man ran out and accosted me who had just come down on this thing—he recognised me, obviously—and just went into a long diatribe about the quality of the experience, the service he got. So, look, the feedback I get, personally, is extremely strong.

Auchinvoe That was rather nice.

Quinn Yeah, it was a bit awkward, I was late—but, no, it was cool. Look, the feedback we’re getting is great. The challenge we have, though, is that two of those trains, as you know, are Christchurch-based. The lack of hotel beds is a critical underpinning for us. The Northern Explorer—the Overlander was losing a lot of money. By changing this we’ve changed both the pitch of it, in terms of the price point, and we’ve changed the operating costs. It’s doing what we’re expecting, but it’s got a long way to go to build to the standard of passenger numbers we need.

Spencer Prior to the Christchurch earthquake, the TranzAlpine was going really well, financially. And, in a way, it was covering the other two. The Coastal Pacific, I’d say, was just washing its face if it was lucky. The Northern was losing money. But overall, as a package, fine. What’s happened, of course, since the earthquake, is the volume on the TranzAlpine’s gone right down. It’s still making a profit, but not enough to cover the costs for the others. So we’re having to look at our individual services.

Genter I just wanted to start by congratulating you on the massive growth in freight volumes on the rail network during a time in which there was virtually no increase, as far as I can tell, in freight volumes carried by road, especially over the last 4 or 5 years. But I’m interested in the planned massive reduction in the spend on track renewals that’s coming up, a 45 to 50 percent reduction. Could you give us some more detail on where exactly those are going to impact the network, and what sort of impacts that might have on performance?

Quinn We don’t expect it to have a performance impact, and in fact, you know, as I’ve said, there are some really clear underpinnings of where we won’t go. This is about us managing a market that is more troublesome than we assumed when we first wrote the plan, and making sure that we keep ourselves and our capital profile as sensible as we can do. We have reprioritised around some of the renewals over those 3 years, and what we’ll do as we come out of that phase is we’ll spend less on rolling stock. Our judgment was we’ve got the market really wanting to use rail, let’s put our priority into rolling stock so that we can continue to grow, and, as we’ve got over the hump of that, decrease the spend on rolling stock and increase the spend on the network. So these are perfectly rational calls, which every business has to make, given there are some affinities somewhere. If Santa
comes along with a really, really big cheque book you’d take a different view, but I can’t see it happening.

Genter But a reduction in network renewals could lead to some increases in temporary speed restrictions—

Quinn Could do, but they won’t necessarily be seen by our clients. So where there’s a difference between the decisions that we know we can make within the tolerance we’ve got in the service, and what the customers would see. We’re expecting the clients to see no difference at all, other than they’ll continue to see us improve. You know, we’ve really significantly improved our standards. Our premium trains’ on-time performance has gone from 60 percent to 92 or 93 percent. So we’ve made terrific gains. You know, we seemed to be front page of the Dominion here every day when I began 4 years ago. Tranz Metro now operates really well and is on time better than 98 percent of the time every day. So we’ve made terrific gains. So I would caution you against making a direct judgment. I’m not daft, eventually they affect each other, but we’re doing stuff within the tolerance of what we’re doing, prioritising where we spend. We’re certainly not going to do anything that the market would see as a problem.

Genter Are the requirements of the Turnaround Plan for KiwiRail to become commercially sustainable in quite a short period of time—in 10 years—

Quinn Yeah, well—

Genter Well, I’m just curious, are those requirements forcing KiwiRail to make decisions about the network that are essentially running down the network and the asset in order to generate cash?

Spencer The answer is no, but let me tell you something about KiwiRail that keeps me awake at night. If someone gave me $2 billion tomorrow, I could spend that on KiwiRail, and I would still be prioritising. That’s what we’ve all got to understand. Let’s not get into the blame game. We’re talking about assets that have been underspent on for years and years. When I first became chairman, I spent 8 days travelling from the bottom of the South Island up to the north. I was staggered at what I saw, to be honest with you. OK?

This management team does a fantastic job, given what we’ve got. So to answer your question, of course we would spend it. I mean, if we could change the gauges—if we could start again, it would be fantastic, all right? We can’t. Sure, there are lots of things that we’d be doing if we had the resource, but we haven’t, and it would be silly to give it to us. There’s only so much we can do anyway, and we have to prove ourselves. Why would you want to throw money at something until it proves itself? We’ve got to prove ourselves, and that’s what we’re on now—we’re on the journey.

Quinn Can I also just add to that, just to be clear on my view of this. We wrote the plan. This is our view of what the best way to approach it was. We then presented that plan and sold it, and got the support for it. So this is not “You must do this.”; this is us saying “This is what we want to do. This is what we think we could cope with, with the finite resource.” We always knew that life would be good, or it would have been good, if the speed
bumps came late in the plan rather than in the start of the plan, but that’s life. And we’re resolved to making sure we do everything we can to deliver the commitment we’ve made, and we’re very clear we’ll only be resiling from that if it just is a bridge too far, pardon the pun. We are doing everything we can to deliver a commitment that we made in setting up how we turn KiwiRail round, as opposed to some sort of “This is what you must do.” It’s not that, at all.

Genter Is it fair to say that, if KiwiRail had more support from central government for capital investment, as there are tens of billions of dollars going into the road network, that potentially KiwiRail could further increase the volumes being carried on the rail network, having some positive benefits on the road network—as in, reducing the maintenance costs, reducing some of the safety risks?

Quinn Look, there’s no doubt that if you had more money you could spend more money. There is a limit to what you can do on the track, because you just get in the way of the trains, so you actually have to be able to run. The things that you could do more of—I’m not trying to inflame Clare, but you could order more rolling stock faster, because that’s not in the way of what we do every day. So they’re the sorts of things you could do. But the judgment we made right from the start was that the most important thing we need to achieve was getting the growth. So allowing the trains to run—I mean, the coolest outcome would have been to close it all down for 3 or 4 years, fix everything, and go away, but that’s not going to happen.

Genter No, but you’ve had huge growth—

Spencer This point, too, was pointed out to me, and that is that we are largely a single line railway. Think about repairing your highways, and there’s only one lane. You can’t go around it. So when you think about, even if we had the money, to keep the trains rolling you can only do it during certain hours of the day.

Genter But this 45 to 50 percent reduction in renewals is basically to find some more cash, right? I mean, it’s not because of restriction on—

Quinn No, you’re right, this is us modifying our plan to sit within the—

Genter So that’s what we’re talking about.

Quinn Yeah, I get that. But just be clear: we are still spending vastly more than has been spent on rail for decades. This is just a tuning to make sure that we do everything we can to land the commitment we’ve made. That’s what management should do and boards should do. That’s what our plan has been. We’ve also got to be mature enough to say, actually, we’ve run out of options, if we get to that point. I just don’t think we’re there.

Genter I just have one question about the passenger service the Northern Explorer. In the half-yearly update will there be any figures about what the impact on demand has been of the change in structure of that? Obviously the cost of now taking a rail service from Auckland to Wellington has pretty much doubled for users, and I assume that’s going to have some impact on demand.
Quinn  Yes, but we had a very clear plan. We had a view, from a budgetary perspective, of what the revenue we expected was, what the cost we expected to be, what passenger numbers we expected, and what passenger yield we expected. The key change in terms of the price point is that this is a tourist-targeted journey now, because we weren’t getting much of the A to B anyway, and it simply wouldn’t have survived if we’d left it with that sort of mentality. I can tell you, before the update, the passenger numbers are about where we expected them to be. The yield is just where we expected it to be—in fact, a little north of that. It’s performing how we expected, and given we expected it was a hill to climb, it’s not there yet, but it’s doing what we thought. So we’re pretty pleased with the response. Tourism journeys such as the three we run are mainly sold through wholesale, and so there is a lag because it takes a while—unlike, say, commuter rail—for the wholesalers to get it into their packages. So we’re not expecting sort of some magic change. It’ll take another couple of years to see the full outcome.

Genter  It’s safe to say that, even though it’s where it’s where you expected, it’s an overall reduction in the number of people taking—

Quinn  Oh, absolutely. For a start, it’s half the trains.

Genter  Maybe 50 percent?

Quinn  Well, no, there’s more than that, because we were running Wellington-Auckland and Auckland-Wellington every day both ways. Now we’re doing half of that. So, no, this is a very differently pitched trip.

King  My region involves Spring Creek and Picton, and I must say that you’re running a very good operation there. My question’s not about that; it’s more about what’s happening in the electrification in Auckland. I mean, it’s something I’m not overly familiar with, but when we talk about electrification, it seems very sensible and pragmatic. Can you just talk us through how that—

Quinn  Sure. So there was a conscious—this all started before I came, but there were three major projects agreed for Auckland, which come to about $1.6 billion worth of spend. Project DART, which did a lot to redesign the network and modernise that—so, the actual ground asset—and, for those of you who go up there, if you go to New Lynn, there’s the wonderful New Lynn trench; some really big changes. That project is getting close to its end now, and has been delivered on budget, on time, and there is a little bit to do in South Auckland, but, aside from that, Project DART is done.

The second one is the Auckland electrification, which is what you’re asking about, and the third one, related to that, of course, is the electric trains to run under them. Auckland and the Government decided that that was a good idea. It would be required for any city rail loop, at whatever stage that tunnel is built. But electric trains are the modern way to run metro-type services. So the Auckland electrification project is about just over half a billion. It’s well under way. If you drive around Auckland now you’ll see the poles along the track everywhere, and a lot of them have got the wires now
as well. I think the first train—which, you will remember last year we handed that project over to Auckland Transport to run. We helped them with that. That’s well under way, and I think the first train’s expected here later this year. So, yeah, look, that’s a phenomenal sea change in terms of where we go. That electrifies out as far as Papakura, and so that’s where it stops.

King You talked about the spend. It’s, what—half a billion. Did you mention about when you expect that to be completed?

Quinn Oh, sorry. The electrification project is due to be complete late this year, so that the trains can run. Sorry, I assumed that; I should have explained it. As you know, Wellington got new trains earlier this year. That was a new train running on a network that had been ready for electric trains for years. This is a bit different, of course, because it’s a new network as well as a new train set. So there’ll be a lot for Auckland and us to work through, just to make sure that we’ve got all those assumptions right.

King Inside your plan, is there any possibility for further electrification, going forward?

Quinn No, we haven’t budgeted for that at all. I should just hasten to add the Turnaround Plan doesn’t include the metro work we do. As you know, the Government funds that, either through local government or directly, in a separate way. We have to account for it in a separate way. The Turnaround’s entirely the focus on the national network. We have an allocation model for freight’s responsibility into the metro, where they overlap.

King So are you telling us, then, that basically the metro stuff is stacking up financially and is a far easier business model to manage, as opposed to the network?

Quinn I think to say that metro rail stacks up financially is an interesting phrase. Metro rail is something that is done for cities’ growth as opposed to a commercial model. Would we invest in electrification elsewhere in the network? Look, that’s just simply a bridge too far for us at this point. Our job at the moment is to get the best out of what we’ve got, and run that as hard as we can, and get ourselves standing on our own feet. I think asking Governments, which are spectacularly big-funding for big-change projects like that, until we’ve proven our worth would be a pretty brave call.

Curran Just going back to my line of questioning around the quality issues with the Chinese wagons, how much has it cost to date in staff time, and making those repairs, and having carriages off rails to be repaired?

Quinn I don’t have the answer to that, but we’ve charged—

Curran Have you collected that information?

Quinn I’m sure I have it somewhere. I don’t have it here, but we’ve been paid for that.

Curran So you are collecting that information?
Quinn: We must be, to charge for it.
Curran: Can that information be supplied to the committee?
Quinn: I’ll find out what we have. I don’t have that in front of me.
Curran: Thanks. Can you tell me how long do the warranties last on the Chinese rail wagons?
Quinn: I’m sorry, I don’t have that in my head. I’m not going to make it up, so I’m happy to come back to you.
Curran: OK. Can you provide that information to the committee?
Quinn: That will be different, by some of the component parts, but, yeah.
Curran: Thanks. When is the next set of carriages due to be ordered?
Quinn: Wagons? The next wagons are under order now and under construction in a month or so. We expect them here for the summer peak next year. Similarly, that’s true of the next 20 locomotives as well.
Curran: And the last question: just to confirm on your response around the economic multiplier effect and that it was not Government policy, you’re saying that it’s Government policy for KiwiRail to downplay or ignore that economic multiplier effect when you’re making—
Quinn: Sorry, those words didn’t come out of my mouth at all.
Curran: No, no, I’m not—I’m saying I’m trying to interpret what—
Quinn: Oh, well, don’t, because all I said was—I have enough trouble reading my mind without you trying to read it as well. All I said to you was that our mandate is very clear. Our job is to make my recommendations to my board, and for my board to approve things, subject to where Government is involved, based on the commercial realities. That’s our job. I have no instruction to downplay anything. We’ve always said we’ll gather all the information. You and I have had several chats about that. It is not that we are ignorant to it. We want to know—we have to think about impacts. But our job, from our decision-making perspective, is commercial.
Curran: To your knowledge, was there an economic analysis done by anyone on the economic multiplier effect?
Bennett: No, no, I think we’ve had enough there.
Curran: You wouldn’t know?
Quinn: I don’t know. I don’t know what work was done.
O’Connor: Firstly, a statement around the whole Auckland thing, it’s coming along really well. I think you guys—you won the New Lynn design competition for the—
Quinn: That was acknowledged, yes, and the technology that was used for that was then used for the Victoria Park bypass
O’Connor: Yes, I just thought I’d acknowledge that, seeing as my colleague from down the line was talking about the Auckland line.
King I apologise about that. However, we are interested in what happens in Auckland now and again.

O'Connor I suppose I just want to—it is touching on the Napier-Gisborne line, where I think many of us are conscious of BERL’s predictable thoughts on any issues that come up. But your confidence in the robustness of what you’ve done—I suppose I just want to draw out from you the process you’ve undertaken and why you have that confidence in the robustness.

Quinn Well, look, I guess, firstly, I have a fabulous team of 4,000 folk who have worked in the railway for a very long time. They understand these things. We estimate these jobs every day. We work in the communities every day. We understand where the revenues are, we understand what the hurdles to us gathering that revenue is, and we’ve been talking in the Gisborne community for the last 2½ or 3 years, specifically thinking about this issue. So I’m very confident of our views. I’ve also said to the communities up there, you know, we don’t resile from it, and we’ve been very clear on what we understand. If there is evidence that a different view is real, then we will engage. That’s why we mothball. I’ve just actually come out of a meeting where the Minister met with the local mayors and the chairman of the regional council, where they’ve agreed to go and do some work on an economic study up there, which inevitably will drag in what is the transport need, if you take a very long view. But, again, that’s not really our role. I’m very confident that our estimates of costs are right. Look, you know, we go back to the question I was just asked around the Auckland electrification. We estimated that at $1.6 billion, and have delivered the projects on time and on budget, so I think we’re quite good at estimating. We know the topography, we know the land, we know the asset state, and, you know, people say there are some quite wide variations in the estimates. That’s true, but over a very long bit of track as complex as that, those averages tend to work into a settled average.

O'Connor Again, yourself and your senior managers have been actively engaging with the key figures in the community there as well.

Quinn I’ve been up there personally many times. I was up there for the public meeting in Gisborne on 21 January. Look, we’ve been very open with folk. We’ve shared the information. Our view of these things is that these calls aren’t easy calls to make. We have to make them, and we have to front up and explain ourselves. We’ve done that, and it will take a new bit of information to change that. People have said “Well, we’ll go and do it ourselves.” I’ve said “Look, fill your boots, but please understand it. I’d hate for you to be surprised because you got it wrong and it’s going to cost you more than you thought. It’s a lot of money.”

King Just going back to the Marlborough situation, and, there you’ve got principally forestry, wine, dairy, and meat, and earlier you talked about the growth you have in moving such products around the country. Can you tell us, overall, what percentage—you know, it’s a startling growth, 24 percent growth, is that right?
Quinn Yes, in 2 years.

King What sort of base are you starting from overall, in comparison between road transport and rail transport?

Quinn Look, the problem you have with that scenario, unfortunately—I’m not trying to duck—is that we’re purely a line-haul operator, and when people talk about transport, you’re talking end-to-end transport. So getting the market shares—I’ve been in transport 30 years now, and you can spend your whole life analysing that, and still come up with different answers. The only thing I know for sure is that, as I think Julie Anne said, neither the economy nor the transport industry has grown that fast, so we must be gaining share. I’m not particularly hung up on share. My view is: are we filling our trains up? Are we making those trains as long as we can? Are we creating the best revenue that we possibly can, to make sure that we can afford the mode we have to run those trains on? The other problem with share is you starting getting competitor angry. Our competitors are the very people who are our customers, so we need to be in a collaborative but commercially savvy mode, not some silly, “rail for rail’s sake”, antsy sort of mode. We’ll just annoy.

Lees-Galloway I’ve just got a couple of questions about the Capital Connection, as you probably guessed, and, before I ask you those, I just want to say that it’s my opinion that the Capital Connection sits uncomfortably in Tranz Scenic. It would be more appropriately in Tranz Metro and, I think, operating under a model that’s as close to possible to the current Tranz Metro services. And I think, on that, we probably share some views. But I do just want to test some of the assumptions in the quantum of money involved. KiwiRail has said that you need about $550,000 a year to continue operating the Capital Connection. So my first question is: if the Capital Connection were cut tomorrow, would that mean that KiwiRail was $550,000-a-year better off?

Quinn No, we wouldn’t be, because some of those costs are costs that you can’t immediately move out, so I get that. However, if you want me to take that view perpetually, you’ll never make any decisions ever. You’ve actually got to still look at things really. So an example of that: that train pays a track access cost, but I’m as likely to ignore that as I would expect the Government would be to say to Mainfreight “Don’t pay *road-user charges, mate. It’s fine.” So, you know, the fact that the world didn’t change because of that doesn’t mean, truly—you need to understand the full commercial aspects. The other thing that people need to understand is that there is investment required, going forward, in the rolling stock, always, because you’ve got to keep it right, for safety and comfort, of course.

The key thing that’s changed this is the extension to Waikanae, as I know you know—no, it is, because the largest population of customers getting on that train were at Waikanae and Paraparaumu. Electrification now runs all the way through, so it’s very heavily dependent on the numbers we get out of Palmerston through to Ōtaki. If we don’t achieve enough, which I know is something you’re passionate about, it simply cannot stand up. Then the question just is: what’s the best model? I think the debates have been well
had. I, personally—for the same money, you could easily run three bus services a day to Waikanae, which I would have thought for the commuters was a much-better option because they have options of timing. At the moment they’ve got one shot—they miss it, they’re dead—both ways, which I think’s an unfortunate thing. So this isn’t an anti-train thing, or anything; I’m just trying to look at what is the best answer for the model. And I do think we’re landing in a circular argument, but we’ve got to deal with that.

Lees-Galloway We could debate all day—

Quinn Yes, we could.

Lees-Galloway —whether buses or trains are better, and the pros and cons of either.

Quinn No, I absolutely think trains are better. That’s different.

Lees-Galloway I’m interested in what would be the impact—you mentioned track access. That’s certainly one that is really obvious. What will be the impact, if the Capital Connection is cut—if NZTA doesn’t come to the party and the train is cut, and you lose some revenue. What is the impact? Would there be some impact on track maintenance, or how does that play out?

Quinn No, it won’t materially change all of that. But just be clear: if you take away the things that don’t go away, we’re still in the red. So there are two things you need to understand. Firstly, take away all those little spurious bits, we’re still in the red. And the second thing is, which I know you know, the passenger numbers are continuing to decline. That’s a fact. So I’m concerned that we’re going to leave this and deal with it when everybody’s just more deeply annoyed, which would be a shame.

Lees-Galloway I appreciate that around the world commuter trains do not run without some support from local and central government—

Quinn That’s right. I understand that.

Lees-Galloway —so to expect the Capital Connection to do that is pretty ludicrous, really.

Quinn And it is an odd train in our network, because it’s the only one that does that sort of distance daily like that in a commuter mode, so it is an unusual train.

Lees-Galloway I know the decision has sort of been bumped up from NZTA to the ministry because of the regional council’s proposal. Have you had any indication from the ministry or the Minister when a decision might be forthcoming?

Quinn It’s under discussion. No, I think we all want to get the decision made quickly, and it’s under—

Lees-Galloway What’s the cut-off point for you?

Quinn Look, at the end of the day, we’ve tried very hard in everything we’ve done to land things having given everybody a fair chance to have their view. So we’ve tried not to be precipitous unreasonably, and I’ll continue to take that view. So I’m not trying to duck; I’m really trying to be as sensible as we can.
I think it’s important in these debates that, you know, as we did with Hillside, the Gisborne line, and all of those things, that we give the opportunity for the debate to be had, and then, when we make a call, we make a call, whichever way. So I’m not trying to duck Iain; I just don’t have a direct answer.

Bennett Thank you very much. We appreciate your time. Keep up the good work with KiwiRail and we look forward to seeing you back here soon.

**conclusion of evidence**
The Government Administration Committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Symphony Orchestra, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Hon Ruth Dyson
Chairperson
2011/12 financial review of the New Zealand Teachers Council

Report of the Education and Science Committee

Contents
Recommendation 2
Introduction 2
Teacher review process 2
Income fluctuation 3
Unregistered teachers 3
Induction, mentoring, and appraisal 3
Pasifika outreach 4
Appendix 5
New Zealand Teachers Council

**Recommendation**

The Education and Science committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Teachers Council and recommends that the House take note of its report.

**Introduction**

The New Zealand Teachers Council is established under section 139AC of the Education Act 1989 as an autonomous Crown entity. Its purpose is to provide professional leadership in teaching, enhance the professional status of teachers in schools and early childhood education, and to contribute to a safe, high-quality teaching and learning environment. Revenue for the year ended 30 June 2012 was $7.385 million, with a surplus of $1.092 million. During the year under review, the council was subject to a ministerial review, the details of which had not been released when we heard evidence from it.

**Teacher review process**

One of the core functions of the council is to investigate issues of teachers’ competence and conduct. Conduct issues are considered by a complaints assessment committee, while competency issues are initially handled by the school in question. Schools initially work with teachers to improve their performance, but about 60 cases each year are referred to the council for further attention. We heard that the primary reason for teachers being deregistered is issues of conduct. The council said it keeps a record of the reason a teacher is deregistered, but this record is not publicly released. We were interested to learn that schools are required to report teachers to the council if they resign within 12 months of a competency or conduct issue highlighted by the school. This process is intended to prevent a teacher from resigning from one school before it initiates a review of his or her competency, and moving to another school which would not be aware of the competency issues. We were reassured to learn of this safeguard.

**Blanket suppression orders**

We understand that the council’s rulings on disciplinary proceedings against teachers are subject to a blanket suppression order. The council explained that this was introduced to protect the identity of witnesses in cases of teacher misconduct, most of whom are children. At the moment, the disciplinary tribunal publishes redacted versions of cases on the council’s website, but media are not allowed to cover them. We agreed that suppression is usually justifiable while a case was being heard, but suggested that once the council had made a ruling, the continued necessity of suppression should be decided case by case.

The council said it is awaiting the result of the ministerial review, so that any legislative or regulatory changes would be made in one action, rather than piece by piece. It assured us that changes to the suppression requirement are being considered in the review. We look forward to the results of the review, and to considering any suggested change to the pertinent legislation.
Income fluctuation

We are aware that most of the council’s income comes from application fees for registration, or re-registration. Newly qualified teachers register with the council at various times of the year. The practising license lasts for three years from the date of registration, so the income of the council fluctuates throughout the year; the proportion of teacher licences up for renewal also varies considerably from year to year. We heard that the council forecasts renewals of licences in a given year and the likely attrition rate to deal with fluctuations in income.

In the year under review, the council exceeded its budgeted income by 10 percent; this was due to an increase in applications for licences, and the payment of late fees. We heard that its income will inevitably fluctuate as the council has no control over teachers’ decisions on renewing practice licences. In addition, the council is careful to spread its spending from licensing fees across the three-year registration cycle.

We asked whether fluctuations in income would be exacerbated by the introduction of unregistered teachers at partnership schools. The council told us that this was just an additional variable and will not change the way they deal with income fluctuation. It said it has robust processes to ensure income fluctuation does not adversely affect its back-office functions.

Unregistered teachers

We are aware that the proposed new partnership schools kura hourua, legislation for which is currently before the House, would be permitted to employ unregistered teachers, and asked whether the council can control teachers employed by the new schools. The council assured us that it will work with any registered teachers employed at partnership schools who want to keep their teacher’s licences; however, it will have no jurisdiction over any unregistered teachers the schools choose to employ. The council maintains a register of unregistered teachers with limited authority to teach, typically used to authorise teaching by experts in a particular field, but told us that on its understanding of the Education Amendment Bill, these authorities will not apply to partnership schools.

Induction, mentoring, and appraisal

We were interested in the induction and mentoring of new teachers. We heard that the responsibility for this area lies with the Ministry of Education, which provides a “generous subsidy” for mentoring teachers in their first two years. The council has commissioned some research on engagement in the mentoring programme, which found a significant uptake. We understand that the Teachers Council has contracted the New Zealand Council for Educational Research to undertake a three-year longitudinal study of the effectiveness of guidelines for induction and mentoring. We will be interested to see the findings of this research.

We heard that the council is working with the New Zealand Council for Educational Research to devise a more detailed survey of teacher training, that will provide qualitative and quantitative evidence on teacher training. At the same time, there is work being undertaken by the council on determining how well teachers meet the registered teachers criteria. We heard that the council would resist a move to appraise fully registered teachers exclusively on the basis of the exam results of their students, favouring a holistic approach, in which learners’ achievement is an important, but not the only, criterion.
Pasifika outreach

We note that the Minister recently released the Pasifika Education Plan 2013–17, which seeks to raise Pasifika participation, engagement, and achievement in education. One of the targets in the plan is a 20 percent increase in the number of Pasifika registered teachers. The council told us it is working very closely with education providers to encourage the enrolment and recruitment of Pasifika students into their teacher training programmes. This is in addition to the work the council is doing with teachers from the Pacific Islands, giving them professional learning support to help them to meet registered teacher criteria.

It told us, for example, of a pilot programme with teachers from Tereora College in Rarotonga. The school is delivering the New Zealand Curriculum, and assessing senior students using NCEA. The council is working with the Cook Islands Ministry of Education and the Principal of Tereora College to allow the appraisal of these provisionally registered teachers against the New Zealand Registered Teacher Criteria, with a view to their eventually gaining full registration as New Zealand teachers. We recognise the importance of Pasifika teachers in improving Pasifika student performance, and we look forward to seeing the results of this work.
Appendix

Approach to this financial review
We met on 18 April and 8 May 2013 to consider the financial review of the New Zealand Teachers Council. We heard evidence from the New Zealand Teachers Council and received advice from the Office of the Auditor-General.

Committee members
Dr Cam Calder (Chairperson)
Carol Beaumont
Catherine Delahunty
Hon Jo Goodhew
Chris Hipkins
Colin King
Tim Macindoe
Tracey Martin
Simon O’Connor
Dr Megan Woods

Evidence and advice received
Office of the Auditor-General, Briefing on the New Zealand Teachers Council, dated 16 April 2013.
Organisation briefing paper, prepared by committee staff, dated 16 April 2013.
New Zealand Teachers Council, response to written questions 1 to 115.
New Zealand Teachers Council, response to written questions 116 to 121.
2011/12 financial review of the New Zealand Tourism Board

Report of the Commerce Committee

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Tourism Board and has no matters to bring to the attention of the House.

We note that the committee’s 2010/11 financial review report on the New Zealand Tourism Board reported the board’s total budget as the amount of its back-office costs. This resulted from a misinterpretation of the transcript of the hearing of evidence. The committee recommends that the House take note of its report.

Jonathan Young
Chairperson
2011/ 12 financial review of New Zealand Trade and Enterprise

Report of the Commerce Committee

Contents

Recommendation 2
Introduction 2
Trade missions 2
Export barriers 2
Small business 3
Government procurement 3
Relationship with Callaghan Innovation 3
Appendix A 4
Appendix B 5
New Zealand Trade and Enterprise

Recommendation

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of New Zealand Trade and Enterprise and recommends that the House take note of its report.

Introduction

New Zealand Trade and Enterprise is a Crown entity whose purpose is to stimulate New Zealand’s economic growth by boosting export earnings, strengthening regional economies, and delivering economic development assistance to industries and individual businesses. In the 2011/12 financial year, NZTE’s total income was $179.558 million and its total expenses were $176.753 million, resulting in a total income of $2.805 million.

The chief executive is Peter Chrisp, and the board chairman during this financial year was John Mayson, who was replaced by Andrew Ferrier in November 2012. The responsible Ministers are the Minister of Economic Development and the Minister of Trade.

Trade missions

NZTE aims to contribute to realising the Government’s goal of increasing the ratio of exports to gross domestic product from 30 percent to 40 percent by 2025. Towards that end, NZTE has completed 28 trade missions, including 13 ministerially-led missions, since July 2012, and we asked how it measures their effectiveness. We heard that it is hard to measure the impact of each particular trade mission; generally the missions help to build a network; initially this involves introductions between businesses, then the gathering of leads, and then deals are completed. NZTE catalogues any commercial deal completed, contacts facilitated, and leads gathered throughout a mission; for example, on the recent Latin American mission, NZTE organised 134 meetings and gained 49 leads.

We were interested in the process NZTE follows once it records a lead. NZTE said it liaises with the New Zealand company to ascertain factors such as whether there is already a distributor, which contacts need to be made, or what business model is needed to create the best chance for a deal. We intend to monitor NZTE’s contribution towards the goal of increasing the exports-to-gross-domestic-product ratio.

We asked about the medium- to long-term benefits of completed deals, and heard that for the year to date, international export deals worth $250 million have been completed; in the last financial year the total was slightly more than $300 million. Some large exporters contribute conspicuously to this result: we heard about the Focus 500, a group of 500 internationalising clients each with export revenue between $3 million and $300 million, for which NZTE provides services specifically. We heard that their estimated growth rate in the last 12 months was 7.4 percent, compared with the overall rate of growth in export goods to the end of 2012 of minus 3.5 percent.

Export barriers

We asked NZTE about the main constraints that exporters face, and heard that, depending on the particular business, they include capital, market access, and governance constraints.
NZTE has implemented a new programme to help companies to access capital. Also, it pointed out that the availability of engineering and software skills appears to constrain some companies, and it alerts Ministers when such constraints emerge.

We heard that it is difficult to gauge the effect of the dollar on companies’ presence in the export market, which fluctuates constantly. However, NZTE is aware that 20 percent of its clients have had a worse year than the previous one. It noted that generally the companies that succeed are exploring a niche in the market and are more competitive. It told us that competitiveness in the market is more important than the value of the dollar for the success of New Zealand companies.

**Small business**

We asked if NZTE’s strategy of providing intensive services for the Focus 500 risks growing larger companies at the expense of smaller ones. NZTE said that it provides $20 million for services smaller businesses can access, such as making connections with regional business partners and business mentors, and training vouchers, for example. NZTE told us that smaller companies need to achieve a certain scale before it invests more resources in them. NZTE noted that small companies are growing; for instance, Comvita New Zealand has grown from a $20-million business to a $100-million business.

**Government procurement**

We asked whether growth in the information technology sector is hampered by companies finding it difficult to tender successfully for local procurement opportunities. NZTE said it often hears that companies want better access to government procurement contracts, which enhance the credibility of New Zealand companies overseas. We asked whether NZTE had informed Ministers of this issue, and heard that many people have expressed this view and there has been active discussion and analysis occurring.

**Relationship with Callaghan Innovation**

Callaghan Innovation is a new organisation with the goal of accelerating commercialisation of innovation in New Zealand firms. To an extent, this is similar to a role of NZTE, and there is potential for overlap. The two organisations are developing their working relationship, and we asked NZTE for an update on this process. Their offices have been co-located in Auckland, Wellington, and Christchurch, and the two boards are working together, with a member in common. Eventually, they plan to refer companies to each other’s services and to share computer systems, while ensuring the confidentiality of information. NZTE believes that the relationships between the two boards and leadership teams will be important. We look forward to seeing this relationship develop.
Appendix A

Approach to this financial review
We met on 28 March and 17 April 2013 to consider the financial review of New Zealand Trade and Enterprise. We heard evidence from New Zealand Trade and Enterprise and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received
New Zealand Trade and Enterprise, Responses to written questions, received 31 January and 12 April 2013.

Office of the Auditor-General, Briefing on New Zealand Trade and Enterprise, dated 28 March 2013.
Appendix B

Corrected transcript of hearing of evidence 28 March 2013

Members
Jonathan Young (Chairperson)
Dr David Clark
Clare Curran
Julie Anne Genter
Peseta Sam Lotu-Iiga
Todd McClay
Mark Mitchell
Damien O’Connor
Dr Jian Yang

Witnesses
Andrew Ferrier, Chair
Peter Chrisp, Chief Executive

Young Welcome. It’s good to have you here. If you’d like to introduce yourself and Mr Chrisp, that would be great.

Ferrier OK. Thank you. I’m Andrew Ferrier, the chairman of New Zealand Trade and Enterprise as of the last 4 or 5 months. On my left is Peter Chrisp, the chief executive. I just want to say I’m delighted to be here in my new capacity as chair of New Zealand Trade and Enterprise. I was actually quite pleased to be asked by Ministers Groser and Joyce to join NZTE because I felt I had quite a unique perspective.

Having run Fonterra for 8 years I had this unique pleasure of representing a truly world-class New Zealand company in the world, a company that was the gold standard in our industry, and a sign, really, of the incredible foresight of the dairy farmers of New Zealand and what can happen when New Zealand pulls all together, when New Zealand Inc. pulls together. I enjoyed that obviously, and we enjoyed that market power we had, the access to the world’s biggest food companies.

So when I was asked to come in as chair of New Zealand Trade and Enterprise I saw this as this unique opportunity. NZTE is one of the key players in an infrastructure where we can truly pull New Zealand Inc. together to further the economic development of our country. I felt I had that unique experience in Fonterra, and I was pleased to bring some of it to bear, to help in this case. So I know this is about New Zealand Trade and Enterprise. It is one piece of a broad effort across the board, from universities—and I’m also on the council of the University of Auckland—Callaghan Innovation, New Zealand Trade and Enterprise, the ministries
MBIE, MFAT, Primary Industries, and so on—and we are very keen to see us all pull together to be efficient.

NZTE has had quite a significant makeover under Pete’s leadership in the last couple of years. Coming in, I’m very pleased with what I see. I know that there’s more to be done inside NZTE, but I think that they’re on a great trajectory and really focused on key customers, and really focused on helping its customers, the companies of New Zealand, grow their export business. I think it’s a good start. I love the passion I see inside the organisation, that Pete has brought on. Right across the organisation you have a lot of passionate people working to be as effective as they possibly can to further the benefits of New Zealand companies.

That’s just a little bit of a preamble, but really the man that makes it happen is Pete Chrisp. So I’ll turn it over to Pete to have a bit of a chat with you about how we’re going and what the strategy is.

Chrisp

E ngā mana, ngā iwi e ngā waka, tēnā koutou, tēnā koutou, tēnā koutou katoa. When we last appeared before the committee we were 9 months into a programme of reform that we had laid out for us, a multi-year programme. Now we are 1 year on again, so I would like to, if I could, just indulge us, just recap the fundamentals of that reform, what we’re doing, and then just update you on where we’ve got to on that programme of change.

You recall that we had a very challenging PIF review in 2011. Then we embarked on a strategy to bring some focus into the organisation, to solve really the biggest problem we have had, and that was that we were spread a mile wide and an inch deep, trying to do everything for everybody. We also needed to comprehensively lift our performance as a group of people. Also over this period the Business Growth Agenda has emerged, and that’s been a very useful consolidation and organisation of the effort. We’ve treated this as a bit like our light on a hill. We’ve mapped our direction—it guides our effort—and really aligned our effort towards that. Over the last year, despite some very strong global headwinds we’ve continued to make solid progress. There are still many areas where we’re lifting our game, but our overall scorecard tells us that we’re on track, and I want to just take the opportunity now to recount that.

Firstly, let’s just go back and talk about the basic strategy. The basic premise is that New Zealand has many global opportunities. There are a number of global megatrends that are actually on our side, such as the rise in global demand for food, the emergence of Asia, the advent of the internet, all of which serve to bring the world closer to New Zealand. But we have a very fundamental dilemma, and it’s scale even more so than distance. With only around 1,000 export companies bigger than $5 million export revenue and even fewer—260—with more than $25 million export revenue, we struggle to have enough companies with sufficient depth to take enough risks, and to convert these global opportunities into sustainable economic growth.

From what I see, after 2 years, that continues to be, for me, the biggest dilemma that we come across all day, every day. So against this backdrop we
made a decision in late 2011. We reset our strategy to focus more explicitly on growing companies internationally for the benefit of New Zealand. Companies became our customers, and the entire business model needed to be reorganised around this principle. We called it being customer-centric. So to do this has required a wide-ranging, comprehensive overhaul of every facet of the organisation, as well as how we interact with other organisations, with no stone left unturned.

So let’s go through it. The basic business model is to treat each of these individual internationalising companies as unique. First, discover what their strategy is and what’s constraining their growth. Following this discovery we ensure they get the right service at the right time at the right place, either in New Zealand or internationally, either from NZTE or from other public or private sector providers. NZTE is available to all internationalising companies, although the real customer base is around about 2,000 customers at any one time, and we intensively focus one-on-one services for an active portfolio of nearly 500 customers. The Focus 500, as we call them, are generally medium sized companies, around $3 million to $300 million in export revenue. You have in the main some international experience and a strong ambition to grow. Our aspiration is to double the export growth rate of these customers.

When you make this commitment it requires us to significantly lift how and where we add value, which is the driving force of the whole change programme. While pursuing this strategy of having a Focus 500 in a broader group of 2,000 companies, we also ensure that the smaller companies continue to access basic services, and we invest about $20 million in SME support, including training vouchers, regional business partners, incubators, business mentors, business 0800 hotline, and in addition there’s nearly 600,000 visitors access our online information and get export resources from us.

So that’s individual companies. We not only work with individual companies, we also work with groups of companies. The aim is to partner with groups of companies that are willing to work together, coalitions of the willing, who have a competitive advantage and are prepared to co-invest in development, and we call these the high-impact programmes. We are currently working with around 440 companies across eight high-impact programmes: wine, global agribusiness, aviation, health, marine, high-value foods; and then one particular market, China; and one particular event, the America’s Cup. So these programmes take a multi-year outlook and a multi-company approach, and they are genuine NZ Inc. efforts, not just NZTE.

So to both the individual companies and the coalitions of the willing we then provide services. There are currently 31 services available. Some are delivered in New Zealand, for example, Better By Design, and others such as Beachheads are delivered internationally. There is now an active service suite with some services being exited and new services being developed. In the last few months, for example, two new services have come on stream.
The first of these is called Better by Capital. In response to the Business Growth Agenda’s aim to build capital markets we have developed a new service to increase the capability of New Zealand companies to raise and deploy capital for international growth. We plan to deliver this to about 120 companies over the next year. A second new service is called Go to Market, and this is about solving the dilemma of how to choose the right business model in a market: should you have an agent, a distributor, a joint venture partner, a franchise, a fully owned supply chain, which is often complex and a challenging exercise. This is an area where there’s a lot of scar tissue and a lot of value can be gained or destroyed. So in response to customer demand we’ve developed a practical, go to market tool kit to help customers make better business model decisions in market, and that’s now being rolled out.

You can’t deliver any of this service to individual companies or groups of companies, or any of these 31 services, without a high-quality workforce glued together by a culture which is motivating and engaging. So over the past 18 months we’ve refined how we want to work. We’ve got these characters, we call them One Team, which joins together the whole global operation and our NZ Inc. partners into one collective effort, working together in a way that is adventurous, agile, and astute. Each one of those characters came from some of the deficiencies that the first performance improvement review pointed out that we were deficient in. So these are characters that I hold myself accountable to, and our team, and the whole organisation. These characters have reformed our recruitment and selection processes, our learning and development framework, and performance management and fundamentally changed how we perform.

We have also reviewed globally where we should be, and the basic principle was that we follow our customers. To this end we established a new Middle East - India region to focus on these important emerging markets. We have reconfigured our Asia footprint to allow greater focus on South-east Asia, for example, with a new trade commissioner in Indonesia. We have split North and South America into two regions to allow us to add a bit more weight to Silicon Valley, which is very strong emerging area for us, and also recognising the increasing growth opportunities in South America. In New Zealand we’ve restructured the South Island team, including a new customer director in Christchurch, and appointed a new regional manager in New Plymouth.

We have had a 13 percent headcount reduction over the last 3 years, including an 8 percent headcount reduction in the last 2 years. We think now, after that quite significant reduction, we’ve stabilised at the current level, and we believe there or thereabouts is manageable in the current environment.

Not only do you need good people but they need to be connected with each other with great technology, and we need to have access in real time to what we know and what we and our customers have learnt. To achieve this we’ve rebuilt the customer engagement system to provide all customer-facing employees with iPads to enable greater mobile access, and on that iPad they
get a new Google search engine, which is an internal search engine, which gives fast access to a knowledge data bank. A new intranet is being designed, and the two externally facing websites will be consolidated into a single, more intuitive interface, targeted for July for completion.

The final leg of the strategy is how we work with our NZ Inc. partners, in particular the Ministry of Business, Innovation and Employment, who in our view has got a role to design and oversee the entire economic development ecosystem. You’ve got the Ministry of Foreign Affairs and Trade, Callaghan Innovation, the Ministry for Primary Industries, tourism, Education New Zealand, Te Puni Kōkiri, Export Credit Office, the Venture investment fund to name just a few. The ethos here is that we work for a cause not an institution. When you’ve got that ethos it allows you to collaborate a lot more effectively between groups of people. But not only do you need an ethos, you need detailed action plans, which we call collaborative work plans. We currently have five collaborative work plans in place, and in this next section I’ll just touch on some of the more significant areas of multi-agency activity.

Clark  Mr Chair, sorry to interrupt but we will need some time for questions.
Young  Yes. Maybe a couple more minutes.
Chrisp  I understood I could speak for 20 minutes, and then we have 40 minutes of questions. Is that enough?
Young  We normally go a little bit shorter than that.
Chrisp  Sorry about that. Do you want me to stop, or carry on, or—
Young  It is helpful, but *(inaudible)*
Chrisp  I’ve got some stuff here I can abbreviate, so I’ll do that straightaway.
Young  Thanks.
Chrisp  So, the areas we are working across NZ Inc. are Callaghan Innovation. The formation of Callaghan Innovation signals a huge step forward to enhance the innovation engine. What we have done quite practically is physically co-locate with Callaghan Innovation, particularly here in Wellington, and in Auckland, with ATEED, Callaghan, MFAT, they are all in the same building. With Callaghan Innovation we’ll develop a coordinated approach to customers and an integrated services suite.

I will now do some abbreviations. So we have had a big NZ effort on trade missions—28 trade missions, including 13 ministerial-led missions since July. We’ve done a lot of work on developing the New Zealand story, which has been a public and private sector endeavour. We’ve leveraged the America’s Cup; more than 200 companies involved in that leveraging effort to date. We delivered later on in the year quite a lot of work across NZ Inc. on the Māori business strategy. For us it’s 25 Māori companies that we’re working with, and the support for Canterbury in particular, the investment across NZ Inc. and the BNZ, and the EPIC innovation precinct. Then finally, led by MFAT, is the small countries initiative, which is, I think, a
very good initiative to reach out and learn from what some of the other highly educated, innovative, smaller countries in the world are doing.

So the final section I want to work through is just the results. So the strategy, as I pointed out, is growing companies for the benefit of New Zealand, working individually, working in coalitions, get the right services at the right time, and to do this you need great people and great technology and productivity. And we do it all at NZ Inc. That’s the basic strategy.

The results: well, as of December 2012 the customer export revenue for our Focus 500 portfolio, which is around about $23 billion, about the same size as Fonterra—so it’s very good that we’ve got our ex-Fonterra chairman here—with an estimated absolute growth rate of 7.4 percent over the last 12 months. So given that the overall export goods growth rate to the end of 2012 was minus 3.5 percent, which is slightly offset by the growth of services of 2 percent, it is fair to say that we’re dealing with a higher than average growth of companies—export growth companies.

Related to this is the international deal flow, or export deals in international markets, which is now tracking at $250 million in the year to date—these are new deals—which is up slightly on this time last year. Customer satisfaction is now at 90 percent, up from 80 last year, and 88 percent of customers consider the NZTE adds value to their company, up from 81 percent. So quite big lifts in both those areas. The International Growth Fund, which is our $30 million fund designed to help companies grow internationally has dispensed 184 grants since its inception in 2009, with a potential economic impact of $1.7 billion. Efforts to attract capital have associated investment flows to companies of $221 million in 2011-2012, and that is running at $100 million in the year to date. With some additional deals in the pipeline, this is an area that we believe requires considerable additional NZ Inc. focus and attention. Employee engagement continues to improve, increasing from 69 percent in 2010 before the PIF review, to 74 percent in November 2011, to 76 percent in March 2012, and 77 percent in November 2012.

The reason I dwell on these numbers is really what Rob Fyfe taught us. What Rob Fyfe taught us was that in Air New Zealand when the employees were engaged they delivered better outcomes to the customers. It is your employees that are your front line, so for us the employee engagement, how people are feeling about the organisation, their level of commitment to the organisation, to their customers is a lead indicator.

During this period the overall spend has come down by 8 percent or $13 million to $143 million, including the previously mentioned headcount reduction of 8 percent. This year we plan to maintain this reduced expenditure of $143 million. So pretty much the story is the level of delivery has gone up and the costs have come down—more for less. In the last year we’ve made significant inroads in our performance improvement programme, but the job is not done yet and we still have a way to go. We have received excellent support from our Ministers, our board, from other NZ Inc. agencies, and also across the entire political spectrum. It is this
support that has allowed us to stay the course and implement what we know needs to be done to make a difference for New Zealand companies and for our economy in general. Now we can take some questions.

Young

Excellent. Thanks very much for your presentation. Let me start off, and congratulate you and team on what you’re doing. We’ve heard that you are a very efficient organisation and doing a lot of work for New Zealand, so appreciate that very much. You talked about 28 trade missions. I think 17 of these had ministerial presence and—

Ferrier

Thirteen, I think.

Young

Sorry?

Ferrier

Thirteen with ministerial presence, yeah.

Young

And around this goal of increasing exports to GDP from 30 to 40 percent by 2025, notwithstanding the international slow-down that’s happening at the moment, in terms of measurable impact have you been able to sort of, you know, lay hold of some assessment around the progress on that?

Chrisp

It’s very hard to measure in quantitative terms the impact of each individual trade mission, but I know, for example, the Latin America mission, and that was pretty intense—17 flights and four countries—but what we did, we catalogued the commercial deals that were being gathered over the course of the mission, on that particular mission. So what happens on a mission is that the Ministers and Prime Minister, they create the overall political context, and they increase the gravitas and the imprimatur and the mandate of the mission, and that attracts a lot of attention. Generally, you get high-level contacts you do not otherwise get. So around that we organised 134 meetings in Latin America, and out of that we got 49 leads. These are documented commercial leads and we got a few deals, as well. So I think if they’re well organised and well run and you do bring a strong commercial focus to bear, then they do add a lot of value. There’s a few caveats in there, but I think if you meet the caveats, then they can add a lot of value.

Ferrier

I think the key message that Pete’s seen is it’s the quality of the trade mission. It’s not quantity—not the number of missions you do—but do a few key ones right.

Lotu-Iiga

Thank you for your presentation, and I recall when you (inaudible) first came, you know, that you set out a vision and I think you’re actually implementing (inaudible) all credit to what you’re doing with this organisation. Just a quick supplementary on (inaudible). So in terms of the quality that you talked about, you now believe you’ve got some transactions that have been done. There’s some follow-through with that, I understand. Could you just talk about the role that you played in going forward in assisting those types of transactions?

Chrisp

The leads come off the mission, and then what happens is very important. They then get catalogued and recorded as a lead. They go into our customer relationship management system and then they are picked up between the customer manager and the company about that lead. So, if it’s Air New Zealand’s jet engines that’s developing a lead into Mexico, which they did,
then, you know, is there a distributor? What contacts they need to make.
What doors need to be opened? What’s the business model they need to
build to deliver on that lead? That’s a very active discussion, because that’s
given you to the detailed planning. It’s like a pyramid, you know. The
think starts with, you build a network, you get introductions, you get leads,
and then you get deals. And deals are always a subset of the broader
network that you’ve built in the first place. So what you’re trying to do is
maximise the ratio of deals to initial introductions and networks.

Lotu-Iiga  Are you monitoring the sort of medium to long term benefits of what
comes out of that?

Chrisp  Then the deals go into that measure I talked about, which is the
international export deals, so that’s the one that’s tracking at $300 million—
aha, $200 million?

Ferrier  250.

Chrisp  —$250 million, year to date; just over $300 million last year. So that goes
into that particular database, and that’s the unique, new deals for that year.

Ferrier  I also think you’ll see it in terms of the growth rate of the focus companies
that NZTE has, which was 7.4 percent. So the frustrating thing for me
coming in new is getting the right numbers to measure performance, and in
the aggregate, if they’re focusing on 500 companies and those 500
companies grew 7.4 percent and the aggregate of their total economy was
quite a bit below that, you’ve got to know they’re doing something right.

Lotu-Iiga  Just on that, you know, again this is I think one of the pertinent questions
(inaudible) how you measure success. I’m glad you’ve got a section in here
that’s all around the measuring of success (inaudible) measure growth, and
again it’s how you measure your impact on the growth. You talked about
customer satisfaction. I’m glad that’s gone up, because that’s one way to
measure, you know, the impact that you have, which is (inaudible) and then
you’ve also gone into case studies, which I certainly discussed with you at
the time. That’s a really nice way of, you know, showing success through
the use of case studies. I’m also interested in this dashboard. Can you just
walk us through that, because that’s quite interesting; how you use this
information you’ve reported. You’ve got these 12 key indicators in a sort of
(inaudible) time.

Chrisp  Look, one thing I will say is that immediate impact of the new chairman
coming on board, the first question he asked was: “Is that the sort of
questions you’re asking?”. He said: “How do you know you’re having a
good day, and how do you know you’re actually performing or not?” So I
think we’re doing a certain amount, but I think with Andrew’s impact we
lifted it up and we’ve created what’s called a driver tree. So we’ve got 61
performance measures, and now they’re organised into a proper system,
and just to say—the problem is that in an organisation like this, there is no
bottom line. We all know that. You can’t do a profit and loss statement. So
what’s the sort of window—the balance window—that you’re looking at
performance on, and the headline ones are the ones that I’ve given you
today, which are, are the companies growing, are they getting deals in market, do they perceive that we are doing a god job—satisfaction—are your employees committed and engaged, are you attracting foreign capital, are you spending the right amount of money, and is your change programme internally on track or not? What I've just done, I've pretty much outlined the 12 on the dashboard.

Young And then there’s—how’s it floating under the—

Lotu-Iiga Sorry—we’ll come back to that, all right?

Clark Given that we’re over halfway through the review, it would be nice to—

Lotu-Iiga No, we’re not over halfway.

Clark have a wee question. Can I say, firstly, thank you very much for your presentation. We in the Labour Party are very supportive of NZTE and we appreciate the hard work that you do on behalf of our growing exporters. I promise not to take as much time as Peseta Sam Lotu-Iiga took, but I do have a—

Lotu-Iiga Are you going to ask your question?

Clark (Inaudible) So my first question is around what exporters are telling you in terms of the limitations that they’re facing. You did outline some of those things, and I (inaudible) an effect on them, and I’ve got a series of questions on that, because I think, you know, you’re facing an uphill challenge (inaudible) primary exports are down 10 percent in the last 4 years in New Zealand, and that is really significant. So you talked a little bit about the scale—[Interuption] Mr Lotu-Iiga, I did not interrupt you once today (inaudible)

Young Sorry—carry on.

Clark—Mr Chair. So just (inaudible) scale, capital _____ and so on, can you talk a little bit more about what the exporters are saying in terms of the key constraints they’re facing?

Chrisp I think we’ve spent a lot of time on this question. We have been unable to put our finger on one particular constraint that’s a dominant constraint, and that’s why the heart of the business model is going to the individual company to understand it. There’s almost always a constraint for a company, but sometimes they are capital constraints, sometimes they are market access constraints, sometimes they are strategic—having the right strategy for a company—sometimes they are governance constraints. So you do get quite a pattern of different constraints for companies.

Clark In terms of capital debt—

Chrisp I mean, that is aside from scale. Because the scale’s a bit like saying, you know, we can’t just wave a wand and fix the scale, but of the ones that we think we can do something about, there’s a whole range of them.

Clark Would capital debt, in your view, be improved through compulsory savings in New Zealand? I mean, it seems to have worked in Australia—$1.3 trillion in savings. We know that’s kind of sticky money in those superannuation
savings accounts. Would you be in favour of having greater capital (inaudible) businesses here?

Chrisp: That’s outside my pay grade, isn’t it?

Clark: Well, (inaudible) big-picture issues than (inaudible)

Chrisp: Yeah, sure, but I’m—

Clark: (inaudible)

Chrisp: We’re an operational agency charged with growing companies, so the role when I sit here today—I don’t sit here being in the position of commenting on the overall macroeconomic policy of the country. I never have done.

Clark: You’ll be wanting—I’m sure you discuss with the Minister the constraints that you face?

Chrisp: Within our sphere, they’re exactly the ones that I’ve been talking to you about in the answer to the previous question.

Clark: (Inaudible) promise to represent businesses and their interests in terms of expansion, in terms of (inaudible).

Chrisp: I think that’s Business New Zealand, isn’t it?

Ferrier: Hmm.

Chrisp: No, no, our job is to grow companies.

?: You’ve got the wrong organisation.

Clark: Well, I think growing companies is actually about trying to remove as many of these constraints (inaudible) and you might see it as something that you would carry on with, regardless of the Government policy you’re operating under—

Chrisp: Yeah, absolutely.

Clark: —presumably when you report back to Ministers, you’ve already (inaudible) from businesses and the constraints there.

Ferrier: I think—Pete, if I could just jump in—Pete pointed out the number of different reasons companies have that might restrain some of their growth, and there’s a plethora of them and it’s difficult to put your finger on one. One of the reasons in terms of capital—one of the reasons that NZTE has now implemented a new programme in terms of access to capital, is actually—there’s plenty of capital around, but many companies don’t know how to access it. So what NZTE is doing is focusing on giving those companies more skills to access the capital that’s already available. That’s something that NZTE can do very effectively, and it was great to see that they recognised that and have implemented a programme to help that out.

Chrisp: But look, to answer your—where we get something that’s coming to our attention regularly that we think needs the attention of Ministers, of course we tell them. Probably the most recent example of that would be engineering and software skills. That’s one that we often hear. We’re dealing with the tech companies. It does seem to us to be constraints in terms of
the availability of those types of skills in the economy, so that’s the type of stuff we would feed back.

Clark  Picking up on that (inaudible) sector plan would be a really good thing for the Government and it doesn’t have one. Minister Joyce has said publicly that he doesn’t think there needs to be a plan. Is that something that you’ve raised with Ministers, and what kind of feedback have you had?

Chrisp  To be honest—I haven’t raised it with Ministers. To be honest, we inherited quite a few sector plans and stuff, and a lot of them were extremely weak. They were just—well, I’m not being disrespectful about it, but they were reasonably loose attempts with not a lot of good, strong, committed companies behind them and not well organised, not well funded, and didn’t really have the cut-through. So there’s nothing wrong with a sector plan per se, but—and that’s why we went to our coalitions, because we said: “Look, if we’re going to work in more than individual companies, let’s try and work with groups of companies who are very strongly committed in their own right.” So that’s why we say: “Let’s co-invest, rather than just fund.”, and that pretty much sorts out who’s really keen to do something and who’s not, and out of that you do get some things—the wine group, for example.

We did a lot of work with the wine industry. We’ve got three wine initiatives. One goes to the US, called the Complexity initiative; one goes to China; one goes to Europe—three countries chosen in Europe. You’ve got the wine growers there who are very strong. They’ve got a levy, so they’ve got funds. We co-invest with them, and again I wouldn’t say it’s a sector strategy per se, but it’s a very joined-up effort across us—it’s more than the individual wine companies, it’s across the whole wine sector. So that’s one of the ones where you can see the companies—they’re keen. You get the chief executives involved and you get some traction.

Clark  So the primary sector continues to be strong. At least in the last GDP quarter the figures are good and the Government’s been crowing about them, and, you know, we need a strong (inaudible).

Chrisp  Particularly, the food processing is the exciting stuff in the primary sector.

Clark  No arguments about the primary (inaudible) but we are subject to shocks. There’s a drought coming up, and obviously those GDP figures will be not so (inaudible) and our industries (inaudible) more at risk—

Young  Can you—question, David.

Clark  Excuse me, Mr Chair—

Young  No, no—excuse me, but you’re making political statements and—

Clark  I’m (inaudible).

Young  Listen. I’ve got a line-up of three other questions—

Clark  This is (inaudible).

Young  OK. Jian?

Clark  (Inaudible).
Young  Sorry—sorry—no, no. I’m stopping your question for that.

Clark  We’ve had one question from the Opposition—

Young  Jian?

Curran  Point of order.

Young  Excuse me. I am—listen.

Curran  Point of order.

Young  Yes, point of order.

Curran  Mr Chair, are you keeping a note of the time that the Opposition—

Young  Yes, I am.

Curran  —and will you give us an indication as to what amount of time there is left and how much the Opposition has had for questions (inaudible).

Young  We are (inaudible). There’s no point of order. It’s a procedural matter.

Clark  These are genuine questions—

Young  Can we come back to your question, and then we’ll come back to Jian.

Clark  My question is around secondary exports and how we grow them, and other countries are taking a proactive stance in terms of that and set the strategies to try and develop non-primary exports. New Zealand has an abysmal lack, in my view—that is my view and I’m very clear about that—in terms of deliberate sector strategies for growing non-primary sector exports. That is something you’ll be hearing again and again and what we hear on (inaudible).

Member  What’s the question, David?

Clark  What are you recommending to Ministers in that regard?

Chrisp  Once again, we are just dealing with our—we’ve got our strategy; it’s laid down in the Business Growth Agenda. We are dealing with individual companies and we’re dealing with coalitions and groups of companies. Both of those avenues of activity are clearly laid out in the Business Growth Agenda, so that’s what we’re operationalising.

Yang  First of all I would like to (inaudible) to China, for example, (inaudible) that’s what we should do. Now, I have (inaudible) the number of employees (inaudible) FTEs has dropped from 584 to 497 in the past 3 years. Now, the question is about (inaudible) that programme (inaudible). China is the only country amongst 80 (inaudible) industry. How many offices of the (inaudible) national offices are in China?

Chrisp  There are 65 people in greater China.

Yang  That’s a large number you (inaudible).

Chrisp  Yeah, it’s our biggest single accumulation of employees, and there are six offices in greater China.
Yang: Yes, you have done *(inaudible)*. Is that a *(inaudible)* programme?

Chrisp: Yes, that was run really as a result of the interest created by the Free Trade Agreements. About 1,000 people have been through the China business training in the last couple of years. But, once again, I mean, the issue with China is not so much the amount of interest you can generate but having enough companies with enough scale, enough ability to take risks, raise capital to go and take advantage of what clearly is a very exciting market.

Yang: Great. I am also interested in the International Growth Fund. I tried to find more information but I was not very successful there. Can you explain that?

Chrisp: The International Growth Fund is a $30 million a year appropriation. It was originally a 5-year programme. It's aimed to help companies grow into the markets; it's generally got a market focus. It's calculated on a direct economic impact. So the company puts forward a project, they have to fund at least half of that project—so it's a half and half. And then you do a calculation that determines is there going to be an increase in the EBITDA they're spending on wages and salaries and they're spending on suppliers, and you need a certain multiple number to qualify as a project. That's pretty important for helping companies develop new networks in a market or particularly as they develop their business models; they might want to put a person into a market for a year or something like that.

Yang: Now I understand the majority of customers are medium sized companies, there are so many smaller companies. But you also said *(inaudible)*. What do you do to small businesses?

Chrisp: OK, just to sort of re-cut that. If you think about the export pyramid, there's about 13,000 exporting companies, there's about 12,000 under-$5-million export revenue, there's 460 between $5 million and $25 million, and there's 260 above $25 million. So we're kind of focused on from about $3 million up to sort of $300 million. So the really big ones like Fonterra—we work with them, of course, and give them what support they need, but they're not really a key customer per say, and all the tiny ones they've just got to have a little bit of scale first. For the very small companies, there's still many other parts of the ecosystem that deliver benefits. So the regional partners, the incubators, and the websites all offer services, and we spend about $20 million on services in that part of the export pyramid.

O'Connor: Thank you very much. *(Inaudible)*, but if you set aside China, for a moment, and then look at the rest of your efforts internationally, acknowledging the growth of some areas, how many companies are being squeezed out because of the dollar being *(inaudible)* at the moment? So one step forward, one step back—how many companies are actually moving out of the export sector?

Chrisp: I can't answer how many credit companies are moving out of the export sector because there's a constant churn of companies coming in and out, but there's reasonably good growth into Australia. An interesting thing about our companies is the ones that are doing well are the ones that have got some sort of specialised niche that they're exploring. There's just no
doubt about that. You’re seeing patterns of growth across the entire world. If you look at the growth into China, it is actually, I think, since 2008 something like about 300 percent growth in the primary into China, but there’s only about 35 percent growth of the specialised manufacturing. So the specialised manufacturing or the high tech stuff is actually not growing into China so much at the moment; it’s growing into lots of other markets.

There’s lots and lots of quite exciting growth into lots of different markets around the world. If you have a look at the TIN100 report—really interesting—you see of the top 100 technology companies, the top four categories there are growing around 9 percent and they’ve all got a digital sort of software base to them. So there are some quite interesting patterns of growth. You see, those particular companies grew very well into Australia. Australia is not to be overlooked.

O’Connor Are you not monitoring companies that may have ended up being uncompetitive, have lost—

Chrisp Yes, we know in our portfolio I think there was about 20 percent and that averaged about 7.4 percent. About 20 percent of them had a worse year than last year. So there’s a certain portion of the portfolio that had a worse year than last year for a range of reasons, but there are some quite good companies out there doing quite well. But it’s all in the niche. You have to really get in amongst the detail to look at it.

Ferrier I think it’s a natural evolution. The companies who are better and more competitive in their space are going to grow, and those who have chosen the wrong strategy, the wrong business model, and so on are going to shrink. So when Pete’s looking at this and seeing on average our major companies have grown 7.5 percent, it’s a strengthening of the overall business competitiveness to see actually that some of the weaker ones fall off and the stronger ones get more competitive.

O’Connor I’m guessing—there’s not an exporter that I speak to that doesn’t raise the issue (inaudible) dollar. Have you formed an opinion on what would be a more advantageous value to drive up export growth, particularly in the secondary sector?

Ferrier Maybe I’ll jump in on that as well, I have a fair amount of experience in dealing with the dollar in my time in Fonterra, and also in my time in Canada competing against the United States when I did business there.

In Canada in particular I found that a weak currency was actually a very bad thing for the country, because companies capitalised on the currency and they didn’t get efficient. When Canada started getting a very strong currency relative to the United States—I was running a business in Canada at the time—we had to get more efficient, we had to get better at what we did. The dollar was telling us at the time that actually the Canadian economy was in good shape because the dollar was going up, but it forced us to get better. So, to some extent, when you see a strong Kiwi dollar over the very long term, it’s actually going to help a number of companies reorganise to get more efficient and to be more competitive over the very long term. But I do
think you cannot come in and say what the right number is; the economy will find it.

Right now we have a strong dollar, we have a drought, and guess what? We’ve seen dairy prices go up remarkably as an offset to that dollar. So I’m a firm believer in economic forces will ultimately get you to a level that is successful. A high dollar in and of itself is not the problem; it’s the competitiveness of our businesses. If NZTE can help the competitiveness of the businesses, help with the broader NZ Inc. strategy to that, we’ll get a lot of winners and we will win regardless of the level of the dollar.

Clark A short one just in relation to the exchange rate. You are familiar with the OECD (inaudible) that for a small trading economy (inaudible) exchange rate because of hedging and other (inaudible) in favour of the primary industry sector as opposed to—and at the expense of secondary (inaudible). Have you got any thoughts—

Ferrier I think broadly speaking—I was talking the same thing in secondary manufacturing—it forces you to ensure you’re running your businesses as efficiently as you possibly can. It’s a market force that you have to (inaudible).

Clark (Inaudible) true but it actually works against them, at their expense, and that’s the argument of the OECD.

Ferrier I think it’s a difficult policy area. I’m not a believer in interventionalist strategy, but that’s not an issue for NZTE.

Mitchell Mr Ferrier, thanks very much for seeking the role as chair, along with Mr Chrisp. I think it would be fair to say that New Zealand has continued to punch above our weight (inaudible) and have better contact with New Zealand Trade and Enterprise, and I’d have to put my hand up and say I was fairly critical of the organisation. But I’ve come home and since Mr Chrisp has taken over (inaudible) there’s been a change in culture. And I’ve (inaudible) is extremely positive now (inaudible). So I just want to congratulate Mr Chrisp on the great job that he’s doing.

The only concern that I have that I just want to flag up is that the strategies around (inaudible)—and I fully agree with it in terms of targeting our bigger companies (inaudible) and medium-sized companies (inaudible) got some new opportunity for revenue growth and growing (inaudible). But smaller business, smaller (inaudible) sized business is still a big part of our economy, and I just wonder—and it’s very clear from this briefing that you are still doing lots for (inaudible), those small to medium sized businesses, but if we continue to grow our bigger businesses then in terms of risk (inaudible) providing assistance and help for small (inaudible) medium-sized (inaudible) then, like I said, a little bit of a risk growing around having—we’re only a small country—having a lot of bigger companies and not necessarily growing smaller (inaudible).

Chrisp Well, I think there’s a bit of confusion of this SME definition as well, because almost all of our companies we’ve got as customers would, if you
were in the UK, be considered to be SMEs. So, we’re a country, apart from Fonterra, that’s made up of SME’s.

Thirty percent of the portfolio is in and around the $3 million turnover, and that’s actually not a very big company. So we still have got a weight of effort down at the bottom end of the equation. It’s just not in the few-hundred-thousand-dollar companies. Those are the ones that are probably feeling that they’re not getting the one-on-one attention, but to them you have got mentors, incubators, regional partners, training vouchers, the easy touch services. We’re definitely not walking away from them; we’re just trying to provide a different type of service proposition to say where 20 million bucks goes into servicing, they are very, very small ones.

Mitchell I totally agree with that. I’m seeing that too at the grassroots level (inaudible). Let me put it another way. Are you starting to see (inaudible) starting to actually get a bit of a foothold in terms of reaching that next level of growth?

Chrisp That had 7.4 percent growth, so yes. I’ll tell you the ones that I really call are Comvita—that’s come from a $20 million business to a $100 million business. You’re getting a research base, taking risks, into the Asian markets on the back of a megatrend, well run, well governed. It’s a good organisation. Orion Health is another one. I think they’ve topped $100 million, haven’t they?

Witness Yes.

Chrisp They are in a niche—a lot of expertise, very specialised. We’ve got a lot of these companies that are growing up: BCS, some package handling systems—all these companies that are growing up quite rapidly, you know, on exploiting a niche and they’ve come from relatively small companies and are becoming medium sized companies. That’s the stuff we’re really trying to get going. But you need the owners and the leaders of these companies prepared to take some risks and be ambitious and we’re quite unashamed about that. So we are working with those companies that are quite ambitious for what they want to do. I think it’s like, from a taxpayer’s perspective, we’re putting the taxpayer’s money in where the private sector says it wants to be ambitious. It kind of, you know, sits alongside each other reasonably well.

Ferrier Just one thing on top of that. First of all, I appreciate your comments on Pete. When I was approached for NZTE and I had a look at it, I was thrilled to see how NZTE had brought focus. The reason I joined was because I saw an organisation that really had its act together, and I think one of the things you have to think about broadly in Government is, how do you get the best possible people into these agencies which can make a difference to the entire economy. So it’s fantastic to see guys with the capability of Pete being prepared to come to an agency like NZTE.

The other thing, though, to the broader question is it is critical to have focus. I mean NZTE can’t be perfect for everybody, and when I saw that they had focused on that 500 customers, it’s $3 million to $300 million, it’s
still a very broad range. But they’re going to make a bigger difference for the country by focusing on 500 than they are on 13,000. We would be so diluted we wouldn’t really have anything, we wouldn’t make the sort of impact that we’re making. So I think that as long as they recognise it’s important to have appropriate services for the smaller companies, but to focus on—$3 million is still pretty small in the scheme of things, focus on 3 to 300 is the right focus.

Curran I just wanted to turn to the IT industry, which is working as a powerhouse of our economy. Are you aware of the recent comments made by Rob Jury, who’s founded one of the most successful companies (inaudible) around the need for the Government to consider appointing an independent technology adviser to advise, and bringing in the private sector, basically, into advising the Government on how to join the dots in a planning sense. So that’s the first part of the question.

The second is, is there another barrier that’s been clearly identified, that I would argue that that sector is reasonably united and is arguing that one of the big barriers to growth in that sector is the lack of ability for our local IT companies to get to first base by being able to successfully tender for local procurement, and the barriers for them to actually do that. Would you agree that that is a key barrier and that is something that needs to be looked at?

Chrisp On the first part of the question, I mean, the most exciting sectoral type work to get organised and under way is the ones where companies stand up in the middle and say “We want to work together.” I think the ones I got a bit allergic to when I started was when I looked through the mists of all these big-sector initiatives all I could see was bureaucrats like me, and that’s when I said “This is not actually adding any value.” But when you’ve got people like Rob Jury standing up in the middle saying: “Me and my fellow chief executive leaders actually want to get a strategy for the sector.”, I think that’s a very different discussion. That’s for the Government to work through, but I think that is a much more exciting proposition when the leaders themselves ask for it as opposed to the bureaucrats leading. It might sound like I’m dancing on the head of a pin but I think it’s actually quite important where the point of initiation comes from. What was your second question again?

Curran My second question was around the barriers to procurement.

Chrisp Look, yes, that is something that we hear—quite common. It’s that New Zealand companies do want better access to Government procurement decisions.

Curran It gets them up to this other level which means that they can then get to the level where they can do better overseas. So it’s giving them internally the ability to develop more.

Chrisp Exactly right and there are two things. It gives them, when they’re overseas, the credibility of saying “I’ve got my Government as my customer.” That’s one thing. The other thing too is when you take something like Howard Wright Beds, they are a very innovative small bed manufacturer. One of the
reasons why they’re innovative is that they’re in the hospitals in New Zealand. They can basically, within an hour’s flight, go into a hospital and see how the bed is working and talk to not the procurement manager of the hospital but the nurses of the hospital about the bed and how the bed is working. They get to innovate through being close to the organisations in New Zealand, the health procurers in New Zealand.

So there’s been a lot of talk about that recently. I see the world thawing a bit on that myself, and, yes, that is something taking it back to, I think it’s David’s point (inaudible)—it is something that we’ll be represented on, so when we hear something that’s really common like that we will go out, and we’ll be saying that, yes, there needs to be more systematic access to Government procurement. But you’ve got to be very careful because there are some countries in the world that approach that issue in a way that just gives inefficient local producers a big leg-up and basically all the consumers end up by paying for it. So there are right ways and wrong ways to do that. I’m not an expert on that, but the general principle of saying that it’s better that New Zealand companies have access to big local procurement, the more the better.

Ferrier I back that. Sometimes you have to be careful with your trading partners that you’re not coming in too strong in your domestic industry. What you also want to do is make sure you haven’t gone too far the other way. My sense is sometimes we’ve gone too far the other way and we have perhaps hamstrung some of our companies.

Curran So have you approached Ministers with that view?

Chrisp I think—I mean, you’ll be more across this than me, but there is quite an active discussion and there’s been some analysis, I think, around what they’re doing around Government procurement and things. I’m not an expert.

Curran But there’s a view that you (inaudible).

Chrisp It’s a view that gets expressed by lots of people. It’s not unique.

Ferrier I think another issue in the ITC is the capability of people coming out of our universities and that’s another one that’s recognised.

Clark I’m concerned about balance of trade (inaudible) worst in the Western World coming out and you’ve got a target of ratio exports to GDP from 30 percent to 40 percent, and, you know, I think nobody around the table would disagree with that extra growth over time. The Callaghan Institute is in (inaudible) into your space, and the concerns and strengths around that are around it not crowding others out of the market place, not doing things that are already being done. How’s that process going in terms of working in?

Chrisp Well, first of all, it’s going very good. But I think, just the way you’re framing that question you have to be really careful because I think the whole idea of who has got what space and who’s crowding out who suggests that entities with (inaudible) —I’m not saying you’ve got this mindset, but you’ve got to be careful that it’s about organisations with the core
role and responsibility. We will be overlapping, and I think it’s how you work out how you add value in the middle of all that. So I’m not concerned at all about the crowding-out or the space or anything like that.

The thing to make sure is that we know what we’re trying to do, which is grow New Zealand companies for the benefit of New Zealand and Callaghan will have a similar sort of model. I’m very confident. Their core role is science, engineering, technology, design, innovation in New Zealand, and all the science and the systems and the culture that goes around that. And that is something that we touch on but it’s not our core. Our core is to grow companies internationally. So we’ve got two organisations with quite separate core roles that we’re going to overlap for sure, and that overlap is OK. It is actually a strength.

Clark  What are you doing to ensure coherence of vision across (inaudible)?

Chrisp Then it gets very practical. I think we’ve stated that we want to share a customer relationship management system. That would be a very practical thing. So if we can get ourselves on the same computer systems, so if they’re going down to a factory in Dunedin, you know, TracMap does GPS in Dunedin, and then go and talk to them about design innovation, that they are able to look into the system and see what we’re doing to help them grow into markets. If they’re funding them and then we’re funding them they can see what that looks like. But there are some quite practical dilemmas that have to be solved, of which confidentiality of information is one of them. So getting ourselves on the same computer system, then services, having consistent services. When we look at the whole thing we’ve got a particular service in New Zealand called Lean Manufacturing. It’s quite a domestic service. You could argue either organisation could deliver it. We thought it was probably better, going to be closer to their core purpose than ours. So the suggestion was that Lean Manufacturing becomes one of their services, which is a good idea. They will get access. They will refer companies through to our services, and we’ll refer companies through to their services. So we’ll just make it as seamless as we can. I think what will matter a lot is the relationship between the two boards and the two leadership teams, and the co-location. So that’s why we thought the most practical thing was let’s co-locate, for a start. So a lot of stuff gets sorted out over the water cooler, and then there’s been some stuff done to get the boards overlapping. So Robin Hapi is on both boards, and I spent a lot of time with the acting chief executive. Andrew has met with the chairperson a number of times. There’s a lot of work to go into joining these two organisations together.

Lotu-Iiga Thanks again for your presentation today. You’ve talked about systems and talked about collaboration. One thing you mentioned in (inaudible) is people. We all know that people make organisations, (inaudible). In terms of, anecdotally (inaudible) relationships and some of the products I get from some of my exporters, if (inaudible) relationships break down and it’s difficult. In terms of building your (inaudible) your organisation can you just give us a flavour on how you build them up, what you’re looking for, how you measure their performance, because it’s really critical that we have the
right people doing those things that we talked about today. Because otherwise (inaudible).

Chrisp: Well, the first thing was to get the right light on the hill. So you’ve got to put the cause out in front of people if you want them to play a bigger game than they play individually. So that was very important—get the light on the hill. That’s where the Business Growth Agenda’s been very useful. Putting customers in the middle of the organisation helps them understand what’s the most important thing in the world, where they have to add value. So you’ve got two big alignment things happening. Then you get down to the rigour of the management system. So what are the measures they’re accountable for? What are the routines in the organisation that hold them accountable to those measures, and the discussions you have around that. What’s the training and development you do, so we do a lot of leadership development at the moment, leadership training. Then the other big one is what you’re doing with—[End of recording]

conclusion of evidence
Contents

Recommendation 2
Introduction 2
Financial and service performance 2
Performance improvement framework 2
National land transport fund 2
Public–private partnerships 3
Planning 3
Public transport 3
Road safety campaigns 4
Driver licensing 4
Appendix A 5
Appendix B 6
New Zealand Transport Agency

**Recommendation**
The Transport and Industrial Relations Committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Transport Agency, and recommends that the House take note of its report.

**Introduction**
The New Zealand Transport Agency is a Crown entity (Crown agent) established from the August 2008 merger of Land Transport New Zealand and Transit New Zealand. Its core functions are planning the land transport networks, investing in land transport, managing the state highway network, and providing access to and use of the land transport system.

**Financial and service performance**
The agency finished the year with a surplus of $41.38 million, compared with a deficit of $34.69 million in 2010/11. Its investment in land transport was lower than budgeted by $54.5 million, due in part to a moratorium on new approvals for improvement activities.

We were pleased to note that the agency achieved 78 percent of its service delivery targets, and 68 percent of the National Land Transport Fund’s investment forecast results.

**Performance improvement framework**
An independent review of the agency under the State Services Commission’s performance improvement framework programme was published in October 2012; we were told that it was largely positive and that the board was pleased with it. We note that the report commented positively on NZTA’s fitness for its purpose in terms of business model, organisational structure, capacity for change, and best-practice procurement processes; and that its expenditure decision-making processes were said to be well-developed and sophisticated by public-sector standards.

The agency told us that it is seeking to establish a value-for-money corporate culture, and has a number of business improvement projects under way. In particular, it has worked with local authorities to investigate how shared road maintenance and operation can be carried out more efficiently; it believes that rethinking procedures could yield savings of anywhere from 2 to 20 percent.

**National land transport fund**
The agency’s management of the national land transport fund is essentially a cash business, with regular revenue adding to the fund, and regular spending on projects from the fund.

We were told that a recent increase in the agency’s short-term borrowing capacity is intended as a smoothing mechanism to manage the seasonal nature of this cash flow; the fund must return to a positive balance at least once each financial year. The agency said that further options for adding to the fund and using it more flexibly, such as public–private partnerships, longer-term borrowing, and increased petrol taxes, would depend on Government policy decisions. We note that accurate reporting and monitoring of the agency’s financial management will become even more important as the agency enters into longer-term funding commitments, such as public–private partnerships.
Public–private partnerships

The expressions of interest stage of the tender process for building the Transmission Gully route is due to close in March 2013. We asked about the potential effect of using a public–private partnership to build this route, rather than the normal funding mechanism. The agency said that the cost of capital and ongoing maintenance would be similar, but the one-off construction cost under the normal funding mechanism did not explicitly include these factors as a PPP contract would. In the case of Transmission Gully, as it is already a designated corridor with all the necessary resource consents, the agency will give bidders an opportunity to propose innovative ways to achieve the broad outcomes sought from the project. The agency acknowledged that the capital cost of building the Transmission Gully route as a PPP could triple the cost to the taxpayer, but noted that it viewed the project, with its 25–35-year maintenance regime, from a whole-of-life perspective, and that the financial implications need to be considered in terms of the long-term contract.

The agency considers that problems with demand estimation do not pose any greater risk for PPPs than for other funding mechanisms.

Planning

Traffic growth

We noted that the agency had indicated that total vehicle kilometres travelled had not increased markedly over the last decade, and asked if this would affect the economic benefits of the Wellington northern corridor road of national significance or the Transmission Gully project. The agency explained that the figures represented the national average, while major roading projects were in areas where vehicle kilometres travelled had indeed increased in recent years; we were told that 6 percent of the state highway network carries 36 percent of all state highway traffic.

Forecasting

We further noted that the agency had published material indicating that two factors are implicated when State highway projects fail to achieve predicted benefits: overestimation of traffic growth, and overestimation of safety benefits. The agency considers that every project carries the risk of not delivering expected benefits, and that this is not related to the way it is funded or delivered.

We heard that there is an international trend away from narrowly-conceived benefit-cost assessments towards wider economic assessments, but that techniques for such analysis were still being developed. The agency told us that it is reviewing its economic evaluation manual, and also plans to introduce new techniques to improve the effectiveness of its forward planning.

Public transport

Auckland issues

We asked how closely agency staff had been involved with Auckland Transport’s City Centre Future Access Study, and were told that agency staff had contributed data and their understanding of transport dynamics, but that it was for Auckland Transport and the Government to assess the final report and to decide how to proceed.
We heard that there are no purely public transport projects planned after the completion of the electrification of Auckland’s rail network, but that all transport infrastructure projects contributed to the options available for future public transport projects.

**Wellington issues**

We referred to a letter the agency had written to the Wellington City Council, which stated that the agency would reconsider its support for a number of transport network projects in Wellington City if the Council were to re-examine the case for the proposed Basin Reserve flyover, and we asked the agency to explain its understanding of the connection between the flyover debate and the region-wide long-term public transport study. The agency explained that the region-wide public transport study covered the “spine” between the railway station and the hospital, including the congested area around the Basin Reserve. We were told that the proposed Basin Reserve improvements are concerned with separating flows of traffic where they currently intersect, and the agency considers the flyover to be the only feasible and affordable way to do so.

**Funding criteria**

The agency is a co-funder, along with local authorities, of the public portion of public transport funding. It supplies roughly half of the funding that does not come directly from passengers, the remainder of it coming from ratepayers via local authorities. The agency told us that, while local authorities can prioritise the interests of ratepayers, including pedestrians and cyclists, its duty is to prioritise the interests of those who pay road user charges and fuel excise duties. When deciding on the priority of its funding of public transport, the agency places more emphasis on congestion relief than on other factors.

**Road safety campaigns**

We congratulated the agency on the success of its “ghost chips” road safety advertising campaign. The target audience is young people who are at risk of driving after drinking alcohol, and the advertisement models applying peer pressure to make this unacceptable. The agency intends to continue to use various styles of advertisement to target different groups of road-users.

**Driver licensing**

Fewer people have been attempting to gain their restricted licences in the relatively short time since the driving age went from 15 up to 16; this was expected as the number of people seeking their restricted licences at the former qualifying age went up immediately before the change took place.

The agency has considered the situation of young drivers in areas where conditions are not suitable for the full practical test, and is conscious that the introduction of a more rigorous test for a restricted licence could be discouraging some drivers from attempting it. It is therefore undertaking trials in Te Kūiti and Porirua, in conjunction with the New Zealand Automobile Association, to establish a driver licence mentoring programme to help young drivers to achieve the required standard.
Appendix A

Approach to this financial review

We met on 21 February and 28 March 2013 to consider the financial review of the New Zealand Transport Agency. We heard evidence from the New Zealand Transport Agency and received advice from the Office of the Auditor-General.

Committee members

David Bennett (Chairperson)
Chris Auchinvole
Dr Cam Calder
Darien Fenton
Iain Lees-Galloway
Sue Moroney
Simon O’Connor
Denise Roche
Mike Sabin

Denise Roche was replaced by Julie Anne Genter for this item of business.

Evidence and advice received

New Zealand Transport Agency, responses to written questions, received 8 February and 22 March 2013.


Organisation briefing paper, prepared by committee staff, dated 20 December 2012.
Appendix B

Corrected transcript of hearing of evidence 21 February 2013

Members
David Bennett (Chairperson)
Chris Auchinvole
Dr Cam Calder
Julie Anne Genter
Iain Lees-Galloway
Andrew Little
Simon O’Connor
Mike Sabin
Phil Twyford

Witnesses
Chris Moller (Chair)
Geoff Dangerfield

Bennett OK, welcome, Chris and Geoff. Good to see you both back in here. Our apologies for being in the most cramped select committee room we could find, but hopefully you will be able to enlighten us today and it'll be fine.

Moller Thank you very much, Mr Chairman. Thank you for the opportunity to discuss NZTA’s work for the financial review for 2011-12. We produce a very comprehensive annual report so that our stakeholders can see how we are tracking and the services we are delivering to communities. The year under review—that is, 2011-12—was the third and final year of the 2009-12 National Land Transport Programme. We fully delivered the expected programme in conjunction with our local government partners. We can see a shift in the quality of our land transport system, better safety, and better services from new road and public transport infrastructure, yet challenges remain.

As we completed the delivery of one 3-year land transport programme, we were busy developing the next one. When we look back on 2011-12, we were involved in extensive work alongside regions in developing transport plans, and establishing a clear sense of regional and national priorities for investment and delivery for the 2012-15 period and beyond. This culminated in the current 3-year programme that we launched in the middle of the last calendar year. The programme gives effect to the Government’s goals and objectives as set out in the Government Policy Statement on Land Transport Funding.

A big part of the programme is the shared investment with local government—roughly 50/50—on local roads, walking and cycling, and in
public transport. There is a major focus on improving public transport in our largest urban areas, and additional investments to improve the attractiveness and the capacity of passenger rail and bus services, such as integrated fares and ticketing, and new passenger rail train carriages and stations in both Auckland and Wellington. We are working with local authorities on addressing challenges in asset management and road maintenance, and we think there are some good opportunities for collaboration between councils and NZTA to lift quality and achieve better value for money.

We continue to focus on the delivery of important infrastructure improvements on the busiest parts of the State highway network. The Waterview Connection in Auckland is now well under way. The Newmarket Viaduct is completed and will be opened in the next couple of weeks. The Tauranga Eastern Link is making good progress, and new sections of the Waikato Expressway are being commissioned, and the Te Rapa Bypass has been completed. A number of these projects were completed ahead of time and under budget, and, importantly, with no lost time injuries.

At the same time, we continued to improve key parts of important regional networks that are so important to our communities, and getting freight to market and to export ports. Next month we will start on the replacement of the bridges across the Waitaki River at Kurow. New works are also planned for New Plymouth and in the Hawke’s Bay.

One of our biggest challenges has been to address the Christchurch and wider Canterbury rebuild after the earthquakes of 2011. NZTA is funding around 80 percent of the costs of the restoration of the local road network, and so far most of this has been found from within the National Land Transport Fund. It is a big exercise that will take a number of years to complete, with the total cost being around $900 million. We have been working closely with Christchurch City Council and the Canterbury Earthquake Recovery Authority on this work.

We continued to deliver important nationwide safety programmes and initiatives, including a more difficult restricted driver licence test, to make our new drivers better equipped to drive safely at their most vulnerable time.

There were changes to the give-way rule in March last year, which went very smoothly, and there have been new road safety behaviour campaigns with a focus on young drivers and alcohol. And our “ghost chips” campaign delighted us in terms of its reach and impact.

The road toll for the last 2 years has been the lowest for 60 years. There have been significant improvements for young drivers—that is, the 15 to 24 age group—although they still feature too highly in the statistics. And there have been fewer motorcycle deaths, too.

I am privileged to lead a very talented and experienced board and management. We have focused on ensuring NZTA is a high-quality and customer-orientated organisation, and that it achieves value for money in
everything it does. The board is pleased with a recent independent performance review of the NZTA, carried out under the State Services Commission’s performance improvement framework programme. It found that we are well placed for the challenges ahead. It said: “NZTA is … fit-for-purpose in terms of its business model, organisational structure and capacity to change … It uses best practice procurement processes … NZTA expenditure decision-making processes are well developed and sophisticated by public sector standards.” And it is well managed and governed.

We are happy to answer any of your questions.

Bennett I just want to congratulate you on the governance and management of NZTA. It is a vital organisation in the growth of the country going forward, and I’m sure all members here in the interactions they’ve had with your organisation have been at the highest standard. So we understand the challenges you face but also the immense work that you are doing. So congratulations on that, and we would like you to take that back to your staff and your board. Our congratulations for the good work you’ve done and are doing, especially when you look at those safety records. That is something that we probably can’t all take credit for, but, you know, the fewer lives lost on our roads, the better. And the improvements in construction of major projects and also that work with local bodies, I think, is something that is vital going forward. Just in Hamilton, for example, we see it with the internal ring route road, and things like that, where there has been a very good collaboration with local government. So on all those levels, you’ve done a very good job. So thank you.

Moller Thank you for those kind words.

Twyford Thanks for the presentation. A first issue that I want to cover off is Transmission Gully and the PPP. I read in the Cabinet papers that building Transmission Gully as a PPP rather than through the normal funding mechanism is projected to cost 3 percent of the National Land Transport Fund revenue each year for the next 25 years. Is that correct? Have I got that right?

Dangerfield Of that order, yes. That is the annual servicing cost, and the repayment cost—

Twyford And do you agree with the Ministry of Transport’s projections on the long-term costs of building Transmission Gully as a PPP that the additional cost of doing it as a PPP will amount to approximately $2.39 billion over and above the approximately $1 billion price tag that the project has had up until now?

Dangerfield I can’t—the numbers they may well have got from us in the first place, but you’ve got to be careful about what you’re trying to compare here. One is a one-off construction cost paid for out of accumulated cash; the other one is a long-term financing cost. If we were to take the capital cost in a one-off sense, and associate that with the cost of finance, you’ll find the numbers are just about equal and the same thing. So you’re not comparing like with
like when you put those two numbers together, because you’re buying different things.

Twyford But, nevertheless, the taxpayer is being asked—those are inflation-adjusted numbers, I understand. So doing it as a PPP more than triples the cost to the taxpayer of this project. That is correct, isn’t it?

Dangerfield Yes. But also the taxpayer gets the benefits earlier.

Twyford So you’re acknowledging that it is correct that it more than triples the cost to the taxpayer.

Dangerfield It triples the cost depending on which way you want to account for it.

Twyford Which way do you want to account for it?

Dangerfield Well, my point is that if we were to take that capital cost and say that there is an opportunity cost of putting it all out in one dollop because we could be investing that somewhere else. It is exactly the same thing as paying for it in a finance sense. So we don’t do that. If we were to treat the NLTF as a bank for every investment that we made, you’d associate the cost of capital with that. It would be the exactly the same.

Twyford So on the basis of the MOT’s numbers that it will triple the cost to the taxpayer—more than triple the cost—have you remodelled the benefit-cost ratios for the project based on the increased expansion?

Dangerfield No we haven’t, because one is an economic emphasis and one is a financial emphasis. And it doesn’t pay to try to confuse the two. The benefit-cost proposition is trying to look at the underlying economics of a project. This is actually a way of financing it.

Twyford In your papers to Cabinet you talk about the innovation that you hope will accrue from doing it as a PPP. And I wondered what evidence you’ve got or what data you’ve pulled together to support your contention that the private sector innovation that you hope will be brought to bear on the project will outweigh the extra costs of capital inherent in a PPP.

Dangerfield Well, we can look at what we can see in other jurisdictions. Plus all PPPs under the Government’s guidelines have got to be measured up against the public sector comparator—in other words, what is the likely cost if you do it in a different way? And that, I might add, imputes the cost of capital at an 8 percent rate, which is the Government’s discount rate, into that analysis. So that is where you get a true like-for-like comparison, being able to choose one route versus another. In this particular PPP, and we are still working our way through that as the process unfolds, the potential here is to ask bidders much more to try to meet a broad outcome rather than for us to give them a deeply specified project in the first instance. So we’re leaving, compared with other procurement processes, quite a lot of room for bidders in this instance to come back with ways to meet the Transmission Gully route end-to-end solution in innovative ways.

Secondly, the whole idea is to take a very strong whole-of-life perspective to the project, because it is not only the upfront capital costs but it is the 25 to 30-year maintenance regime that goes with it. So by tying those two things
together, then we think we can get a better result. But ultimately the decision about whether this is procured as a PPP or not still remains on the table until such time as we are well through the process. It depends on this comparison with two alternative procurement methods.

Twyford But my question was what data or evidence have you got to support the contention that the innovation that you hope will accrue will outweigh the increased cost of capital and the tripling of the cost to the taxpayer.

Dangerfield Well, we see that in the evidence from other jurisdictions. We haven’t done a PPP in this country before on the transport side, so we looked for what we can see in other places, and there is plenty of evidence all around the world of some pretty good results, depending on the method chosen on the innovation quotient alone.

Twyford Well, there’s also a very patchy international literature on transport PPPs, so I would have thought that there’s quite a lot of evidence of innovation not occurring—

Dangerfield No, I think that what you may be referring to is there have been some poor financial deals, but that doesn’t necessarily equate to the innovation component that we’re trying to discuss. I mean, there was a proposition just in this week. There’s been a financial failure around one of the Brisbane projects, but those projects were constructed in quite a different way, around patronage, which is not on the table in this PPP at all. In many of those instances they became bidding wars from the financial institutions trying to up the patronage levels, which weren’t borne out. Twyford Can I ask, Mr Chairman, that the agency supply data, international case studies, whatever evidence has been used to support the contention that there is significant savings and innovation to be achieved through this kind of PPP contracting mechanism.

Bennett OK, We’ll do that. Chris Auchinvole had a question.

Auchinvole Thank you. Good morning, Chris. Good morning, Geoff. I’d like to take advantage of your background, both of you, in marketing and ask you about the road safety “ghost chips” advertisement. What’s the public response been to that, and did you specify the creative, or how did it come about?

Dangerfield Well, it came about trying to think through the target audience around young people who are at risk of driving with alcohol, and comes from the notion about applying peer pressure. And we worked closely with a creative agency on experimenting with ideas around that, and that’s how that grew. And there’s quite a lot of material that goes back and forth and quite a lot of testing with focus groups about whether we think we’re getting the right message to the right target group, and we try and use different messages and different methods. Somebody asked me once upon a time whether we’d changed our policy from a sort of blood-and-guts approach to a, you know, more humorous approach. And we’re trying to say: “Look, we’ll use all sorts of approaches depending on the target audience and what works.” In the “ghost chips” advertisement, we seem to have hit the pay dirt. It went really
well. It’s really resonated, to the extent that schools were doing mimic sort of, you know, “ghost chips” ads within the next few weeks or so—

Auchinvole    Really?

Dangerfield    So those things, you know, we’ve had great success out of that, lifting the profile.

Sabinl         Analysing a very complicated situation in your head.

Dangerfield    So that little phrase has really resonated. It’s hard to exactly find a formula, you know, why something works as well as that did, but that’s had huge recognition internationally and we’ve won a number of awards.

Auchinvole    Well done, sir. Well done.

Twyford        I want to ask you about the overall state of the National Land Transport Fund and the announcement of the petrol tax before Christmas. So the papers that have been released painted a picture of a National Land Transport Fund that’s being driven very hard. Would you agree with that?

Dangerfield    Been driven hard? We’ve been utilising the revenues to the best effect. I think I said to this committee last time that you can’t get a better transport system by leaving money in the bank. So we certainly have used the fund to the full extent, yes.

Twyford        And to the extent that, in fact, the fund will run out unless it’s replenished fairly generously or the new State highway building programme would have to be significantly scaled back, wouldn’t it?

Dangerfield    Well, the fund never runs out. I mean, it’s all about adjusting the programme to meet the revenue flow, and that’s exactly what we do. There’s two parts to this whole approach, as we have to keep an eye on what the revenue is, and we have to be able to play with the programme on the expenditure side. That’s exactly what we do every year to make sure that the fund stays on the right level, plus the Government has given us more flexibility to manage cash flow. So that’s why they’ve given us an opportunity to run the fund into an overdraft of $150 million on seasonal finance. But it’s just like a farmer borrowing seasonal funds. You’ve got to pay that back. You’ve got to pay that back once a year to the Minister.

Twyford        It doesn’t run out. You just go into the red for a while.

Dangerfield    Well, it’s a perfectly sensible thing to do. There’s no point in us telling the guys out there on bulldozers today because it’s sunny not to work because we haven’t got enough cash. This is a cash business with, literally, cash coming in every day and cash going out every day. So it makes a lot of sense when they’re busy for us to keep them busy and then, when they’re quiet in the winter time, to build up a stock for the next season.

Moller         And it’s also a sector that’s been under huge pressure, and so for the economy we need to make sure we’re using the resources as well as we can.

Twyford        What do you mean by pressure, Mr Moller? What sort of pressure?
Moller: The whole construction sector, as we know—basically the global financial crisis has had significant problems. A recent failure, a very high-profile one—there’s plenty of evidence to that. So we are one of the—if not the—most significant users of those construction services, and that is critical to the economy and the health of this country in the short term, not to mention the long-term benefits of the activities we carry out.

Twyford: So the Government’s increased your short-term borrowing capacity, essentially for smoothing purposes, right?

Dangerfield: Yes. There’s two elements to that: the seasonal cash flow, as I mentioned to you, plus another $100 million, which has been extended to $200 million, to allow for timing or unexpected timing on major projects, and we use that in relation to the pace of the Victoria Park Tunnel, for example. But we’ve now repaid that or on the verge of repaying that. And the expectation is, just as you said, to use that as a smoothing mechanism.

Twyford: Right, and there’s a bill before the House that would allow long-term net borrowing by the fund? Right?

Dangerfield: That’s right.

Twyford: Yep. And this is where we were just discussing Transmission Gully, by doing that as a PPP it enables you to push $3 billion of expenditure out into the future for a future generation of taxpayers, and not appearing in the short term in the Government’s debt reduction targets.

Dangerfield: It fully comes on to the Government’s books.

Twyford: But it doesn’t appear in the debt reduction targets, does it?

Bennett: Well, we’re getting out of the transport thing—

Dangerfield: I’m not—

Twyford: No, hang on, David. I haven’t finished.

Bennett: Well, you have. Mike Sabin.

Sabin: Thank you both very much, and I just reiterate the chair’s comments. I just want to touch on the change with driver licensing. I’m the MP for Northland, and one of the challenges in areas such as mine, and obviously other similar rural and provincial areas, is that you don’t necessarily have the traffic congestion or roading conditions to meet the licence. Having said that, as an ex-policeman, the importance of robust testing and improving driver skills, as well as the condition of the roads, is obviously very important. So I just wondered, since the changes to the driver licensing, have you got any figures on what’s happened in terms of whether there’s been any fall-off in people doing their restricted tests and so forth?

Dangerfield: It’s about a year now since the new restricted driver licence just came in. I think it was the end of February last year. There are two things that are going on here. One is what are the number of people who present for the restricted driver licence test, and then also what is the pass rate at which they come round and get re-tested. This has been going on at the same time, of course, as 6 months earlier, that there was a change in the age at
which you could get a licence, from 15 to 16. Leading up to that change, there was quite an increase in activity—people, of course, trying to come under one regime before being deferred for another. So that will lead to lower numbers presenting anyway. We’ve had initially relatively low pass rates for the new restricted driver licence—again, not unexpected. Under the old test about 80 percent of, I think on average, people would pass, so a bit over 50 percent now, is it?

Unidentified It’s about 50 percent now.

Dangerfield And that’s tracked up over the 12-month period, because when we started it was high 30s or so. Again, we see that in other jurisdictions. We saw that in Australia, and, in fact, we think that that’s picking up slightly better than Australia. What we’re worried about, of course, or concerned about, is that you know, people who may opt out of the system entirely, that you end up with a number of—

Sabin Unintended consequence of people thinking, well, it’s a 200 or 300 kilometre return trip repeatedly to try to get a crack at this thing—I might just switch off, sort of thing.

Dangerfield We’re trying to trial some programmes that will draw members of the community into mentoring young drivers to get them through this. Because, you know, proper licences are very important economically—a passage to employment, and into economic activity, and, you know, it’s really important that we try and find ways around that. So we’ve got some trials going on—one in Te Kūiti and I think out here at Porirua—trying to find, basically, a driver licence mentoring programme and in touch with the community, and we’re partnering with the AA.

Auchinvole A sort of rite of passage.

Dangerfield Well, some of the problems people strike is, you know, availability of a vehicle to learn to drive in, and someone to sit alongside them and coach them, mentor them, get them to be a good driver, so that when they present to that test, there’s a higher probability that they will pass. I mean, coming back to Mike Sabin’s point, we want them in the system in the first instance, and then we want them to be good, competent drivers as well.

Sabin I guess what I hear you saying, then, is that you’re looking at ways to ensure that the engagement in the driver licensing process, that—I mean, there’s obviously going to be bumps in the road, so to speak, in terms of realigning with what is, you know, a higher expectation and some changes going on there, which is to be expected and is not a bad thing, but the concern and why I want to raise it with you is to ensure that we’re not seeing people switching and disengaging out of the process because we’re trying to raise the bar, so to speak. I’d appreciate your response.

Dangerfield We’re very aware of that issue.

Twyford I just want to come back to my earlier questions around the financing of the fund. The point I was trying to make was that there are several pretty ambitious initiatives to bring more money into the fund and provide more flexible options, so we’re talking about PPPs, net borrowing, which is in the
bill before the House currently, short-term borrowing, and a petrol tax that by my calculations will deliver to the fund an extra $6 billion over the next 10 years—the petrol tax increase that came in just before Christmas—an extra $56 billion over the next 30 years. So pretty big changes and a lot more money being injected into the fund.

My question is did you consider that an option might be to cut your cloth and build the new State highways, the so-called roads of national significance, more slowly or to consider putting some of the ones, for example, that have very low economic value, by your own figures, to the back-burner for a while? Was that considered as an option?

Dangerfield These were options that the Government needed to work through. These are Government decisions, not NZTA decisions. They have made it very clear about the rate of the programme they’re looking for, and they’ve made some revenue decisions on that basis. So I can’t really add much more to it than that. It’s really a question for you to ask politicians, rather than to ask us.

Twyford Sure, but in your formulation of all the strategic options, presumably deferral or slowing the programme was an option that you put to the Government?

Dangerfield Deferral of the programme is certainly an option, and that’s really a decision for the Government to take.

Twyford OK, thank you. Can I move on to the piece of work that I understand your officials have been closely involved in, and that’s the City Centre Future Access Study. Can you tell me what the role of NZTA staff was in that project—what did you do, what was the special contribution that your staff made to that?

Dangerfield I think we helped with some of the data and understanding on the transport dynamics and, you know, because we, along with Auckland Transport, are pretty familiar with the network flows and network demands, so, you know, we’ve been a—

Twyford Do you know how many staff were involved or what the size of the contribution was?

Dangerfield Not off the top of my head, and I’m not sure whether we made a major contribution or not over and above the normal transport planning stuff. Just part of the normal transport—I mean, transport planning is one of the activity classes where we co-invest with local government, and there will be money in there that Auckland Transport would have no doubt used for that study, which is their study.

Twyford Yep. You’re a major stakeholder in it. I mean, were you part of deciding the terms of reference for the study?

Dangerfield I can’t recall.

Twyford No. Would it be possible for you to supply that evidence?

Dangerfield Yep, sure.
Twyford I wondered, given that the agency was such a major stakeholder in the report, my understanding is that your staff made a substantial contribution to the work that went into the report. Does the agency stand by the report and the analysis and the findings that were made in that report?

Dangerfield Look, I think that it’s Auckland Transport’s report, and there are different interpretations of the final report, and it’s really a conversation that’s going on between Auckland Council and the Government, and the Government’s the ones that are needing to assess how they want to proceed.

O’Connor Look, thank you very much. I think, listening to elements of the question around the expenses, that the analogy really is, with our own personal finances as well, we go into debt in order to repay it off the next day and so forth. But what my primary point of interest is is around this new form of outcome contracting that you referred to very quickly, so I assume you’re not now going down a rigid “Build this road this length, this width.” You’re trying a new, innovative approach. I just wondered if you could elaborate for me and the committee on that.

Dangerfield Well, look, it’s only in relation to the Transmission Gully proposition. We have already in Transmission Gully a designated corridor. We have all the resource consents. And the way we’re trying to explore this with potential bidders is to talk about—it’s obvious where the road is going to go, but the more detailed design spec is something which we’re sort of taking a step back. We’re talking about reliability, about time of travel, and about safety. So we’re trying to do that in a specification in outcome terms. And that may end up being that the—you know, as we move through it, that the bidders are looking for more specification as that goes through, but we’re trying to work our way through that in a way that we can get more innovation out of this project than we might have tried elsewhere. And, to be honest, if that gives us a good result, then we might experiment with that in other places as well.

O’Connor So the contract will be result-driven as well, obviously. If they can’t deliver—

Dangerfield The whole thing here is to actually get a result-driven and a performance-driven contract, because the payments are tied to performance. It’s called an availability payment mechanism because you want the lanes to be available, and there are penalties that attach to it at all times if the lanes are not available. The other big bit, as I responded to Mr Twyford’s questions, is that, of course, you tie together the upfront capital expenditure with the ongoing operating expenditure for maintenance. So that changes the dynamic about how people think through the initial construction. Otherwise, they wear the cost for maintenance in, you know, 10 years’ time.

Genter Thank you, Chris and Geoff. I have some questions about Transmission Gully and the PPP as well, some related questions about post-implementation reviews and traffic growth, and a couple of questions about economic efficiency of the projects that are being built. So, with respect to the PPP, you mentioned that in other jurisdictions like Australia there’ve been a number of motorways built that have turned into financial
dangerfield That’s the same for every other road, yep.
genter So—
dangerfield No change.
genter So is it not the case that the economic benefits of the project are directly related to the demand for the project? The demand for us? The demand for—
dangerfield No, not entirely, because there are significant safety benefits. But you could relate the safety benefits to the level of traffic, which wouldn’t be unreasonable, but it’s a broader sweep than simply absolutely every little traffic number, yes.
genter But in the case of the PPPs in Australia, it was a failure of demand to reach the levels that had been previously forecast by the traffic modelling. Is it—
dangerfield Yes, they got very bullish about traffic, and the one that failed this week, the winning bidder’s traffic numbers were twice the Queensland Government’s numbers, yes.
genter I note that in the answers to the questions, we’ve got a graph showing that there’s been little to no increase in traffic volumes on State highways for the better part of a decade now, particularly in Wellington. There’s actually been no increase over a decade. That’s obviously not been reflected in the planning for the Wellington Northern Corridor RONS, where there’s been pretty typically ambitious—or not ambitious, higher than what’s been observed forecasts of what the traffic growth will be. Is it the case that the economic benefits of Transmission Gully and the Wellington RONS could be lower than what was forecast in the initial planning for them, if traffic volumes continue to stagnate?
dangerfield Well, if—and it’s a big “if”, and you know, you’ve got to look forward. But the word of caution here is that those graphs—the question that was asked—are nationwide VKT (vehicle kilometres travelled) numbers. Our traffic patterns are very concentrated. So we have in our State highway classification system a number of what we call high-volume strategic highways in and around Auckland, in and around Tauranga, up and down the coast to Wellington, and around Christchurch. It’s a very small proportion of the State highway network—around 6 percent—but it carries 36 percent of all State highway traffic. So—
genter So the Wellington Northern Corridor is not one of those areas, is that—
bennett Julie Anne, just let him finish.
dangerfield It is one of those areas. If you have a look at our State highway classification system, it is—
genter So what has the traffic growth been over the past decade?
Bennett  Julie Anne Genter, he is trying to answer the question. Just let him answer it, OK?

Genter  Is he answering? I’m not sure he is, actually. It seems to be taking all—

Bennett  Do you want to have another question or not?

Genter  Yes, please.

Bennett  Let him answer it.

Dangerfield  I’m trying to answer your question, because you asked me—you talked about growth on the networks as a whole. Absolutely, but the growth is not distributed evenly on the networks. That’s my point. The growth is very concentrated. You asked me a question: is the Wellington Northern Corridor one of the high-volume State highway corridors in the national classification system? The answer is yes. That is absolutely clear. Go and have a look at our national classification system.

Genter  And what’s the traffic growth on the Wellington Northern Corridor been over the past decade?

Dangerfield  I’m sorry, I can’t answer that off the top of my head.

Genter  OK. I note that the NZTA this year published a number of post-implementation reviews and a research report about summarising or accounting for the benefits of investment in transport. In a number of the recent ones it noted that State highway projects didn’t achieve the benefits that were forecast, because of two factors. One is lower than forecast traffic growth, and the other was an overestimation of the safety benefits. So the NZTA is committing us to 30 years of paying back a loan on Transmission Gully, wherein the total economic benefits rest on forecasts about traffic growth and forecasts about safety. If that doesn’t materialise, we’ll still be paying back from future land transport funds the loan on that.

Dangerfield  To be honest, the procurement method has nothing to do with the risk around whether projects deliver the expected benefits or not.

Genter  Right.

Dangerfield  That remains for every single project. We undertake post-implementation reviews. I’d like us to be able to do that better than we’ve done it in the past, and we’re reshaping quite a lot of work with that. We’ve said that in a number of answers to you on questions you’ve asked. There is a little bit of a systematic bias in the projects that we’ve put in the post-implementation reviews. We tend to put ones that we’re worried about, so one of the things we’d like is probably a better sampling, so that we get—it’s a bit biased towards the things where we know that we’ve got some issues. Does that lead me to a conclusion that there’s a systematic problem in here? I don’t think so. But all the time we’re wanting to make sure that we’re using the best data that we’ve got. Right now, yes, the numbers are a little flat but in the current economic times the judgment everybody has to make is whether we think we’re dealing with something that is cyclical or structural.
Are you aware of a letter that was written by 32 transport experts and academics in the UK to the Secretary of Transportation in the UK stating that the Department for Transport in the UK’s road traffic growth forecasts are called into question, there is little evidence for the boost to economic growth from investment in inter-urban motorways, and that evidence from the UK and around the world shows significant signs that road traffic growth is levelling off, even after accounting for lower than anticipated economic growth? Is that being factored into the NZTA’s assessments of the best use of money for transport projects?

Look, there is a whole lot of literature around that, and there is not a huge consensus. In the UK there are quite a lot of people writing that they think that demand is saturated—certainly per capita demand is saturated, and future demand comes from population growth. You don’t have to be that smart to work out that we’ve still got a lot of population growth - driven demand, especially in our major urban areas in New Zealand.

Is it not the case in New Zealand—

We are also trying to grapple with a completely inadequate capacity in a number of important areas, so we’re looking backwards to try and fix issues. I think when you try to compare that with the UK, the US, where they’ve had much more constant levels of investment over time compared with New Zealand’s investment over time, then I think you’ll start to see why we’ve got some different circumstances.

At what point might the Transport Agency begin to incorporate the trends that we’ve seen over the past 5 or 6 years into their forward planning for an economic evaluation of transport projects?

Again, what’s happening in economic evaluation of transport projects around the world is to keep on incorporating wider and wider economic benefits, and understand the contribution that transport makes to land use change and land use development and the induced effects of land use development. This is contentious because the methods of doing that are—well, they’re still being developed. In many respects, and we’re heading down this track too, it’s to move away from a narrowly conceived benefit-cost assessment into a wider economic assessment. In all of our material we have tried to play absolutely with a straight bat by saying “Here’s what the data tells us based on a relatively narrow assessment, and here’s what we think are the wider economic benefits.” We’ve given sensitivity around different values of money over time, and a whole lot of other things. We are in the midst of reviewing our economic evaluation manual, and we will continue to do that and bring in new techniques, to make sure that we’re as good as we can be.

Sorry, it was just a supplementary question directly on that point, Mr Dangerfield, with regard to, I guess, the 2012-15 intent as it pertains to economic development and the wider context of economic development as opposed to just sort of measuring volumes of vehicles across the roads.
You were sort of covering it off to some extent, but I would just actually like you to expand on that further in terms of the context and the importance of front-loading and getting ahead of the wave instead of waiting for the wave and then start paddling, if you get my drift, in terms of how the economic benefits—the broader economic benefits—of your approach to roading.

Dangerfield And, look, to be honest these are difficult things to do, because the flow with all of these sorts of projects, the costs are very apparent, they’re upfront. You can see what the cost of a new project might be over a 5-year period, but the benefits come over a 50-year period. It’s having the wisdom and foresight to understand what those benefits and dynamics look like and how you value those appropriately and how you bring those together. The economic studies in New Zealand tend to look at what are the wider economic benefits of highway development done by reputable economists—and Arthur Grimes is a good example of that. The wider benefits are considerable, and, if anything, there is an underestimation by our analysis, rather than an overestimation. So we should attribute more. But, look, this is still, as Miss Genter is pursuing, this is stuff that is unfolding all around the world about how you do this this effectively.

Calder You garnered great kudos for the creativity and innovation of your “ghost chips” campaign, which we’ve been through. You mentioned the programme improvement framework. Are there any particular innovative and creative ways that you are trying to increase your operating efficiency?

Dangerfield I think, as the chairman said in his opening remarks, the culture we are trying to build in the agency is to take a value-for-money approach in everything that we do. I want all people in the agency to have that as part of the framework about how they think about everything. We’ve got a number of business improvement projects under way this year, following on from last year, which are trying to get to the fundamentals of some of the processes we do to try to drive more value. A lot of our work is focused out with local authorities. Last year, in conjunction with local authorities, we did, for example, a task force on how we can collectively deliver the road maintenance and operations work ourselves and with them more efficiently, by better collaboration, by pooling contracts, by working longer term. We think there are potential gains for local government—potential gains of somewhere between 2 and 20 percent—

Calder Really?

Dangerfield —if we rethink through some of those procedures. We’re trying to take that sort of thinking into a whole lot of parts of our business. In the material that we do on State highway investment, we keep on trying to tune up our procurement methods to see whether we can get and extract better, and better, and better value for money.

Calder Is that a challenge?

Dangerfield To get better value for money?

Calder In terms of procurement, given the market in New Zealand.
Dangerfield Well, this is a very effective time to be in the market for construction projects, because there is capacity in the market, and then, as the chairman indicated, most of our projects we’ve been able to bring in below budget.

Genter I was wondering, because Chris mentioned that you are investing in public transport, once the electrification in Auckland is completed, what new infrastructure projects are planned for public transport in Auckland?

Dangerfield Well, the big challenge is to get the completion of the new rail carriages together, and then to optimise the track utilisation. Although it is not strictly a public transport issue, there is a wider issue about the capacity of the rail track to be able to deal with the freight task and the public transport task, and whether there is, in fact, what we call the third line that’s required through Auckland. Whether you want to call that a piece of public transport infrastructure or not, I don’t really know. The big issues are, of course, to continue to increase the capacity and efficiency of the bus fleet, which is still carrying the majority of transport. We’re working with Auckland Transport on the redesign of the bus networks and the services, because basically this is all about reoptimising our service offering to make that attractive. So if we do the upgrade on the rail, we’ve done the upgrade on the stations, and there is still a little bit of that to play out, there is still some more station work to be done, the redesign of the networks around the buses and the ticketing regime, we’ve got many of the elements that we’ve been looking for. There have been some things happening on the ferry services together. Then you come back to the question that Mr Twyford was coming towards of what happens in relation to the ability to optimise the throughput of Britomart and increase the service levels around that. That’s a question about the timing and management.

Genter So at this time there’s no new infrastructure for public transport planned once the electrification and rail station upgrades are finished?

Dangerfield No, because in some respects the infrastructure is not the question; the service levels become the question.

Genter It’s not the case that bus services can be vastly improved through the provision of dedicated infrastructure?

Dangerfield Well, dedicated infrastructure for bus services is largely about dedicated lanes on existing highways, and this is one of the things that sometimes—

Genter Like State Highway 16, for example, which is being upgraded. There’s no plan for dedicated bus infrastructure on that at this time?

Dangerfield We may, certainly on State Highway 20, but maybe potentially on the shoulders, be able to run buses on those, but to be honest the real gains are on the local networks and being able to—and this is not necessarily easy—but being able to run dedicated bus lanes on local networks is where you get most of the gains.

Twyford I know you’re both intimately familiar with the Basin Reserve flyover issue.

Moller Just to correct, I am not, because I have declared my conflict of interest and have had no participation since I became a board member.
Twyford  But you’re familiar with the issue, I presume.
Moller  I read the newspapers.
Auchinvole  Are you saying you’ve dropped out of cricket involvement?
Moller  No, I’m not saying that, Chris.
Twyford  I’ll direct my questions to Geoff, in that case. Geoff, after the Wellington City Council voted in December to relook at this issue, you wrote them a letter in which you said that you were confident the flyover was necessary, there was no reason to reopen the debate. You said: “We will also need to reconsider our support”—if the council goes ahead and relooks at the issue, that NZTA would—“for a range of other transport network projects within Wellington City”, including the public transport spine study. What is the logical connection between a debate over the Basin Reserve flyover and whether it should be a flyover or a tunnel or some other configuration, and an entire region-wide, long-term public transport study? Why would you threaten to pull those projects if Wellington City Council didn’t go along with your flyover?

Dangerfield  It’s not a threat, but the point is the spine study is not a region-wide public transport study. It’s actually a study of a spine between the railway station and Adelaide Road and the hospital. The linkage there is pretty apparent. The current State highway around the Basin Reserve is very congested, and the conception of the Basin Reserve improvements come out of what’s called the Ngauranga to airport study, which is about separating those two conflicting flows of traffic to allow both to work well. Notions of light rail or even other forms of public transport being able to come up Kent Terrace, move around the Basin Reserve, and head up Adelaide Road is about being able to separate those from the traffic that’s heading east-west and heading towards the airport. Those things are perfectly—

Twyford  So you’re suggesting that no other possible design solution for the Basin Reserve could be accommodated within the broad ambit of the spine study, is that you’re saying?

Dangerfield  No, no other service option. We’ve formed a view that an underground option is neither feasible nor affordable.

Twyford  Do you think it’s acceptable for an unelected public servant to make that judgment and threaten the democratically elected Wellington City Council?

Bennett  No, I think that question is out of order.

Twyford  Well, I’m asking it. I’d really like an answer. Is that an acceptable way for a public servant to behave?

Bennett  Phil, I’m ruling that question out.

Twyford  Maybe Mr Dangerfield would like to answer it.

Bennett  No, I’ve ruled it out.

Twyford  Well, I think it’s unacceptable.
Lees-Galloway I’d like to ask just a couple of questions around public transport funding. I’ll use the Capital Connection as an example, because it’s the one I know most intimately, but I don’t want to debate the merits of that particular one. The agency has expressed its reluctance to fund the Capital Connection under a similar model to the Tranz Metro trains. The sole reason that you’ve given is that it, in your opinion, does not provide congestion relief north of Waikanae. There have been no arguments about economic impact, no arguments about social impact on people who, say, are reliant on a wheelchair and can’t use a bus or a plane or any other form of transport. There has been no argument about environmental impacts, no arguments about road safety. Is congestion relief now the sole criterion by which you judge whether or not to invest in public transport?

Dangerfield It is the thing that we said we would place emphasis on, and it’s the issue that tends to drive the prioritisation of investment, which is relatively scarce. So just like every other thing that we do, we need to be able to say out of all of the things that you could spend NLTF public funds on, how do we prioritise? And in the public transport space, how do we prioritise investment? We’re putting an emphasis on congestion.

Less-Galloway So economic, social, environmental, and safety all come behind congestion relief, and, in fact, in the case of the Capital Connection, seem to have not been considered at all.

Dangerfield No, I didn’t say that. I said that that is the priority. If that was the only and sole proposition, then we wouldn’t invest in public transport in many of the very small provincial centres, because there is no congestion of any substance, and that is certainly not the case.

Lees-Galloway In a letter from Jenny Chetwynd to the Kāpiti Coast District Council she wrote: “It is important to remember that the source of the funds that NZTA uses to invest in public transport is the road user charges and fuel excise duties that both you and I and every road user pays when we use our vehicles on the roads. Any subsidies paid from this fund therefore need to attract significant wider transport system benefits for all road users who contribute to this fund (such as congestion relief) and represent good value for money for those contributors.” So does that mean that because pedestrians, cyclists, to a certain extent, bus users, aren’t directly paying into the fund that their needs are no longer considered by the NZTA, and you have to drive a car for your transport needs to be taken into consideration by the NZTA?

Dangerfield I think, probably, it pays to just back up a couple of steps here. The NZTA is a co-funder of the public portion of public transport, and every investment is made with local authorities. We share that public subsidy on, basically, a 50/50 basis. Ratepayers pay for half, and in the logic that is largely reflecting the benefits that they see to their communities. We’re paying half, and, as the logic that Jenny Chetwynd outlined in the letter that you just read, because that reflects the transport network benefits. It’s hard to draw an exact line down the middle and have the wisdom of Solomon to split this entirely in half, but that is the broad rationale. Users are paying, on
average, up and down the country, a little under half what it costs as well. So you’ve got to come back to understanding what is the basic public policy rationale for the investment of public funds in public transport. You’ve raised some important things about accessibility, environmental spillovers, and the like. I’m not saying that they’re not valid, but they get paid for out of some form of public funds. When it comes to the NLTF contribution, and given the statutory responsibilities we have and the objectives that we’re given, we’re saying that the priority we’re placing on the next investment in public transport is to look at where we get the best congestion relief, where do we get the broader network benefits. There are no broader network benefits in many cases—not to say they’re not valid, but you do have to ask about how they should be paid for and where does the public benefit versus the private benefit come in.

Bennett Members, we’ve run out of time now. Thank you very much, Geoff and Chris. We appreciate your time. Keep up that good work. We look forward to seeing you back here.

**conclusion of evidence**
The Local Government and Environment Committee has conducted the financial review of the 2011/12 performance and current operations of the New Zealand Walking Access Commission, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Eugenie Sage
Deputy Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Northland District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
Contents

Recommendation 2
Introduction 2
Financial and service performance 2
Blood glucose meters 3
Named Patient Pharmaceutical Assessment 3
Expanding role 4
Herceptin 4
Oxycontin 4
Trans-Pacific Partnership 4
Appendix 5
Pharmaceutical Management Agency

Recommendation

The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Pharmaceutical Management Agency, and recommends that the House take note of its report.

Introduction

The Pharmaceutical Management Agency (Pharmac) is a Crown entity as defined by the Crown Entities Act 2004, and is funded through Vote Health. Pharmac’s main responsibilities are managing the pharmaceutical schedule of subsidised medicines, promoting the responsible use of medicines, assessing and procuring pharmaceuticals on behalf of District Health Boards (DHBs), and managing the subsidised use of certain pharmaceuticals in particular clinical situations.

Financial and service performance

In 2011/12, the agency’s total revenue was $30.192 million, and its total expenditure was $17.724 million, resulting in a net surplus of $12.468 million. Pharmac’s public equity increased from $14.912 million to $27.380 million, which includes $15.202 million in the Discretionary Pharmaceutical Fund.

Pharmac manages the annual Combined Pharmaceutical Budget (CPB), which is agreed each year with DHBs, and set by the Minister of Health. In 2011/12, the total spend was on budget at $777.4 million; $766.1 million was spent on combined pharmaceuticals, including cancer medicines; and $11.3 million was transferred from DHBs to the discretionary fund.

The Office of the Auditor-General (OAG) rated Pharmac’s management control environment and financial information systems and controls as “very good”. Its service performance information and associated systems and controls were assessed as needing improvement. All these results were consistent with those of the previous financial year.

The OAG advised us that Pharmac needs to clarify and develop its impact measures, particularly for activities associated with medicine usage and population health programmes. The OAG also recommended that Pharmac improve the consistency of accountability documents, and include targets for at least the three-year period of the statement of intent. We expect to see Pharmac implement these recommendations.

Health sector savings

Since 2000, Pharmac estimates that it has saved DHBs a cumulative total of $6.941 billion, the difference between actual and estimated pharmaceutical expenditure. Pharmac’s data also shows a significant increase in estimated savings from 2011 to 2012, including for first time savings in pharmaceutical cancer treatments. Projected savings are also forecast for the next three years totalling nearly $8.6 billion, which will include vaccines. We recognise Pharmac is viewed internationally as a very successful model, and we congratulate the agency on their financial performance and the work they are doing to give New Zealanders affordable access to innovative, effective, safe pharmaceuticals.
**Discretionary Pharmaceutical Fund**

The Discretionary Pharmaceutical Fund (DPF) was introduced in 2010/11 as an additional source of equity to allow Pharmac flexibility in managing the CPB. In years when spending exceeds the CPB, Pharmac can supplement funding from the DPF, and if spending is lower than expected Pharmac can request funds from DHBs to top up the DPF for future years. The DPF was not used in 2011/12 as the CPB was under-spent, whereas in 2010/11 $6.116 million of the DPF was used.

**Blood glucose meters**

In August 2012 Pharmac announced changes to the funding of blood glucose meters and the associated test strips. In March 2013 three types of blood glucose meters and two types of test strips, all from the one supplier, will be subsidised for patients who are insulin-dependent or take certain other medications, rather than the six that are currently subsidised. Pharmac estimates that approximately 120,000 people in New Zealand currently use a blood glucose meter, with 80,000 qualifying for a subsidised meter.

We were disappointed that Pharmac did not mention the blood glucose meter changes in its annual report, considering that there was strong opposition to the change, and the issue was discussed frequently in the media. The agency told us that it did not consider the meter change relevant to the 2011/12 report as it takes effect in 2013, and will be covered in the 2012/13 report. We will monitor this coverage with interest.

The agency assured us that by the end of March 2013 there will be 222,000 meters in the market, which is more than enough to provide a funded meter to every person currently eligible. To ensure a smooth transition, Pharmac and the supplier are providing information and training about the meters for doctors, practice nurses, diabetes centres, and pharmacists. The supplier is also visiting all pharmacies and general practices to provide additional information and training, and an online educational module has been developed. Pharmac is also funding its own educational measures including a website, call centre, and multi-language brochures. We were pleased to hear that Pharmac is meeting with diabetes patient support groups to review their public consultation process.

We asked the agency what benefits they expected from the change. Pharmac said the expected $10 million in savings will be used for general pharmaceutical spending and investments in new medicines and technologies. Pharmac said they always seek value for money to allow reinvestment in health, and also to ensure proper competition in the marketplace. We recognise that New Zealand is encountering a diabetes epidemic, and Pharmac is anticipating an increase in spending on meters and test strips, so the expected volume growth will be funded from savings created now.

**Named Patient Pharmaceutical Assessment**

In March 2012 a Named Patient Pharmaceutical Assessment (NPPA) policy, based on individual need, replaced the three former Exceptional Circumstances (EC) schemes, which catered only for patients with rare disorders. The NPPA allows patients to apply for unfunded drugs which are not on the pharmaceutical schedule. We were told that the rationale for the change is to allow more responsiveness and flexibility regarding patients’ needs, and to allow individual health cases to be heard. We are aware that people who have been denied funding under the NPPA or EC have travelled overseas for treatment at their own expense.
In 2010/11 Pharmac forecast annual expenditure of $8 million for the NPPA, a $3-million increase on the previous year. Between March and June Pharmac received 367 NPPA applications, compared with 343 for the EC for the same period in the previous financial year. We note that the ratio of approvals was higher under the NPPA at 94 percent.

**Expanding role**

We are aware that Pharmac’s role is expanding considerably in three areas: responsibility for all medicines used in DHB hospitals; funding and assessment of vaccines and management of the national immunisation schedule; and the national management of medical devices. We will monitor its performance in these areas with interest.

We are aware that skills in economic assessment and commercial procurement in the medical field are in short supply in New Zealand, and asked what Pharmac is planning to do to recruit and retain the specialised staff it will need for the significant expansion of its role. We heard that Pharmac has had much interest in these roles, and is engaging with relevant agencies to secure the appropriate expertise.

**Herceptin**

Herceptin is a treatment for HER-2-positive early breast cancer. It is the subject of the international herceptin synergism or long duration (SOLD) trial, which is examining whether nine weeks or 12 months of treatment produces the best results. We understand that in 2007 Pharmac committed $3.2 million of funding over at least 10 years to trial costs; Pharmac is aware of 88 New Zealand women involved in the trial. We asked whether it was unethical to prescribe herceptin for nine weeks when new data shows that 12 months of treatment is the appropriate standard of care. Pharmac replied that at this stage they are still committed to the SOLD trial, and that the data will be considered by the cancer advisory group.

**Oxycontin**

We are aware that oxycontin, a highly addictive drug used to treat acute pain, has been widely abused, and asked the agency what they were doing to educate health professionals on appropriate prescribing. Pharmac told us that oxycontin is more potent than morphine, and is intended for use when a patient is allergic to morphine or when morphine fails. We were told that use of the drug had been growing at a steady rate but has now slowed thanks to education programmes in some district health boards on appropriate prescription and access to the drug. The programme will eventually be rolled out to all DHBs.

**Trans-Pacific Partnership**

We asked Pharmac whether the Trans-Pacific Partnership free trade agreement currently being negotiated by the Government could undermine their role in negotiating with pharmaceutical companies and keeping prices affordable for New Zealanders. Pharmac assured us that the agreement will not affect their ability to deliver high-quality affordable medicines to New Zealanders.
Appendix

Approach to this financial review

We met on 12 December 2012 and 30 January 2013 to consider the financial review of the Pharmaceutical Management Agency. We heard evidence from the Pharmaceutical Management Agency and received advice from the Office of the Auditor-General.

Committee members

Dr Paul Hutchison (Chairperson)
Shane Ardern
Dr Jackie Blue
Dr Cam Calder
Kevin Hague
Iain Lees-Galloway
Andrew Little
Barbara Stewart
Hon Maryan Street
Dr Jian Yang

Evidence and advice received


Pharmaceutical Management Agency, responses to committee questions, received on 10 December 2012.

Pharmaceutical Management Agency, responses to additional committee questions, received on 22 January 2013.


Organisation briefing paper, prepared by committee staff, dated 7 November 2012.
2011/12 financial review of the Privacy Commissioner

Report of the Justice and Electoral Committee

Contents

Recommendation 2
Introduction 2
The privacy environment 2
Funding and workload 2
Privacy law reforms 4
Data breaches 4
Privacy Commissioner’s powers 5
Use of recorded telephone calls 5
Appendix 6
Privacy Commissioner

**Recommendation**

The Justice and Electoral Committee has conducted the financial review of the 2011/12 performance and current operations of the Privacy Commissioner and recommends that the House take note of its report.

**Introduction**

The Privacy Commissioner is an independent Crown entity established under the Privacy Act 1993. The commissioner has wide-ranging functions to develop and promote a culture in which personal information is protected and respected. The current Privacy Commissioner is Marie Shroff, and she is supported in carrying out her functions by an office established for this purpose.

**Financial and service performance management**

In 2011/12 the total revenue of the commissioner was $3.595 million and total expenditure was $3.467 million, resulting in a net operating surplus of $0.128 million. The surplus largely reflects the timing of additional funding of $100,000 to manage the increased workload resulting from the implementation of credit reporting. In 2010/11 the office broke even.

The Office of the Auditor-General gave the Office of the Privacy Commissioner “good” ratings for its management control environment and financial information systems and controls. The office received a “needs improvement” rating for its service performance information and associated systems and controls. This rating is the same as the previous year, and the Auditor-General told us the Privacy Commissioner will need to make improvements to ensure an unmodified opinion on service performance can be issued for the 2012/13 financial year. We will report on this next year.

**The privacy environment**

The commissioner highlighted the news stories about privacy breaches which have been breaking almost daily, and said we are in a revolutionary environment where information technology is transforming the way we do business and live our lives, with unknown implications. She likened the environment to a global ecosystem that is multiplying and mutating before our eyes. As the regulator in the privacy field, she said it is an exciting time, but one that also puts pressure on the office. We will follow the privacy environment closely, and in particular the implications for the Privacy Commissioner.

**Funding and workload**

The commissioner told us her office is very busy, and is concentrating on making the best of limited resources. Static baseline funding over the last eight years has not kept pace with the commissioner’s increasing workload. This has meant tough prioritising, finding creative solutions, and looking for appropriate sponsorship.

We asked how much additional funding would be needed to meet the increasing demand. Without naming a figure, the commissioner said she would welcome more resources and a
review of the support received, which might include comparisons with the funding other regulators receive. She recognises that the redress provided by the commissioner needs to be visible for people to feel confidence in the regulatory system. We acknowledge the need for funding appropriate to the commissioner’s workload.

In terms of the trade-offs being made, the commissioner said she tries to manage risk by channelling resources selectively. However, she recognises that the continually increasing workload may reduce the ability to investigate some of the less serious complaints received. We are concerned about this and will continue to closely monitor the commissioner’s service performance measures.

The commissioner highlighted the economic dimension of privacy matters, commenting that if people do not trust the protection afforded their information when they are engaged in internet commerce, this may hamper economic development.

**Enquiries and complaints**

The commissioner told us that the office has nearly reached its limit in terms of productivity. Individual enquiries increased by 21 per cent in 2011/12. The commissioner received 1,142 complaints in 2011/12, an increase of 18 percent on the year before, and up 42 percent on 2008/09, and 2011/12 was a near record year for media enquiries with 295 received (topped only by 323 in 2009/10). An ACC privacy breach alone accounted for around 70 media enquiries. Complainants’ and respondents’ satisfaction with the complaints process was recorded at 76 per cent in 2011/12, slightly lower than the 77.5 percent the previous year and 80 percent in 2009/10. We heard that the office had exceeded its timeliness target in 2011/12, completing 95 percent of its complaint investigations within nine months.

The commissioner said she would find out how many complaints are received on cyber-bullying issues. In the first instance, however, people with queries about such bullying are usually advised to talk to the non-profit cyber-safety organisation NetSafe. We were pleased to hear that the commissioner is working with NetSafe to develop teaching material about the digital environment for primary schools.

**Information technology privacy work**

Cloud computing is a focus of the commissioner’s work relating to computer privacy issues. Working with the Institute of Information Technology Professionals, the office has created privacy guidelines, which are available on the commissioner’s website, for small and medium-sized businesses using cloud computing services. We heard that Microsoft is going to promote the guidelines to clients who are considering cloud computing.

**International work**

The commissioner considers overseas cooperation essential in relation to privacy matters, as data knows no borders. However, stretched resources mean that the office has had to reduce its international engagement. The commissioner recognises that her office is probably lagging somewhat behind what comparable regulators overseas are doing in areas like the protection of children’s privacy. We were concerned to learn this.

We heard that protecting data and giving individuals more control over their data is proving to be a global issue. In respect of trade, the European Union has now recognised that New Zealand’s privacy law offers an adequate standard of data protection, which
presents big opportunities for this country. We commend the commissioner on her efforts to achieve this standard.

**Privacy law reforms**

The Privacy Amendment Act 2013, passed on 26 February 2013, provides for information sharing agreements within the public sector and between the public and private sectors. This is one part of the Law Commission’s recommendations for privacy law change. The Privacy Commissioner said she is looking forward to more of the Law Commission’s recommendations being implemented, to assist her in carrying out her functions more effectively. We are very interested in seeing further privacy law developments.

**Government data hub**

We asked the commissioner about her involvement in the government data hub initiative, whereby information held by government agencies would be pooled. We heard that the Treasury had invited the commissioner to be an observer on a working party on the hub. As an independent Crown entity, the Privacy Commissioner needs to work independently and prefers observer to participant status, as it allows her to maintain her independence.

**Data breaches**

An ACC (Accident Compensation Corporation) data breach in March 2012, involving more than 6,500 clients, was a significant instance of the recent breaching of state-sector data security. We asked the commissioner how many of the data breaches are due to malicious hacking and were told that this information is not collected by her office.

The commissioner told us that while data breaches are nothing new, media and public interest has become more intense. She sees this as positive because it means people are paying more attention to privacy issues. Although her office monitors individual data breaches, the commissioner has chosen to apply the commission’s limited resources to pursuing systems solutions to data breaches, rather than fixing immediate problems without addressing underlying issues.

Participating in government working groups enables the office to contribute to help get systems right at the start. We heard that the commissioner has been asked to participate in around 12 working groups, which is challenging given resource constraints. We appreciate that the commissioner’s input is valuable and would want to be assured that sufficient resources are available.

We questioned the Privacy Commissioner about the privacy breaches at EQC (the Earthquake Commission). We heard that while there will always be human error, errors are more likely in organisations without a culture of privacy. People in an organisation need to be taught to handle information properly. Organisations need leadership, good management, and systems and technology to protect citizens’ and customer’s data and maintain their trust. The Privacy Commissioner is working with the private and public sectors, particularly the Government Chief Information Officer and the State Services Commission, to develop good privacy practices. We recognise the importance of this work in helping prevent data breaches.

**Spending on ACC data breach investigation**

We asked whether the commissioner contributed financially to the ACC investigation. We were told that the commissioner spent between $6,000 and $8,000 on the forensic analysis
We asked the commissioner whether she considers her legislative powers to be adequate. She explained that while she can inquire into things, she lacks enforcement powers. In her view the existing power to inquire into and publicly expose businesses or government agencies with poor standards of data protection could also be more clearly mandated. She said that the Law Commission’s proposed privacy law changes would give her more powers, allowing her for example to issue enforcement notices if someone is not looking after their data properly. Compulsory data breach notifications would also help to set a privacy standard.

We heard that while the commissioner’s existing powers work quite well in the public sector, she has limited ability to persuade private-sector agencies to participate in inquiries.

**Use of recorded telephone calls**

We asked about the use of telephone calls recorded for training or quality control purposes and were told that the purpose for which information is collected must be at the heart of all subsequent handling of it. To use it for any other purpose would almost certainly put an agency at risk of a privacy breach. We were pleased to have this clarification.
Appendix

Approach to this financial review
We met on 11 April and 6 May 2013 to consider the financial review of the Privacy Commissioner. We heard evidence from the Privacy Commissioner and received advice from the Office of the Auditor-General.

Committee members
Scott Simpson (Chair)
Dr Jackie Blue
Hon Lianne Dalziel
Julie Anne Genter
Andrew Little
Alfred Ngaro
Denis O’Rourke
Katrina Shanks
Hon Kate Wilkinson

Jan Logie replaced Julie Anne Genter for this item of business.

Evidence and advice received
Office of the Auditor-General, Briefing on the Privacy Commissioner, dated 11 April 2013.
Organisation briefing paper, prepared by committee staff, dated 11 April 2013.
Privacy Commissioner, responses to committee questions, dated 11 April 2013.
2011/12 financial review of the Reserve Bank of New Zealand

Report of the Finance and Expenditure Committee

Contents

Recommendation 2
Introduction 2
Financial performance 2
Insurance supervision 3
Current account deficit 3
Quantitative easing and the exchange rate 4
Fiscal and monetary policy interaction 5
The manufacturing sector 5
Housing affordability 5
Crown retail deposit guarantee scheme 6

Appendices
A Committee procedure 7
B Corrected transcript 8
Reserve Bank of New Zealand

Recommendation

The Finance and Expenditure Committee has conducted the financial review of the 2011/12 performance and current operations of the Reserve Bank of New Zealand, and recommends that the House take note of its report.

Introduction

The Reserve Bank’s purpose is to formulate and implement monetary policy designed to promote price stability and a sound and efficient financial system. Its main priorities over the past year have been assessing the impact of the Canterbury earthquakes and the implications for monetary policy; implementing lessons from the global financial crisis to encourage banks, non-bank deposit takers, and insurance companies to manage their risks carefully; developing its approach to managing foreign reserves; and planning for a major upgrade of New Zealand banknotes. It has also increased its oversight of the payments system, and strengthened surveillance against money laundering.

Policy Targets Agreement

A new policy targets agreement was signed with the Minister of Finance in September 2012 when Graeme Wheeler took up his appointment as the new Governor of the Reserve Bank, replacing Dr Alan Bollard. The agreement sets the parameters within which the Reserve Bank formulates and implements monetary policy.

The new agreement remains focused on maintaining price stability. It continues to require the bank to keep Consumers Price Index inflation between 1 percent and 3 percent on average in the medium term. However, within this target range, the bank is now required to focus on keeping average inflation near 2 percent, with the aim of helping to anchor inflation expectations.

The agreement also gives more emphasis to financial stability, including asset prices among the indicators the Reserve Bank monitors, and requiring the bank to have regard to the soundness and efficiency of the financial system in setting monetary policy.

Financial performance

The Reserve Bank’s operating expenses are financed under a five-year agreement with the Minister of Finance. The current funding agreement specified net expenditure of $50.2 million for 2011/12. Actual net expenses under the agreement were well below this, at $47 million, an increase of just $200,000 over the previous year. We commend the Reserve Bank on this result.

In addition to receiving Government funding for its operations, the Reserve Bank earns income by investing the pool of funds from its equity and currency issued to the public. Its profits are volatile because they are affected by interest rate changes, and because it has a policy of holding unhedged foreign exchange reserves to allow it to intervene if necessary to support the New Zealand dollar. The high exchange rate at the end of the year resulted in a loss on its holdings of unhedged foreign exchange, but it nevertheless made a net
profit of $118 million in 2011/12, on net interest income of $280 million. It paid a
dividend of $160 million to the Government for the year. We note that the size of the
dividend is not directly related to net profit, as it depends on when revaluation gains and
losses are realised.

It is commendable that the Office of the Auditor-General has assessed the Reserve Bank’s
management control environment and its financial information systems and controls as
“very good”, recommending no improvements.

Insurance supervision

The Reserve Bank now has responsibility for prudential supervision of the insurance
industry under the Insurance (Prudential Supervision) Act 2010, and has worked with
insurers to meet the provisional requirements for licensing by March 2012. All insurers
have done so, with over 100 licenses issued; the bank is now working with them to
complete full licensing by September 2013.

The legislative changes made in 2010 were designed to close a gap in prudential
requirements that resulted in AMI Insurance being unable to meet its obligations after the
Canterbury earthquakes, and taxpayers having to step in to guarantee its solvency. We
asked the Reserve Bank whether it is satisfied that the new prudential standards, and its
new supervisory role, are sufficient to keep New Zealand’s insurance companies on a
robust footing so that such a situation does not arise again.

The Reserve Bank commented—and we agree—that you can never provide for every
eventuality to eliminate risk entirely. Nevertheless, it is satisfied that the new standards for
full licensing are sufficient, and probably on the conservative side. The new requirement
for disaster insurance is that companies must carry enough capital and reinsurance to cover
a one-in-1,000-year event. We understand that Australia has a much lower requirement, of
one in 250 years, which it is reducing to one in 200 years. Several insurers are building their
buffers to meet New Zealand’s new standard. The bank has increased its staffing for the
new supervisory role, hiring 15 staff, including three actuaries.

The Reserve Bank notes that AMI was not regulated at the time of the earthquakes, so the
bank did not perform any detailed prudential investigation. However, based on the
information provided by AMI, its capital and catastrophe reinsurance would probably have
been sufficient to meet the new standards. We were told that AMI’s difficulty was related
mainly to the high concentration of its risk in Christchurch, and to its lack of backing from
a parent company. The Reserve Bank added that it is normal for companies to specialise in
particular industries, but actuaries normally look for geographic diversification of risk.

Current account deficit

In our recent financial review of the Government’s financial statements for 2011/12, the
Minister of Finance told us he did not fully agree with projections by the Reserve Bank, the
Treasury, and the IMF which see New Zealand’s external deficit continuing to deteriorate
over the next few years, saying he is more optimistic that the situation is changing. We
asked the Reserve Bank to comment on its analysis and the advice it has been providing
about the current account deficit.

The Reserve Bank told us its forecasts are based on its best assessment of the information
available at the time, and the most recent, published in September, projected some
deterioration in the current account associated with an increase in investment. The
governor agreed that New Zealand has a substantial current account deficit—probably the third-worst in the OECD, after Greece and Turkey. However, he declined to comment on the bank’s current outlook for the external deficit, saying it would be more appropriate to discuss the forecasts to be released on 6 December in the December monetary policy statement.

The governor set out the factors the bank considers in its forecasts and modelling. New Zealand’s current account deficit over the past several decades arises because its savings have been consistently low relative to the investment needs of the economy, requiring it to draw on foreign savings to finance domestic consumption and investment. Therefore, the bank assesses whether households, businesses, and the Government are saving or dissaving, investment by the Government and businesses, and residential investment, especially the planned $30 billion of investment for the rebuilding of Christchurch. It also looks at indicators of the economy’s competitiveness, the most important of which is the real exchange rate.

As to whether financial markets would allow New Zealand to continue running large current account deficits, the governor said conditions have changed dramatically since 2008. In the period from 2002 to 2007 global growth was the strongest for 40 years and high deficits were the norm; investors were prepared to expose themselves to high risk in return for high interest rates. They are now much more cautious about the credit risk of individual countries, and balance exposure carefully against potential yield.

Quantitative easing and the exchange rate

We remain interested in the way Switzerland’s central bank has used quantitative easing—increasing the supply of money—to purchase foreign exchange as a means of lowering the value of its currency. The approach appears to have been effective in pegging the Swiss franc’s value relative to the euro, but concern has been voiced by the Reserve Bank and others about the potential losses such measures entail. We asked the Reserve Bank to explain this concern by outlining the accounting treatment of quantitative easing measures. Some of us consider that the potential loss is minor relative to the resultant value effectively created out of nothing, and the benefits from avoiding an over-valued currency.

The Reserve Bank said that standard financial accounting would apply to quantitative easing, evaluating it under two aspects: the effect on a central bank’s balance sheet, and the effect on its profit and loss. In terms of the first aspect, a central bank’s balance sheet would expand by the amount of money created; the amount would be recorded as both an asset on the central bank’s balance sheet and as a liability, owed either to commercial banks or to the Government. Such an expansion of the balance sheet would raise the risk of higher inflation: as more dollars were put into the banking system, banks would compete to lend it out. Monetary policy would become less effective, as money market rates would fall below the level of the OCR. The price formation mechanism in securities markets would be distorted, and the value of all the money in circulation would effectively be reduced.

The Reserve Bank considers the second accounting aspect of quantitative easing—its impact on a central bank’s profit and loss—to be even more important, as it would eventually feed through to the Government’s accounts and operating balance. In the bank’s view, it would be unrealistic to assume that funds created through quantitative easing would be left unused, generating no profit or loss. If used to purchase foreign exchange
More broadly, the governor said the price to be paid for quantitative easing is the difficulty of returning to normal monetary conditions afterwards, and the inflationary risks inherent in doing so. The Federal Reserve, he noted, has been deeply worried for some years about how the USA will manage this transition. The challenge for a central bank is how to reabsorb the massive amount of liquidity that has been injected into the economy without incurring rapid rises in interest rates and inflation, reducing potential economic growth. The fact that countries have been willing to take on such risks by using quantitative easing is a sign of their desperation, having reduced interest rates to zero but finding this still insufficient to restore health to their financial systems.

The governor added that the scale of recent quantitative easing is extraordinary, and unprecedented in the post-war period. Central banks would not normally print money to finance a government’s fiscal position, yet the central banks of England, Europe, Japan, and the USA have expanded their balance sheets to the point where their assets now represent about 20 percent of GDP. Inevitably, he said, such massive financial support for domestic economies has had huge spill-over effects for other countries in the form of currency appreciation, as New Zealand has found.

**Fiscal and monetary policy interaction**

We asked about the role of the Government’s fiscal policy in the Reserve Bank’s formulation of monetary policy during the year under review. The governor replied in broad terms, noting that a central bank’s job is made easier to the extent that a government improves its fiscal position and moves toward surplus; monetary policy can then be more supportive in terms of providing stimulus to the economy. Moving a fiscal position toward balance or surplus would also help the central bank as it would improve the current account deficit over time, and reduce the accumulation of foreign liabilities. Conversely, the governor noted, a large fiscal deficit could require a central bank to push harder against such stimulus in its monetary policy, essentially requiring higher interest rates.

**The manufacturing sector**

We heard that current manufacturing output is about 9 percent below that in 2007, before the financial crisis, the main decline being on the domestic side as a result of considerably lower investment, particularly in the residential sector. Manufacturing exports have fared better, growing at about 3 percent a year on average over the past three years, despite the headwind of the high exchange rate. We asked the Reserve Bank to break down that figure, as it would appear that much of the growth in exports has come from primary-sector manufacturing, with other manufacturing exports struggling against the high dollar.

The Reserve Bank commented that the manufacturing sector in many countries has tended to decline as a share of total output and employment, regardless of the exchange rate, simply because of worldwide trends of increased productivity and globalisation. It considers any continuing decline in a sector to be a matter for concern, but believes Canterbury’s reconstruction will provide a major boost to manufacturing for several years.

**Housing affordability**

The Reserve Bank told us it largely agrees with the Productivity Commission’s March 2012 report on factors affecting the affordability of housing, particularly on the supply side,
which it sees as especially relevant in Auckland at present.\(^1\) Factors include the availability of land, the cost of development and infrastructure for new subdivisions, and the time-consuming and expensive consents process. The bank sees the cost of materials and labour for building as particularly unsatisfactory, being about 25 percent higher than those in Australia.

**Crown retail deposit guarantee scheme**

We recall that the Auditor-General’s report in September 2011 about the Crown retail deposit guarantee scheme indicated failings in the Treasury’s monitoring of the scheme, partly because it did not seek forecasts and information from the Reserve Bank about the growth in deposits with finance companies and the developing risk to the Crown and taxpayers from the companies’ risky lending practices. We asked what advice the Reserve Bank had given the Treasury or the Minister of Finance when the scheme was implemented in 2008 or subsequently, and whether it is confident that it now has processes to avert such risks in any similar situation.

The Reserve Bank told us it worked closely with the Treasury on the design of the scheme, and eventually supported the scheme as adopted. It had not had any subsequent discussions with the Minister or the Treasury, but would certainly do so to incorporate the lessons learned in any such future arrangement. It said that experience underscored the importance of charging risk-based fees for any such guarantee, to avoid a situation where relatively risky institutions could under-charge, and expand, thanks to the guarantee.

Appendix A

Approach to this financial review

We met on 28 November and 12 December 2012 to consider the financial review of the Reserve Bank of New Zealand. We heard evidence from the Reserve Bank of New Zealand, and received advice from the Office of the Auditor-General.

Committee members

Todd McClay (Chairperson)
Maggie Barry
David Bennett
Dr David Clark
Hon Clayton Cosgrove
Paul Goldsmith
John Hayes
Dr Russel Norman
Hon David Parker
Rt Hon Winston Peters
Hon Dr Nick Smith

Evidence and advice received

Office of the Auditor-General, Briefing on Reserve Bank of New Zealand, dated 28 November 2012.

Organisation briefing paper, prepared by committee staff, dated 28 November 2012.

Reserve Bank of New Zealand, responses to written questions, received 11 December 2012.
Good morning, governor, welcome back to the committee. Can I say it’s good to see you again so soon after our last visit, and I note that you will be back with the committee on 6 December for the Monetary Policy Statement, so we’ve certainly had our fair share since you were appointed governor.

We have before us today the financial review of the Reserve Bank and so I invite you to make any comments you choose to do so and then my colleagues I am sure will have questions.

Thank you very much Mr Chairman, we are happy to be back and to serve the committee: just some opening comments for 3 or 4 minutes.

The activities of the Reserve Bank over the financial year reflect significant challenges posed by the global financial crisis, the European sovereign debt crisis, and the Christchurch earthquakes.

The bank has taken on additional responsibilities including registration of about 60 non-bank deposit takers. We’ve taken on licensing and prudential supervision of what will turn out to be over 100 insurance companies. We’ve taken on greater oversight of the payment system, and introduced a supervisory regime for anti-money-laundering. Our decisions on monetary policy are reported through the regular OCR announcements, and the
quarterly Monetary Policy Statements, and every 6 months we provide a comprehensive report on financial stability.

During the year the main priorities were to assess the impact of the Canterbury earthquakes and its implications for monetary policy, the developing implementation framework for macro-prudential tools to help address systemic risks relating to financial stability, insurance licensing, developing a plan for Basel III prudential requirements, developing a benchmark framework for our foreign reserve management, and undertaking planning to upgrade our banknotes and continually investing in building the cross-functional skills of bank colleagues.

During the year the Reserve Bank board met nine times. Financially the bank made a profit of $118 million, which includes realised and unrealised gains. This was down from $144 million the previous year due to lower net interest income. We paid a dividend of $160 million to the Crown for the June year. The 5-year funding agreement for the bank, which began in 2010, specified a budget net expenditure of just over $50 million for the year. Our net operating expenditure came out at $47 million, just $200,000 higher than the previous year.

As I said at the beginning, chair, we are happy to be here, and will be pleased to answer questions, but I do note that we are appearing before the committee on Thursday 6 December when we release our Monetary Policy Statement, and perhaps questions on the economic situation outlook and policy settings could best be covered then.

With me on my right I have Grant Spencer who is the deputy governor, and on my left is Mike Wolyncewicz, who is the head of the financial services department, so thanks very much.

Smith My first question is in respect of the new role the Reserve Bank has with the 2010 legislation to monitor the solvency of our insurance companies. I think all members of Parliament have been very disappointed to see that the taxpayer has had to step in in respect of the AMI Insurance company in Christchurch, and effectively that insurance company was taking premiums for providing earthquake insurance without the proper risk management and solvency to be able to meet its obligations in the event of, certainly a large earthquake, but not an unpredictable earthquake, given New Zealand’s level of risk. We’ve recently found out that the level of exposure for our taxpayer has almost doubled.

My question for you is: are you satisfied with the 2010 legislative changes that the Government made, and the new functions that you are now implementing, that we have our insurance companies now onto the proper robust footing where we can be reassured that the gap that was clearly identified though the Christchurch earthquake and AMI is now covered off?

Wheeler Well, let me make just some initial comments and hand over to Grant. You’re right, there certainly was a gap, and the legislation has been
extremely important. The bank has seriously stepped up its activity in this area. We've got 15 colleagues that we've hired, a number from the private sector in New Zealand, but some from overseas, including three actuaries, so we've staffed up very significantly over recent months. We've done the provisional licensing. We need to get on and complete by the end of June the full licensing and part of that will involve tests about fit and proper standing for directors etc. But it's a big gap and we're putting a lot of effort into it. But let me hand over to Grant on that.

Spencer Yes, so we're aiming for full licensing by September next year, and we're satisfied that the standards that we've set are strong enough and in fact are probably on the conservative side—we'd had quite a bit of push-back from a number of the companies during the consultation, but for disaster insurance we're talking about a one-in-a-1,000-year standard. You have to carry enough capital and re-insurance to cover a one-in-a-1,000-year event. Some companies were at that level, a number have been below and will have to build up their buffers to meet that new standard. We've given them a few years to do that. But we're happy that those standards will be sufficient. You can never be sure you're going to cover every event—

Smith There's no such thing as zero risk.

Spencer Exactly. But I would just say that in the context of AMI it is not necessarily the case, and in fact it was not the view of the Reserve Bank’s insurance analysts and actuaries that AMI was under-capitalised, under-reinsured. AMI was in a situation where it had a concentration of its business in Christchurch. It had no parental support, but it did have capital, it did have re-insurance up to a normal acceptable standard in the industry. So, you know, there'll be debate around that, but from our point of view—

Smith Sure, but don't we need some reassurance that the new regime—your last comment makes me a bit nervous, because it almost suggest that well, the exact scenario we saw with AMI could repeat. You point out that AMI was heavily exposed to the Christchurch market, but to me it would seem if that is the case, then an insurance company needs, in your prudential checks, to ensure that it is not excessively exposed to a single area in which it does not have the capability to meet its liability. If we look in terms of New Zealand's earthquake history, the Christchurch scenario was certainly probably a one-in-50 or a one-in-100-year event. But actually you don't take out insurance for things that don't occur; you take them out for managing those risks. So can you reassure me that if you'd covered your prudential tests that you are now going to have implemented by September next year that an excessive exposure that AMI had, for instance, of the Christchurch market would be flushed out and taxpayers would not be again exposed?

Spencer The AMI was meeting standards that were acceptable in the market that were “market norm”, shall we say, at the time. I would say in light of the Christchurch experience the standards we’re setting now in terms of the capital and re-insurance you now need to hold against a one-in-a-1,000-year event is greater, because the cost of Christchurch was greater than all the sort of actuarial records had indicated. So it is the case that now the
standards are being lifted in light of the Christchurch experience. What I’m saying is that at the time of the earthquake the capitalisation and solvency of AMI was not out of line with acceptable standards at that time.

Bennett So just following on from Nick’s question, if you’re looking at industry type rather than location type, would you have the same issue? Like if you had an insurance company that was dominating one industry or one profession, would they be in a similar problem if something happened in that industry?

Spencer Well, I think the actuaries talk mainly around geographic diversification, so if there was a major quake their risks are spread in that respect. Companies do specialise in certain industries and I think that’s a normal part of the business. Some companies, for example, are more specialised in commercial than residential.

Smith Can I just question—it’s a very specific one but it’s a very important question, and that is: if AMI fronted up to the Reserve Bank with its old regime of the risk profile from its actuaries and the like, would it meet the equity and security requirements that the Reserve Bank has now put in place from the 2010 Act? Would you give it a tick if I fronted up with an insurance company with the same characteristics on which AMI failed its insurance obligations, would it make it through the regulatory regime that you’re administering?

Spencer I think it would have required—I’d have to get back to you with specifics on that, but my expectation is that given that we’ve lifted the standard that AMI in line with most of the other companies do have to put a bit more aside now to meet the new standards.

Smith Thank you.

Cosgrove I wanted to ask you about the bank’s forecasting and modelling. Correct me if I’m wrong. You had forecast a substantial deterioration in New Zealand’s current account deficit—correct?

Spencer This is getting in the direction—we have a current forecast now in the context of our Monetary Policy Statement next week, but we have—

Cosgrove I’m not asking about what’s going forward, I’m asking about what you’ve already stated so it’s—

Spencer In our last forecast, that’s correct, we have forecast some deterioration in the current account associated with the pick-up in economic activity that we’re projecting, in particular the increase in investment.

Cosgrove And it is correct that we are No. 2 in the world in terms of the negative state of our current account and forecast to be the worst in the world in OECD terms next year?

Wheeler I think if you look at the numbers, in terms of OECD we’re third. I think Greece is the worst, then Turkey. South Africa is outside the OECD, of course.

Cosgrove We’re forecast to be No. 1 next year by OECD standards—correct?

Wheeler Well, let’s deal with that next week.
Cosgrove: No, no, I'm not asking about next week, I'm asking about what the OECD's already stated.

Wheeler: I'd have to check the OECD economic outlook, the last one that they've released. But when I look at the most recent numbers that I've seen, in essence Greece and Turkey have a more serious current account deficit than New Zealand.

Cosgrove: So again, looking at current forecasting, not future forecasting, it is correct to say that your forecasts line up with the IMF and with Treasury. The three agencies all forecast a deterioration of the current account deficit?

Wheeler: Are you talking about the previous forecasts?

Cosgrove: Correct.

Wheeler: They did show—I can't recall the exact numbers of the IMF, and again as I say I haven't looked at the OECD economic outlook, but if your point is that there's a significant current account deficit, then, indeed, sure, that's the case.

Cosgrove: I suppose the reason I ask, and I presume you're standing by your forecast, is we had the finance Minister here some weeks ago on other issues, and we put it to him, and he agreed, that the Reserve Bank, the IMF, and his own department, Treasury, were all in line forecasting a deterioration in the current account. The only outlier was himself. And what I'm interested in, and the Minister of Finance didn't proffer any evidential bases for his prediction that everybody was wrong—you, the IMF, and his own department. He was right. But he didn't proffer any evidence to back that up. So my question is could you outline for us in detail the factors and the evidence that you survey, if you like, in putting together your forecasts and your modelling, because I think it would be helpful on this particular issue.

Wheeler: One looks at several things when you're compiling a forecast of the current account deficit, because New Zealand has had deficits for the best part of three decades or more. In essence the current account deficit reflects a savings and investment imbalance—it's an identity if you like. And it basically says that your savings are low relative to the level of investment needs of the economy, or the investment that's expected to take place. And so therefore you need to draw on foreign savings and that's been a consistent problem in New Zealand, because foreign savings get used to finance domestic consumption but also domestic investment and that's the nature of the current account deficit.

So when we compile our forecasts we're looking at what sort of savings behaviour the household sector might be undertaking—are they increasing their savings ratios, are they decreasing them, what's happening to corporate savings in the economy, therefore essentially corporate profits, and what is happening to Government saving or dissaving, and to what extent is the Government reducing its dissaving in terms of moving towards a financial balance or a financial surplus? So that's the saving side of things.

On the investment side we would look at Government's likely investment spending. We'd look at what business investment is likely to do. We would
look at what residential investment is likely to take place. So we’d pay special attention, for example, to the rebuilding of Christchurch with the planned $30 billion of investment there.

So they’re the two dimensions to it in terms of looking at savings and looking at investment. In addition we take a careful look at the competitiveness indicators in the economy, particularly the real exchange rate, which in essence is the true level of competitiveness between New Zealand and other trading partners.

Cosgrove So are you broadly confident that your forecasts and predictions are consistent with IMF and Treasury?

Wheeler Well, I haven’t seen any IMF projections, but when we did them in September, that was our best projection of the future outlook, and, as I say, it showed a significant current account challenge there for New Zealand.

Cosgrove Does the growing challenge concern you, and if so, what advice would you have in respect of settings?

Wheeler I think a current account deficit of the order that the September forecast contained is a significant issue for the country, absolutely. In terms of policy advice perhaps we might cover that next Wednesday.

Cosgrove Because the only advice the Minister could give us, which some of us found quite odd, was the strategy seemed to be to quote him—that the world will never let us get to a point of disaster if you like in terms of the current account. It’s a bit like saying we’ll just keep borrowing and one day the bank manager will say there is no more money, so it’s a bit like addiction: cut off the product. It didn’t seem to us to be a sort of a strategy that would fill us full of confidence. Do you share the Minister’s view?

Wheeler Well, perhaps as I say, we might come to that next Wednesday.

Cosgrove Well, no, with respect, I’m asking about now, I’m not asking you about your predictions, that would be inappropriate. But today as we sit here do you share that strategic view of the world, that the world just won’t let it get to a point where disaster will strike?

Wheeler Well, financial markets in the period, for example, up to 2007—in that period 2002 to 2007—we’d the strongest global growth for 40 years. I mean it was a pretty unusual period. There were some very large current account deficits that were being financed, some extremely large current account deficits. I mean the investors were essentially looking to generate a higher yield on their investments and they were prepared to take exposure in emerging countries or countries that did have high current account deficits and higher interest rates. Some extraordinary current account positions were being financed, including of course Greece at that time. The world changed dramatically, as we all know, in 2008 after the financial crisis and I think investors are much more cautious about country credit risk and what they are prepared to take on. Although having said that, they do make a judgment about credit exposure and potential yield.
Cosgrove I suppose what I’m getting to, do you think it’s a sound strategy to basically say that we’re all on the right track, it’s all good, even if we hit No. 1 in the worst current account deficit in the world, the world won’t let us sort of just drop over the abyss. Is that a strategy you would recommend? It seems a wee bit high risk to me.

Wheeler Well, I think what I said is that financial markets will always provide a reflection on whether to take on credit exposure and the trade-off versus the higher yield for taking on that exposure, and in general you’ve seen markets much more conservative and less willing to finance large current account deficits.

Cosgrove So we should just hold course. All’s well, no problems?

Wheeler No, I didn’t say that.

Cosgrove Well, what would you recommend?

Wheeler Well, let’s deal with what we recommend next Wednesday.

Bennett Just with housing affordability, it’s been quite a topical issue. In regard to land prices for sections, have you done any reports on that or any indications of sort of what you would perceive to be a break of costs that go into a section price?

Spencer No, we haven’t done detailed work on that, no.

Bennett Well, what do you see as some of the main issues in that area of housing affordability?

Spencer I think the Productivity Commission report canvassed a number of those issues, particularly on the supply side, which we essentially agree with, and I think a lot of them are relevant in Auckland in particular right now, and they included things such as land availability, the cost of the development and putting in infrastructure for new subdivisions etc., the consents process, the bureaucracy of getting things through is expensive and time consuming. And then the other factor which the Productivity Commission rightly pointed to I think is just the cost of building, and the cost of building materials and labour in New Zealand is like 25 percent higher than Australia, which clearly is not particularly satisfactory, and contributes to the housing affordability problem.

Bennett So what is that cost for an average house? What’s the building cost compared with Australia?

Spencer I haven’t got the actual numbers.

Clark An extra $100,000; 25 percent of $400,000, at a guess.

Bennett So you’re saying—

Clark A lot cheaper down in Dunedin.

Bennett —$400,000—if you’ve got any of that information, it would be quite helpful.
You might also want to look at what the Auckland City Council’s done, because they’ve actually done very well. That'd be a good case study to look at.

My question is about how you account for some of your foreign currency reserves, and it kind of comes a bit out of the debate around quantitative easing and it’s kind of an interesting question—how do you account for potential losses for a bunch of money that you just created out of thin air. So it’s a strange kind of accounting measure. So what I’m trying to get my head around is if you were engaged in quantitative easing, like many other banks were, effectively you’re generating new currency and then you’re purchasing foreign currency with it and then it falls into your foreign currency reserve pool, how do you kind of account for, like in your accounts, as to what that means in terms of gains or losses? Because obviously there’s potential losses if the relative values of the currencies change in the future but on the other hand it’s a whole bunch of money that you just created out of thin air, effectively? So it’s a very unusual kind of situation. How do you account for it?

Well, firstly if we go and buy foreign exchange and sell New Zealand dollars, we put more New Zealand dollars into the banking system. So the deposits at the banks would increase substantially. That’s quantitative easing. The first thing that would happen is all that extra cash the banks have they try and get rid of it because they’re only getting paid 2.5 percent here so they’d be trying to get more in the market. It would push down money market rates. And so if the OCR is at 2.5 percent, money market rates would go down below 2.5 percent. So in other words we would cease to be operating monetary policy in line with our OCR. Our job with liquidity management is to keep money market rates in line with the OCR, our policy rate. So I guess what I’m saying is this is why quantitative easing doesn’t make any sense when you still have a non-zero OCR. So the first thing you have to decide is should we be dropping the OCR to zero, then maybe think about quantitative easing. If you don’t do that and just do the quantitative easing—

Sorry, that actually wasn’t my question. I know you have your opinion about QE and we’ve heard of it some length and you don’t like it, right. That’s not my question. My question is how do you account for it?

Well, the accounting would be as per normal standard financial accounting and as represented in the annual report. We would essentially be left with an open position if we’d acquired foreign assets, so it would just mean that we’d be marking to market our balance sheet every day. If the exchange rate goes up, we make a loss. If it goes down, we make a profit, and it is unrealised at that point until such time as we sold those foreign reserves back and bought the currency back.

So that accounts for the potential currency gains or losses with that foreign reserves that you have. But it doesn’t account for the fact that if you just generated a billion New Zealand dollars, for example, which you have the
ability to do as a central bank, how do you account for that—that you’re a billion dollars up?

Spencer Well, that would expand our balance sheet and so the balance sheet gets larger, and this happens from year to year. It does go up and down, so money, as you say, or money base is created and contracted depending on the circumstances, and in terms of an accounting point of view it just means we have a larger balance sheet and it also means that the entities that hold deposits with us, namely banks and the Government, one or both of them has more deposits at the Reserve Bank.

Norman So let’s say there’s a 10 percent risk in terms of the currency fluctuation so you could gain or lose $100 million on a billion New Zealand dollars that have been converted into some kind of foreign currency, right. So you say: “Well, we’re sitting on a potential gain or loss of $100 million, but we’ve just gained NZ$1 billion so we’re effectively either down—we’re at NZ$900 million ahead of where we were, or we’re at $1.1 billion ahead of where we were.” That’s the effect of what you’ve done.

Spencer Well, I would disagree with that. The gain or loss is a profit or loss. It goes to P and L. The billion dollars that you’ve just, as you say, created, that’s not profit and loss. That’s just a larger balance sheet. In fact it’s an increased liability of the Reserve Bank’s to the Government and/or the commercial banks.

Norman But if you purchase, say, earthquake bonds for example with that money, then that’s an asset. You’re sitting on a billion dollars’ worth of earthquake bonds that you just purchased.

Spencer OK, well that’s an alternative, so instead of buying foreign exchange, yes you’re right, you could go and buy domestic assets, you could buy Government bonds, for example.

Norman And so the Government doesn’t have to borrow overseas; you’re effectively replacing foreign borrowing by the Government. So you’re sitting on $1 billion worth now of Government earthquake bonds, it’s an asset.

Wolyncewicz But you’ve paid someone for it so it’s a liability. You’ve had to discharge funds to acquire that asset.

Norman Well, except you don’t because you’ve created the funds, you’re allowed to, you’re the central bank.

Wolyncewicz But you’ve put those funds to the vendor of the bond—you’ve put it with their bank. So you now owe that bank $1 billion.

Norman Yes, but you’ve created $NZ1 billion. You use that to purchase $1 billion worth of bonds. You’re sitting on an asset now worth $1 billion whereas previously you had nothing.

Spencer And you’ve created a liability and an asset—double entry accounting. Both sides of the balance sheet increase.

Norman Where’s the liability?
Spencer: The liability is the Reserve Bank’s liability to the banks, because when we bought the bonds we paid for it with cash. The cash goes into the system and the banks’ deposits with us go up by $1 billion.

Norman: No you gave the cash to the Government. They’re the ones you got the bonds off.

Spencer: OK, well either the Government or the banks’ deposit goes up by $1 billion, but the Reserve Bank’s liability goes up by $1 billion.

Norman: So you’ve created a $1 billion out of nothing, which is what you’re allowed to do and you bought—it’s crazy, but it’s true. Right, this is what central banks do. This is what’s happening all over the world. It’s very strange but it’s happening. And so you’ve created $1 billion, you bought $1 billion worth of bonds from the Government and you now have $1 billion worth of assets in the form of these bonds.

Spencer: Yes.

Norman: And so any potential gains or losses that may come will be based around that billion dollars that you’re ahead.

Spencer: Well, I’m just trying to distinguish between a balance sheet entry and a profit and loss entry. The profit and loss entry will be what you’ve earned on the asset versus what you’re paying on the deposit.

Norman: It’s kind of interesting and significant. So the Swiss Central Bank obviously is engaged in this process more than probably anyone in the world and in trying to bring down the currency it’s been very effective. It’s kept it at 1.2 to the euro so far. Yet people say that the Swiss Central Bank has a potential loss on its books because it’s bought all this foreign currency. But, of course, the Swiss Central Bank didn’t have any of this money; it simply created it literally out of thin air, so it’s very hard for me looking at it to say well you say that there’s a potential loss but actually they started from nothing, they created billions in Swiss francs, which then they’ve traded for euros and other currencies now. And yet you’re saying there’s this great potential loss, whereas I look at it and go, well, they’re way ahead of where they were because they created a whole bunch of Swiss francs that they didn’t have.

Spencer: Well, if we did the same thing—say we doubled the size of our balance sheet and we increased our foreign assets by $20 billion and we expanded our deposits held by the banking system at $20 billion, so it’s quantitative easing, throw it all into foreign assets, our open FX position would increase from $2 billion to $22 billion and any upward movement in the exchange rate would cause massive losses in terms of hitting our profit and loss. That’s real money. You can’t just ignore it or say somehow it’s virtual money.

Norman: But you’ve just created $20 billion in order to do it. It costs you nothing to create $20 billion.

Spencer: Yes, but it created a huge foreign exchange risk for the central bank and for the Government.
Norman: But if the foreign exchange risk is 10 percent of all of that money you created, say the $2 billion, then you’re still between $18 and $22 billion better off than you were at the start.

Spencer: Well, if you had $22 billion and you lost 10 percent, that’s $2.2 billion. That’s a significant loss, which I’m not sure the Government would be very happy with.

Norman: But you’re still $20 billion ahead.

McClay: I’ve got a question, because I’m not sure I’m following this logic completely. Why not do $200 billion, you lose 10 percent, which is $20 billion, you’re still $180 billion up, and we heard it is coming from thin air. Where is the boundary of this? Is it OK to advocate $1 billion or $2 billion? What’s the difference between $200 billion, because it sounds like a pretty easy solution?

Spencer: The key is the difference between profit and loss and just the balance sheet expansion. The balance sheet expansion—increasing both sides of our balance sheet—is not getting you ahead. It just means you’ve got more assets and more liabilities. The key is the impact on the profit and loss—that’s what you have to wear in terms of what will eventually feed through to the Government accounts and OBEGAL, etc.

Parker: I understand what you’re saying and Russel Norman does too, and I don’t think that Russel’s suggesting that this would not be without cost; he’s just saying—I’ll put it this way. If there was no intention to in the future take that money out of the system that you had put in the system, the effect would be to, on average, reduce the value of all money in circulation. Is that right?

Spencer: Yes.

Parker: And that’s the problem that you have with it.

Spencer: Yes.

Norman: The problem we have with money at the moment is it’s over-valued.

Parker: Yes. So I think at one level Russel Norman’s suggestion to you is correct—that if the money was made, then to the extent that those things are off your balance sheet, because you’re never going to repay the money if that was the assumption that was being made, he is right that the Reserve Bank might be ahead but depending on whether he’s right or wrong, and I’m not opining on that, the economy might not be ahead. Is that the distinction we need to make?

Spencer: There’s one aspect: expanding the balance sheet, you’re right, would be long term and have an inflation risk, but there’s still the P and L risk—the risk to the Government accounts of having a huge foreign exchange open position. To say that you create $20 billion of foreign reserves but then you never spend them so you never realise any losses, I don’t think is realistic. If you’re holding foreign reserves, the purpose of them is to be able to use them and spend them when you need them.
Parker  Well, not necessarily; that could be a purpose. But Russel Norman’s point is that a purpose might be just to bring down the exchange rate, which is what he suggests the Swiss are doing. I’m not advocating it; I’m just trying to explain. I agree with his logic.

Bennett  But that $20 billion would also have an effect, though, wouldn’t it on the domestic economy and the devalued assets would decrease, wouldn’t it?

McClay  David Bennett, sorry, we’re going to run out of time. Others want a question. We have given that one a good lash. I figure on the sixth we are yet to talk about it some more.

Goldsmith  My question was in a similar vein, Mr Chair. When we look around the world and we see countries doing quantitative easing or printing money whatever, what are the dangers or the risks you see—and I think you mentioned inflation—for the global economy, and how do you think New Zealand can best protect itself against that risk going forward?

Wheeler  The quantitative easing that’s taking place where essentially the central banks—the Bank of England, the European Central Bank, the Bank of Japan, and the Federal Reserve—are expanding their balance sheets, grossing it up in essence, as Grant said, is very, very significant. Central bank assets globally are now the equivalent of something like 20 percent of GDP. Certainly for that group of countries I mentioned, on average it’s around 20 percent of GDP, etc. So this is massive financial support, if you like, for their domestic economy, and it has huge spill-over effects for other countries, including New Zealand, including several other countries that are experiencing currency appreciation as a result. The countries that are undertaking this financial easing basically are faced with the challenge of what are the potential inflationary implications from all that liquidity support. They’ve basically done considerable damage to the price formation mechanism in their securities markets. When the central bank in these economies is going and purchasing huge proportions of Government securities in the price determination or the price formation process, assessing true risk around those securities is very significantly damaged. But the longer term challenge they face is how do they get out of this tremendous liquidity support without generating inflationary pressures, and when they try and absorb this liquidity how can they do so in a way that their open-market operations don’t create very significant interest rate pressures that damage the economy? So that’s the challenge they face. As I said, it’s desperate times for these countries. They ran out of options in terms of being able to use interest rate policy, more traditional policies, to be able to manage their economies, and they’ve resorted to it mainly because they’ve reduced their interest rates to effectively zero in an attempt to try and fix some of the damage in their financial system, and found that that wasn’t sufficient. So they’ve resorted to quantitative easing in taking on the sorts of risks that I just mentioned.

Goldsmith  Looking back over history, can you think of any other time when this hasn’t been followed by massive inflation?
Wheeler  Quantitative easing on this scale is really quite extraordinary. I don’t think we’ve seen it in the post-war period. I can’t think of any central banks in the OECD that in normal times would, in fact, basically print money to buy securities from the Government. They will not finance their Government’s fiscal positions. That’s standard practice, and has been for years, amongst OECD central banks, so this is quite extraordinary.

Clark  My questions are primarily around advice. The audit material I’ve seen suggested that the Reserve Bank broadly is doing a good job within the parameters of the kind of 1980s inflation-based framework that you’re encouraged to adopt. So my questions really though are around the nature and quality of advice you’re able to provide, because I think that has more future bearing on the success of our country economically.

The Minister of Finance made some unguarded comments when we had him before us a few weeks ago in response to some questions by Mr Peters around the Crown retail deposit guarantee scheme, and he suggested something that was not known to the committee, at least to my awareness, before that time, and that was that Treasury had recommended caps on the individual deposits and the review by the Auditor-General found that one of the individual depositors had increased by 10 times in the 5 months that followed the South Canterbury Finance increase by 25 percent. The whole of dubious lending went on in the 5 months that followed; we remember why the scheme was put in place and it had to be done in a day to stop a run on the banks, so we accepted it was a good thing to do at the time, but the monitoring was poor afterwards. And the main reason, we’re led to understand, from the Auditor-General’s report, that the monitoring was poor was because Treasury didn’t ask the Reserve Bank for forecasts it could have done around that risky lending and the developing risk to the taxpayer of that guarantee the Reserve Bank could have done.

I’m wondering what kinds of advice you gave to Treasury, either then or subsequently, that could avert such future risks and scenarios, and probably more around process actually, because what is clear is that there was a process breakdown. There was 5 months where there was an extraordinary growth of risk to the taxpayer, best estimates in the hundreds of millions of dollars of avoidable cost to the taxpayer, that hasn’t been finally quantified. Are you confident that there are processes that have subsequently been put in place that, I guess, could avert that risk in future in similar situations, or in different situations?

Spencer  Back at the time of the deposit guarantee scheme, we worked closely with Treasury and worked on the design of the scheme. We, in the end, supported the scheme that was adopted. But in terms of in light of the experience, you’re right, there’s a key issue, and the key issue with deposit insurance is always the fees that are charged and the need for them to be risk based. And there was a situation where we were differentiating between the fee that was charged on, like, existing deposits, and then the more risk-based and graduated fee regime for growth in deposits. And I would say that, yes, the experience underlined the point of having truly risk-based premiums and fees, particularly at the margin as you say, because otherwise
there’s a risk of moral hazard essentially of those institutions—relatively risky institutions—that are effectively under-charging for the guarantee are going to expand relative to the more conservative ones.

Clark I guess each situation is different when you get a crisis situation like that. The main thrust of criticism from the Auditor-General was that there was a failure of monitoring, and that as that risk grew to the taxpayer, particularly over the first 5-month period—

Parker By the Treasury, not the Reserve Bank.

Clark —I should be clear, by the Treasury not the Reserve Bank—Treasury should have been talking to the Reserve Bank and asking for the Reserve Bank to provide advice, which was quite within Treasury’s purview to do, and it failed to do that. So I’m certainly not laying any blame at all with the Reserve Bank; I’m wondering what kinds of conversations have happened since between the Treasury and the Reserve Bank to ensure that kind of monitoring situation, to ensure that that kind of policy advice, where there’s a boundary there, goes over into policy, just to make sure that those conversations are happening because hundreds of millions of dollars of taxpayers’ money was lost and it needn’t have happened, and what kinds of conversations have taken place since, what kinds of processes are in place? That’s my question.

McClay Just before we get onto that, to be fair that wasn’t the finding of the Auditor-General, so the question of how much might or might not have been—

Clark No, there’s been no quantification done. The best estimate we have is somewhere between $100 and $500 million.

McClay It may or may not have, but what you’ve just said is in fact, it was as a result of that and I think we’ve heard lots—but carry on.

Cosgrove But just on that though, it’s a fair point but you’ll also note that this committee refused to have an inquiry into it to ascertain those points.

McClay No we didn’t; it was never put before it.

Cosgrove So no one knows, finger in the air! ( Interruption )

Spencer I’m not sure whether there’s anything much more we can add to those comments. If there was another proposal or proposition for another guarantee scheme, another crisis or whatever, then clearly we’d try to learn from the experience and we would be talking very closely with Treasury in terms of the experience and the lessons, as you describe.

Clark Have you had conversations with the finance Minister subsequently to discuss how that failure of monitoring came about and how similar situations could be avoided in future?

Spencer Well, essentially as you say, we were involved in the initial design, then as the scheme was running, it was essentially a contingent liability of the Crown and it was run by Treasury. We were pulled back from the process.
Clark So are you saying you haven’t had any conversations with the finance Minister subsequently about the—

Spencer Subsequent to the thing closing off we were involved in discussions when the scheme was extended and the nature of the pricing to the extension, and the terms of that, we were involved in that, but then once the thing ended, we haven’t talked further about it.

Williams At the end of the day, you know you can shuffle all the money and move things around, but if country’s not producing more, we’re going nowhere, we’re going backwards, and if we’re not marketing and exporting our products to a higher level than we’re importing products, and it’s a slippery slope. And you look at the economies like Germany and those that are succeeding and doing well, it’s because they’re still major manufacturers and their manufacturing sector is holding up the rest of their economy in the likes of Germany, while other economies that don’t have the same manufacturing base are struggling—the ones in Southern Europe, which simply don’t have that sustainability from their manufacturing side. What’s the Reserve Bank’s prognosis of the current state of manufacturing in New Zealand, both primary industry - based and other hard-core manufacturing in terms of where we are now, and where the economy is heading in the next sort of 3 to 5 years in terms of where our position will be in terms of export receipts, and the basis of—is the economy going to be in a better position in 5 years and is our manufacturing going to provide greater returns for this economy in the 3 to 5-year period or are we actually seeing a decline in manufacturing, apart from agriculture, which is going to basically, in terms of the current account deficit and everything else is going to balloon out?

McClay Just before you go on, governor, and I don’t want to limit your question, but as far as this financial reviews it is past and current policy, and the governor is before us next week when he may want to go into that in greater detail. But go ahead please.

Wheeler Thank you, Chairman, for pointing that out. So I won’t comment about the future if you’ll forgive me, and perhaps we can cover that next week. But if you look at manufacturing, I mean, one, manufacturing output is basically about 9 percent lower than where it was just before the global financial crisis, so 2007. In the last 3 years manufacturing exports have been growing possibly around about 3 percent per annum on average; it jumps around for seasonal factors. So the main output effects for the manufacturing sector have been on the domestic side and a lot of it has been linked to the significant decline in investment that’s taken place, particularly residential investment in recent years.

If you go back over a longer period, you see in many countries a decline in manufacturing as a share of total output. That’s been true not only for countries with high exchange rate; it’s been true for countries with depreciating exchange rates as well, and a lot of that is tied in with globalisation. You’ve seen employment falling in manufacturing across the world in the advanced countries. On the other hand you’ve seen
productivity increasing and usually increasing more rapidly than productivity for the overall economy. So there are some big global trends there that are affecting manufacturing. For us, as I say, in the last 3 years the manufacturing sector has been affected by the exchange rate appreciation; there’s no doubt about that. But you’ve still seen exports grow in volume terms of the order of about 3 percent per annum. But the real output decline has taken place mainly on the domestic side, and a lot of it is building related.

**Williams**

So you have a situation like this week with Carter Holt Harvey closing its Rotorua panel plant because they simply say domestic consumption has got down to the point where they can’t sustain keeping that panel plant open. Are you seeing, in your analysis of the internal domestic market, a situation where this is going to basically just get worse because it’s on a slippery slope in terms of the sustainability of construction in the building industry and everything else?

**Wheeler**

Well, perhaps we can come to that next Wednesday. But one thing to keep in mind is that the reconstruction of Canterbury, the investment likely to take place, is of the order of $30 billion spread out over several years, of course, but one would expect that would be a very positive influence for manufacturing.

**Parker**

Just that figure you gave of a 3 percent per annum increase in manufacturing, was that manufacturing or manufacturing exports?

**Wheeler**

That was manufacturing exports, and it’s an average roughly for the last 3 years. But it jumps around in seasonal quarters.

**Parker**

Yes, I’m aware of those facts. In real terms, though, outside of the primary produce, export manufacturing is down. Do you concede that?

**Wheeler**

I’d have to check the numbers.

**Parker**

Well, I would ask you to, because essentially when you’re facing deteriorating terms of trade as an exporter and you’re in the primary sector, of course you’re still producing just as many litres of milk and many livestock to be manufactured, so volumes do stay up, but where you see the effects exacerbated, and the stats show this, is that we’re seeing continued, quite substantial real decline in the non-primary sector manufacturing, so I suppose for me, and you might say this is outside your purview and that’s fine, I wouldn’t criticise you for it, but I suppose the economic concern is that if are of a view that New Zealand needs to be more than a producer of primary products based exports, then the decline in the non-primary sector is of concern. Do you have a view on that, and I’m not saying you should have a view, but do you have a view on that?

**Wheeler**

Well, I think you know if you see any sector in an economy over a long period of time, and I referred to the global trends that were taking place in terms of the size of the manufacturing sector relative to total output, and, as I say, are also taking place in countries where you see an exchange rate depreciation. So for example if you look at the US data of which I’m sure you’re very familiar with you see the same sort of contraction in the
manufacturing sector. Any sort of ongoing decline of any sector I think is a concern. I mean, you want to really analyse it carefully and see what lies behind it and whether there are policy judgments that need to be rethought.

McClay A new line of questioning from me. For the financial year we are reviewing, 2011-12, what role has the Government’s fiscal policy played in monetary policy options for the Reserve Bank and has this been an important time for you?

Wheeler Forgive me, Chairman, I’m sorry I missed the early part of that.

McClay For the period that we are currently reviewing, 2011-12, what role has the Government’s fiscal policy played in monetary policy options for the Reserve Bank and how important has this been for you?

Wheeler Thinking about monetary conditions and also thinking about, say for example, our current account position, and this is where we started off the discussion earlier where I’m saying that the savings–investment imbalance in an economy is basically reflected in its external position or its current account position, and to the extent that a Government is dissaving or reducing its dissaving and moving towards surplus has an important implication on the current account.

For us, in terms of managing monetary policy to the extent to which a Government starts improving its fiscal position and moving towards surplus, then that makes our job easier in the central bank and we can be perhaps more supportive in terms of the impetus of monetary policy and the stimulus it may be providing to the economy.

It’s when you get large fiscal deficits that it makes the central bank job a lot more difficult.

McClay A recent report is just out from the OECD and I want to quote a bit about New Zealand because it goes into what’s happening around the world and the forecast and outlook and we’ll have a chance to traverse that next week. But the bit I quote says that “The persistence of a heavy net foreign debt burden in an environment of considerable external risk underscores the need for proceeding with fiscal consolidation plans and for implementing structural reforms to raise national saving and improve long-term growth prospects.” Now, that’s very much the focus the Government had over the last 3 years but in particular this financial period we’ve just come out of. Has that been important when you compare New Zealand’s economic situation with many other countries of the world during that period of time?

Wheeler Well, New Zealand’s fiscal position deteriorated quite markedly as you know in terms of what we call structural fiscal deficits, for example—so, non-cyclical fiscal deficits—and that deterioration was substantial. Now to the extent that the Government or any Government is improving its fiscal position and moving towards balance or surplus then that would over time help to improve the current account deficit and therefore the accumulation of foreign liabilities, and it would also make the central bank’s job easier. So by and large what the OECD have said, based on your quote, I would agree with, yes.
Hayes Can I just ask you, and it relates to Todd’s question and also your comments about the structural easing, when all of these Government bonds are produced, then under the Basel Convention, Governments or banks internationally can lend up to the value of those bonds, because Government bonds are treated by that convention as cash. Isn’t that causing us a fundamental problem in the sense that if you’re going to lend to the farming community, you’ve got to keep 100 percent cover for these lending groups?

Spencer In terms of our banking system our banking system doesn’t hold a large amount of Government stock. Most of the New Zealand Government bonds, like 65 percent of those plus are held offshore and then the rest of them domestically are held by fund managers, portfolios of investment funds. The banks do hold some, but really it’s not an important driver of their lending behaviour to, say, the agricultural sector.

Smith I just want to crystallise down the point in your initial answer to the Chairman around the extent of Government’s fiscal policy and its impacts on the responsibilities the Reserve Bank has. Are you saying that if the Government runs larger deficits, that that would have to be taken into account in your setting of monetary policy to the point where New Zealanders would face higher interest rates for things like business and home mortgages in the event that the Government decided to spend more and run larger deficits?

Wheeler To the extent that a Government is running a very large fiscal position—I’m talking about a Government—and in flow terms that position is deteriorating, so there are larger and larger deficits, then by and large that will be reflected in higher interest rates essentially. The central bank has to push much harder against an enormous Government fiscal stimulus and in terms of sort of getting the monetary conditions that it sees as consistent with inflation objectives it essentially means that it has higher interest rates.

Smith Would there be a risk if the Government decided to spend large sums of money, for instance, on a Government housing programme with their desire for a stimulus effect funded by deficits that that would, in fact, be counterproductive as a consequence of Reserve Bank policy having to take a higher rate, which would then have an adverse effect on housing affordability for Kiwi families that may not get one of those houses that are built from those deficits, but end up paying more for their interest rates?

McClay Again, governor, just before you go on, again we are looking previously so I don’t want to rule the question out and some of it we may deal with next week.

Smith It’s a very important question.

Wheeler Well, it’s a question about policy and interest rate policy, in effect, and if you’ll forgive me, I’d rather address that next Wednesday.

Clark A quick question really around modelling and how you test your models and so on. With the Christchurch rebuilt I can recall asking the previous Governor a question about the impact of the Christchurch rebuild on the
growth figures, and it was a substantial element in the modelling—the precise number if anyone here can remind me I’d be grateful for, but I can’t remember that off the top of my head. That rebuild was first predicted to happen at the beginning toward the middle of this year, then towards the end of this year, and now it’s predicted to be next year, and I think if I read correctly the material provided, you’re less optimistic that it will happen in the consensus timeframe than you were before, so you’re saying perhaps later next year at best. What’s illustrated there is that it seems that the Reserve Bank has not had good information on this, which is a substantial part of its modelling. There may be no way around this. You may have got the best information there was. It may be that the Government has failed in various ways, and that’s not for you to pass judgment on necessarily, but what confidence have you got and what reviewing of your modelling is done to ensure that those projections of future growth are as accurate as they can be, particularly with reference to the rebuild?

Wheeler In essence, I mean the numbers have changed because there’s massive uncertainty about the scale of the challenge there—an enormous catastrophe, as we all know. We work very closely with CERA, for example, and other agencies involved around Christchurch. We’re regularly down there talking with industry groups and EQC. But in essence the source of our information is from those conversations, say with CERA and others.

Peters Mr Smith was inviting you to agree that larger fiscal deficits lead to higher interest rates. Has that been the experience of the UK, USA, Europe recently?

Smith We don’t want an economy like theirs!

Peters Can I just ask a question without interruption from Mr Smith? ( Interruption) I am just commenting on the recent facts of Europe, UK, and even Japan where larger expanded fiscal deficits nevertheless did not result in higher interest rates but the very contrary.

Wheeler Well, I think we discussed this earlier in the committee discussions. These are extraordinary situations where basically central banks have tried to lower their interest rates to try and stimulate the economy, to try and help repair some of the damage of the financial system and also the massive deleveraging that’s taking place in the household sector and in corporate balance sheets. So they’ve built up their balance sheets very, very substantially, in doing so done quite considerable harm to the price discovery process in financial markets tied in with auction processes on securities. But in essence there’s a price to pay. I was in a G20 meeting in 2009 where the central bank representatives from the Federal Reserve were essentially saying the massive challenge in front of us right now is to get back to normalised monetary conditions, and they were anticipating doing that in 2010. They were deeply worried about how to reabsorb that liquidity to prevent inflation from rising and to absorb that liquidity in a way that didn’t lead to a rapid build-up in interest rates that would affect the growth potential of the economy. So that’s the challenge. You can provide financial support, massive liquidity, as basically a desperate measure when your ability
to lower interest rates has been taken away, if you like, because they are essentially at zero. But the price you pay in doing that is the potential inflation risk and the interest rate costs that you will bear in trying to absorb that liquidity again and re-establish normal monetary conditions.

McClay Governor, thank you very much for your time with us today. You are back before us on 6 December for monetary policy statement, following its release. David Bennett will have the first question on that day.

**conclusion of evidence**
2011/12 financial review of the Social Workers Registration Board

Report of the Social Services Committee

Contents
Recommendation 2
Introduction 2
2011/12 performance 2
Registration 2
Appendix 5
Recommendation

The Social Services Committee has conducted the financial review of the 2011/12 performance and current operations of the Social Workers Registration Board and recommends that the House take note of its report.

Introduction

The Social Workers Registration Board is a Crown entity (Crown agent) established by the Social Workers Registration Act 2003 to ensure that social workers are competent and accountable for the way they practise. The main functions of the board are to promote the benefits of registration of social workers, manage their registration, enhance professionalism in social work, and consider complaints. The board is appointed by the Minister for Social Development and comprises ten members, of which four new members were appointed from 11 February 2013.

2011/12 performance

In the 2011/12 financial year the board’s total income was $1,141,891 and its total expenditure was $1,074,101, leaving a surplus of $67,790.¹ The Office of the Auditor-General assessed the board’s management control environment as “good”, and noted that deficiencies identified in 2010/11 had largely been resolved. However, the Office of the Auditor-General recommended, as it did in 2010/11, improvements in processes and policy relating to fraud.

We note that due to a higher than expected number of voluntary registrations the board generated a surplus even though it forecast a deficit. At this stage we have no concerns about the board’s financial sustainability.

The board’s financial information systems and controls were assessed as “good”, although it was recommended that the board review the accuracy of its cost allocation methodology. As in 2010/11, the board received a “needs improvement” rating for its service performance information and associated systems and controls. The Office of the Auditor-General has recommended that the board improve its performance measures and targets for the medium-term impacts, and ensure output measures cover all dimensions of performance, particularly the quality aspect. We expect to see improvement in both these areas and to be updated at the next review.

Registration

Voluntary registration for social workers was introduced in 2003 to improve the consistency and quality of social work by ensuring that practitioners are adequately educated, supervised, competent, and accountable for their actions. The assessment for registration includes recognition of qualifications, and competence and practice requirements. The board can also register unqualified social workers if they have sufficient

¹ The corresponding “net comprehensive income” figure given in the board’s annual report was $67,760. However, we were told by the Office of the Auditor-General that this was a typographical error.
experience. Registered social workers must adhere to a code of practice and undertake
professional development. The Act also provides for a disciplinary process.

At the last financial review the board told us 13,170 people identified themselves in the
2006 New Zealand Census of Population and Dwellings as social workers. At this review,
the board told us there are 3,984 registered social workers in New Zealand, compared with
2,942 in June 2011 and 2,485 in June 2010. Approximately 2,200 are employed by the State
through district health boards and Child, Youth and Family, which will require all their
front-line staff to be registered by 2015.

The board maintains a focus on the introduction of mandatory registration, which was one
of the principal recommendations resulting from their 2011/12 review of the Act. During
the hearing the board raised issues of public expectation and public safety in relation to
voluntary registration. A survey conducted by the board found that 81 percent of the
public thought that registration was already a requirement, 80 percent thought that social
workers were required to have a minimum qualification, 78 percent thought they would
undergo continuous professional development, 92 percent thought they could complain to
at least one agency in the event of poor practice or behaviour, and 88 percent thought a
social worker could be struck off. We took this to mean that public expectation does not
reflect the reality.

According to the board, a criminal record supplied to a prospective employer by an un-
registered social worker is not required to include any convictions for which name
suppression has been granted. However, a registered social worker is required to undergo
police vetting, which can lead the police to recommend to the board that a person not have
unsupervised access to children, young people, or vulnerable people. The board can then
act on that information and advise an employer that the person in question will not be
registered.

A registered social worker is also required to provide proof of any name changes, and
certified copies of birth certificates, qualifications, and references from current and
previous employers. The board can withhold an annual practising certificate if it is
concerned about a registered social worker’s fitness to practice.

The board said it has the necessary systems and processes ready should mandatory
registration be introduced. It also argued that mandatory registration would allow
economies of scale, so the cost of individual registrations for government entities and non-
governmental organisations could be reduced.

Along with the board, some of us were surprised that mandatory registration has not yet
been introduced despite support from responsible Ministers for its introduction. The board
said it was disappointed that the White Paper for Vulnerable Children Volume II did not
recommend mandatory registration for all social workers.

We note that the white paper references the board’s own discussion document, Mandatory
social worker registration: A discussion paper, saying little is known about the effectiveness of
mandatory registration in improving the quality of practice; and with reference to the
board’s paper, Mandatory social worker registration: Report from the discussion paper, it cites
concern about possible negative consequences of mandatory registration, including the
financial costs involved, a potential reduction in the social work workforce, and the
possibility that people will change job titles to avoid registration. The white paper also
notes that NGOs currently face considerable financial pressures and says this measure would place an additional burden upon them.

While we believe that mandatory registration is not a panacea, we agree that it has merit. Some of us believe it is important its implementation be advanced as soon as practicable. We note that the board agrees that further discussion is needed about the effects on NGOs, the social services sector, and those who would no longer be able to practise as social workers if compulsory registration were introduced.
Appendix

Approach to this financial review
We met on 13 March and 8 May 2013 to consider the financial review of the Social Workers Registration Board. We heard evidence from the Social Workers Registration Board and received advice from the Office of the Auditor-General.

Committee members
Peseta Sam Lotu-Iiga (Chairperson)
Jacinda Ardern
Hon Phil Heatley
Melissa Lee
Jan Logie
Le’aufa’amulia Asenati Lole-Taylor
Alfred Ngaro
Dr Rajen Prasad
Mike Sabin
Phil Twyford
Hon Michael Woodhouse

Evidence and advice received
Office of the Auditor-General, Briefing on Social Workers Registration Board, dated 13 March 2013.

Social Workers Registration Board, Responses to written questions, dated 8, 14, and 27 March 2013.
# 2011/12 financial review of Solid Energy New Zealand Limited

Report of the Commerce Committee

## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation</td>
<td>2</td>
</tr>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Former chair and chief executive</td>
<td>3</td>
</tr>
<tr>
<td>Financial performance issues</td>
<td>3</td>
</tr>
<tr>
<td>Reasons for financial difficulty</td>
<td>3</td>
</tr>
<tr>
<td>Involvement of Crown shareholder in business decisions</td>
<td>7</td>
</tr>
<tr>
<td>Keeping shareholding Ministers informed</td>
<td>8</td>
</tr>
<tr>
<td>Discrepancy in valuation</td>
<td>9</td>
</tr>
<tr>
<td>Plans for recovery</td>
<td>9</td>
</tr>
<tr>
<td>Lignite development</td>
<td>10</td>
</tr>
<tr>
<td>Former chief executive’s contract</td>
<td>11</td>
</tr>
<tr>
<td>Potential conflicts of interest</td>
<td>11</td>
</tr>
<tr>
<td>Campbell Live email</td>
<td>12</td>
</tr>
<tr>
<td>Hearing of evidence and resulting issues</td>
<td>12</td>
</tr>
<tr>
<td>New Zealand Labour Party and Green Party minority view</td>
<td>14</td>
</tr>
<tr>
<td>Appendix A</td>
<td>18</td>
</tr>
<tr>
<td>Appendix B</td>
<td>19</td>
</tr>
<tr>
<td>Appendix C</td>
<td>45</td>
</tr>
</tbody>
</table>
Solid Energy New Zealand Limited

Recommendation

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of Solid Energy New Zealand Limited and recommends that the House take note of its report.

Introduction

Solid Energy New Zealand Limited is a state enterprise under the State-Owned Enterprises Act 1986 and is New Zealand’s largest coal mining company. It mines hard coking coal primarily for export to steel mills in Asia, and thermal coal for the Huntly power station and the steel, dairy, and cement industries.

Dr Don Elder was the chief executive for the 2011/12 financial year, but resigned in February 2013. He remained an employee of the company, but was replaced as chief executive by an interim chief executive, Garry Diack, previously the company’s group manager, organisational development and performance. Mark Ford is the chair of the board, having taken over from John Palmer in August 2012.

On 21 February 2013 the Minister for State Owned Enterprises announced that the Government had been advised that Solid Energy was facing serious financial challenges, and it was working with Treasury, advisers, and the banks on restructuring options, with the aim of returning the company to a sustainable financial position. The Minister said that large decreases in world coal prices had contributed to its deteriorating financial position.

We heard from the current chair of the board, Mark Ford, and interim chief executive, Garry Diack, on 7 March 2013. In early February 2013, following the resignation of Dr Elder as chief executive, Solid Energy contacted us to confirm the line-up of officials expected to attend the hearing. On 14 February 2013 we sent a letter to Solid Energy requesting the attendance of Mr Ford and the interim chief executive Garry Diack, and saying that if Solid Energy chose to invite Dr Elder the committee would have no objection. On 20 February Solid Energy sent a letter confirming the attendance of the current chair and interim chief executive, and two other senior officials (group manager Bill Luff and chief financial officer Anthony Burg), and saying that Dr Elder would not be attending.

On 14 March 2013 we heard further evidence from former chair John Palmer and former chief executive Dr Don Elder.

Before both hearings of evidence, the chairperson of our committee, Jonathan Young, declared an interest in that his sister was a former director of Solid Energy, appointed under the previous Government and reappointed under the present Government. Mr Young had sought formal advice from the Clerk of the House whether it was appropriate to remain in the chair. The clerk conveyed that declaring his association with his sister was sufficient. At the start of both hearings Hon Clayton Cosgrove respectfully invited Mr Young to vacate the chair during the period that this financial review was an active item of committee business. Mr Young declined.
Former chair and chief executive

John Palmer was on the board of Solid Energy from November 2006, and was chair from January 2007. In May 2012 he announced that he would step down as chair, and in July 2012 he resigned following the publication and presentation of the 30 June annual results. He formally stepped down at the end of August 2012. He told us his resignation was a personal decision, and he was not pressured to resign. He said that he wished to explain certain decisions made by the board, to demonstrate that the board took seriously the responsibility for its decisions and their consequences. During the period in question five of the seven other board members also resigned.

He said also that he was proud of his association with Solid Energy, although he acknowledged he had made some mistakes. He believed in the necessity of taking risks to succeed in business, even though some risks may not work out. He had no regrets about the board’s strategy, though he had some about aspects of the company’s performance.

Mr Ford confirmed that Solid Energy’s former chief executive, Dr Don Elder, had resigned from his position as chief executive but was still employed by the company. He had accepted a two-month advisory position as a transition measure, and was working from home.

Dr Elder said that although he was proud of the achievements of the company in the 12 years he was the chief executive of Solid Energy, with the benefit of hindsight he would now make some decisions differently. He said he was truly sorry for the way what was happening with the company was affecting some people. He said there were no constraints on what he could tell us during the hearing.

Financial performance issues

Mr Ford said that Solid Energy’s financial position had deteriorated since the last formal financial statement for the 2011/12 year, with its balance sheet currently carrying approximately $390 million in debt. It had engaged in major restructuring and a refocusing of its core business, and expected this approach to restore the company to profitability by 2015.

Dr Elder believed that the company still had a strong future, but would have to work through the next period very carefully, with full support from all involved.

We asked about Solid Energy’s operating cash flow over the past five years. Dr Elder said that cash generated by product sales amounted to more than $900 million over the last 11 or 12 years, which was almost entirely reinvested in the company.

Asked about the company’s management of exchange-rate risk, Dr Elder said its policy was to hedge for the period of each set-price contract. He said that hedging beyond that point created rather than reduced risk.

Reasons for financial difficulty

We asked whether the reasons for the company’s issues were unrelated, or reflected the company culture. Mr Ford believed a series of conditions had led to its troubled situation.

World coal prices

Mr Ford said a key factor in Solid Energy’s financial situation was a massive decrease in world coal prices in 2012.
Dr Elder noted that in mid-2012 prices for coking coal, the company’s primary export, had suddenly fallen far lower than anyone’s predictions. Price drops in 1999 and 2008 had been accompanied by a falling New Zealand dollar, but in 2012 the currency had stayed high, and the company was now mining much deeper coal at much greater expense. He described this combination of circumstances as “a perfect storm”, resulting in large losses.

Mr Luff said that equities analysts around the world had been surprised by the sudden decline in the price of coal, which was caused largely by a major Chinese infrastructure programme ending and a decrease in Chinese steel production by 33 percent from the previous year. The United States had also begun exporting coal, which led to a softening in demand. Stimulus measures in Europe and the United States and the high exchange rate in Australia and New Zealand had also contributed to the decline in coal prices.

Dr Elder said the United States faced competition problems in its electricity market; its producers of coking coal had maintained their cash flow by selling to Asian markets at below-cost prices over several years, which undermined markets for New Zealand exporters.

We asked how other coal companies around the world were faring. Mr Luff said that in 2011 the sharemarket values of Australian coal companies were reduced by about 50 percent, in spite of an overall increase at the Australian Stock Exchange. He said also that a similar group of coal companies in the United States had lost 42 percent of their value while the Dow Jones had increased.

We asked why Solid Energy took so long to react to the decline in the price of coal. It said that coal prices dropped very dramatically in July 2012, and by August/September it had begun restructuring the business; it completed this restructure by December. This process occurred under the new chair of the board.

We asked over what periods contracts were negotiated, and whether they meant that the risks regarding coal price could not be mitigated. Mr Luff said that its contracts were usually long term, but as pricing was set quarterly it would negotiate quarterly on a fixed price for any committed deliveries. He said that some companies calculated prices monthly, or used the current market price. Solid Energy calculated prices using a benchmark price set by large competitors in the same markets. Mr Luff said that the current market price and the benchmark price had both been rising since September 2012.

We asked what analysis the company had undertaken of the volatility in coal prices. Dr Elder said that Solid Energy talked to global industry colleagues, listened to market analysts’ forecasts, analysed past behaviour, and examined reports from research organisations. Analysing this information would yield a wide range of possibilities for planning purposes; but in the past 12 years or so the company’s prices had gone outside the forecast range several times.

Changes to gearing

We asked about statements by the Government that one reason for Solid Energy’s financial difficulties was its decision to increase its ratio of debt to equity, and noted a letter from the shareholding Minister dated 28 May 2009, which noted a decline in coal prices and suggested an increase in gearing. The letter also noted the Minister’s disappointment “with the forecast decline in Solid Energy’s financial performance over the next three years, in particular the dramatic decline in profitability and dividends”. The Minister’s letter stated that the capital structure of the entity was one of the most direct and effective tools he had
available to improve the governance, accountability, and financial performance of state enterprises. The Minister’s letter also said “I would like all SOEs to increase their gearing from current levels, to a level more consistent with a BBB flat credit rating. I urge the Solid Energy board to give serious consideration to this proposal. I note that Solid Energy currently has a gearing target of 35%, including the company’s rehabilitation liability as if it were debt.”

We asked Dr Palmer whether during his time as chair of Solid Energy the Crown had requested that Solid Energy increase its gearing. He confirmed that it had, and that the aim of doing so would have been to “ensure that there was more cash available… which would ultimately increase the dividend yield.” We asked Mr Palmer “Has ever a shareholder asked you to borrow to pay the dividend?” He replied, “No. There was no request for that.” Labour members do not accept Mr Palmer’s explanation. We asked what the forecasts for coal prices were at the time the Government made this request. Mr Palmer said that even taking into account the global financial crisis, Solid Energy expected the price of coal to rise overall, through normal market volatility. Dr Elder noted that the company had been aware of the potential for very wide variance from forecast prices, and had explained this in its annual report.

Mr Palmer believed it had been clear that the Government approved of Solid Energy’s plans to expand production, at the same time expecting it to increase its debt. Solid Energy opposed the request, as it believed its gearing of 35 percent was appropriate for the company’s circumstances and the industry. Mr Palmer believed that following the request, the board decided to increase the gearing to 37 percent.

We asked whether Solid Energy had understood clearly that the Government had requested an increase in borrowing and dividends at a time when the coal price was falling. Mr Palmer said the company had understood the shareholder’s expectations regarding dividends, and had developed a plan to grow the business with what it considered to be reasonable risk. It had accepted that an increase in risk would be entailed. Mr Palmer explained that the coal processing plant and new equipment at Stockton was funded entirely through borrowing—a total of $270 million. It had been confident that this was a good business decision, as the additions increased the safety and extended the life and value of the mine.

We asked whether Solid Energy had received any other recommendations from the shareholder that it had opposed or did not agree with. Dr Elder and Mr Palmer could not recall any such instance.

Dr Elder confirmed that the gearing ratio in the 2011/12 financial year could be calculated at over 40 percent, if asset impairments were included in the calculation.

**Spring Creek mine**

Mr Palmer said that a major contributor to the company’s increase in debt had been monthly spending at Spring Creek mine, attempting to make it profitable and safe. The company recorded a net impairment of $47.1 million in 2011/12.

Dr Elder told us the mine had lost more than $150 million in the previous five years, and that it had always had significant geological and geographic difficulties. He believed the mine had been opened in the wrong place, under the wrong conditions, and with the wrong plan.
We asked Solid Energy why it had purchased the Spring Creek mine for $64 million and then closed it. Mr Luff said that coal prices had dropped during the four-to-six-month-purchasing process, and the mine already had development issues.

Dr Elder explained that Spring Creek was a long-negotiated purchase, and that the mine was not closed permanently but put on care and maintenance with the possibility of being reopened.

Mr Luff noted that the mine still had value, which Solid Energy was looking at ways to realise.

**Diversification of business**

Mr Palmer said that about 80 percent of investments made by the company during his time as chair had been in the conventional coal business. We noted that Solid Energy began investing in alternative energy between 2003 and 2007, and asked whether the shareholders had endorsed this. Dr Elder emphasised the need to differentiate between Government policy and shareholder direction. He believed Solid Energy’s strategy was consistent with Government policy. He said the strategy was based on good international understanding of the direction of the energy market and not shareholder direction; in hindsight, however, it proved to be based on too many incorrect assumptions.

We noted that Solid Energy’s submission to the emissions trading scheme in 2012 mentioned investment decisions including “multimillion dollar projects for emissions mitigation …”. We asked Dr Elder to expand on these decisions. Dr Elder said that coal could be mined affordably in New Zealand only for another 20 to 40 years, so Solid Energy recognised a need to diversify against the risk of the coal market. Among the many options for diversification, Dr Elder acknowledged that biofuels had been a poor choice.

We noted that Solid Energy had projected a large increase in production of biofuel, and then recorded a net impairment of $6.7 million in 2011/12. Dr Elder told us the company had undertaken due diligence before purchasing the Canterbury biodiesel project, which used a successful, proven manufacturing process, and that issues with biodiesel related to the market rather than the technology.

We asked whether the removal of the mandatory obligation to include biofuels in domestic consumption had an effect. Dr Elder told us that “the removal of the mandating percentage had a dramatic effect on the demand and therefore the ability to have an economic price”.

We also asked whether the failure of its biodiesel project was directly connected to the end of the Government’s biodiesel grant scheme and the fall in the price of carbon. Solid Energy said that the biodiesel scheme was unprofitable even with the subsidy, because of strong competition and the high cost of raw materials. Mr Luff told us that carbon prices had recently not been close to reaching the $25 per tonne needed for the scheme to succeed.

**Company spending**

We asked why the board had paid bonuses when the company’s debt had been increasing. Mr Palmer said the board had stood by decisions to make payments rewarding staff for effort in line with the objectives of the company.

We asked about Solid Energy’s bonus scheme, and whether bonuses were incorporated in or additional to salary packages. Mr Diack explained that Solid Energy set its remuneration at about the middle of the market range, and then staff could earn amounts calculated
according to a formula for achieving productivity improvements. We asked what proportion of incentive payments went to miners relative to management staff. Information provided by the company showed that its 1,172 staff working on mine sites had received a total of $5,238,498 in performance payments in 2011/12. They included not only underground workers but people such as mobile plant operators, electricians, geologists, planners, administrators, and mine management. A total of $5,835,386 was paid to 260 staff working in corporate services, support services, new development, and renewable energy in 2011/12.

We raised the issue of public perceptions of performance bonuses paid when the company was in financial trouble. Mr Ford said that the payments were contractual, and many were part of collective agreements. Subsequently, Solid Energy advised in reply to additional written questions that approximately $1.3 million in bonuses was paid to employees on collective agreements, and approximately $9.7 million in bonuses was paid to employees on individual contracts in 2011/12. Mr Diack agreed that increased productivity did not always result in better circumstances for the company, which was affected by changing global commodity prices. Asked whether the company would be changing its incentive payment schemes, Mr Ford said that as the company is restructured it would look at all jobs and salaries.

We asked the reason for the 50 percent increase in communications staff over the past four years. Mr Luff attributed this to the increased complexity of the business and larger numbers of stakeholders. Mr Luff noted that the number of communications staff had more than halved from nine to three following the restructure.

We asked why the company’s budget for overseas travel had increased by nearly 50 percent in the same period. Mr Diack said that moving from annual to monthly pricing regimes had greatly increased its need to visit markets to maintain relationships.

We asked for a list of all the sponsorships Solid Energy engaged in since 2009, including the beneficiary, how much was spent, and for what purpose. The company provided a list of all sponsorships and grants, which showed that between 2001 and 2013 it administered 18 grants of $100,000 and over, 18 grants between $50,000 and $100,000, and 50 grants between $10,000 and $50,000. Between 1 July 2007 and 2013 it administered 50 grants between $5,000 and $9,999, and 400-odd grants up to $4,999. Information provided by Solid Energy stated that these grants helped it to meet its Crown obligations and corporate responsibilities, and helped it to build its reputation and benefit local communities.

Impact of partial sale on business decisions

We noted that both the times Solid Energy had been in serious financial trouble coincided with proposals for partial sale of the company. We asked whether the consideration of sale of the company had led to overly ambitious schemes to increase its value prior to sale, noting that its statement of corporate intent had listed one of the objectives of the company as maximising the value of the Crown’s asset for partial listing. Mr Palmer said that this had not happened in either occasion, and Solid Energy was being run in the best interests of the company, without a view to being sold.

Involvement of Crown shareholder in business decisions

We asked whether a speech made by Prime Minister Helen Clark in 2006 could have been viewed as political permission for state enterprises to expand. Dr Elder said that it would
not have influenced Solid Energy’s development and expansion plans. Dr Elder said that in his experience the board of Solid Energy took sole responsibility for decisions to expand beyond the company’s core competencies.

We asked about reports that Solid Energy had asked the Crown for $1 billion in capital. Mr Palmer explained that Solid Energy had recognised it had a responsibility to seek ways to monetise “the largest energy asset in New Zealand”. It looked at projects such as converting lignite to urea, which would require a very large capital investment on this scale, and discussed them with the Crown, but did not expect the Crown to fund them. Indeed it indicated it was aware that it was not necessarily appropriate for the Crown to participate in raising this capital, “or certainly to take all the risk”. We further discussed a letter sent by the shareholding Minister dated 28 May 2009, and noted that it said that if Solid Energy was unable to fund a significant commercially viable investment from its own cash flows it could seek an equity injection from the Crown. Mr Palmer believed, however, that the board did not diversify the business in expectation of additional capital from the Crown.

We asked whether the Crown had instructed Solid Energy to increase or decrease its coal production. Mr Palmer did not believe the Crown had ever given instructions regarding production, which had always been a board decision.

We asked Dr Elder and Mr Palmer their position on dividends over the last four years. Mr Palmer said that dividend decisions were made by the board, and could not recall the shareholder asking Solid Energy to borrow money to pay the dividend.

We asked whether shareholding Ministers had asked about the company’s strategy when the coal price declined, or provided any instructions. Mr Diack did not know. We asked whether during Mr Palmer’s time as chair of the board Ministers had suggested that the company’s strategy should change, or acted in any way to change the company’s direction. He said that this had not happened. He said that he had met with the Minister for State Owned Enterprises in late 2011 or early 2012, when it became clear that the company was facing significant financial issues. Mr Palmer informed the Minister that he was resigning as chair, and did not offer to stay on beyond finding a replacement chair.

Mr Ford told us that the previous chair and the board of the company resigned because they felt they had lost the confidence of the Crown. We asked for the date on which shareholding Ministers personally expressed to the chair concern about the company’s deteriorating position. We heard that correspondence sent around November and December 2011 indicated concern from Ministers about issues at Solid Energy. We also asked Solid Energy to provide a list of all meetings—including the dates and who was present—that representatives of the company had with Ministers, officials, or the Crown Ownership Monitoring Unit since 2009. Information provided by the company said that documents released on Treasury’s website referred to many of the meetings that took place between Ministers and the chair, but Solid Energy did not have detailed records of these matters. It said that most of the staff who had held such records were no longer with the company.

**Keeping shareholding Ministers informed**

We noted that Solid Energy’s annual report stated that “Shareholding Ministers are encouraged to make their views known to the board and to raise matters of concern directly with it”, and that “The board adheres to a no-surprises policy, which ensures that shareholding Ministers are provided with regular information and updates on the
We noted also that in 2010 there had been a dispute with the Crown over the company’s valuation, a scoping study by the Government in 2011 had shown problems, in 2012 the company was put under month-to-month close monitoring with Ministers receiving monthly reports, and in August 2012 there was a meeting with Ministers Tony Ryall, Steven Joyce, and Bill English, and the former chair of the company.

We asked Mr Ford what action the company had taken between 2009 and the present, how shareholding Ministers had made their views known to the company over that period, and what information was provided to Ministers and how it was received. We were unable to secure answers to these questions; Mr Ford said he had been appointed after these events had taken place.

We asked whether Solid Energy had provided information to Ministers apart from the month-to-month close monitoring beginning in June 2012, and what information was provided to Ministers about Solid Energy’s financial state. Mr Diack said the company issued quarterly reports. We asked whether the board or shareholding Ministers had raised questions about increased spending in a time when the company’s value was decreasing. Mr Ford said that he could not answer as he was not privy to the dialogue with the shareholder, which again preceded his time as chair.

We asked Dr Elder and Mr Palmer whether they believed they had kept shareholding Ministers fully informed of all activities, in accordance with the company’s “no surprises” policy. Mr Palmer said he had taken this as a prime responsibility, and liked to think he had fulfilled it diligently.

Discrepancy in valuation

We observed that Macquarie and Forsyth Barr had independently valued the company lower than Solid Energy’s own valuation in its statement of corporate intent. We asked about Solid Energy’s self-valuation of $3.5 billion on 30 June 2010 compared with Forsyth Barr’s valuation of $1.6 billion on November 4 2010, and noted a comment by Forsyth Barr that a decrease in coal price and an increase in the New Zealand currency could result in a valuation of zero. Dr Elder explained that valuations rely on certain assumptions, and it was possible to reconcile the different valuations by taking into account those assumptions.

We noted that Forsyth Barr had described Solid Energy’s self-valuation as “aggressive”, and said the valuation possibly relied on over-optimistic prices. Dr Elder said he agreed the valuation had been aggressive, and regretted it. The company reduced the valuation substantially the following year.

Plans for recovery

Mr Ford told us that Solid Energy’s plan for returning to surplus included major restructuring and a refocusing of its business back to coal production. We asked about the risk associated with world coal prices, and heard from Mr Ford that Solid Energy was adopting a very conservative approach, anticipating prices below most projections. We asked why it would focus its business on coal mining when it was forecasting weak global coal prices. Mr Ford said that it had increased efficiency of its mining operations, and thus its productivity.

Dr Elder said that New Zealand had some of the most difficult geology and geography in the world for developing coal resources, and noted that the company was nearly closed
down in 1999 because there remained only a few years’ worth of readily accessible, high-quality coal. Since then the company had doubled production and generated approximately $7 billion in revenue and about 10,000 person-years of direct employment, well beyond expectations in 1999. He believed that the company’s net positive effect on the environment almost every year for the past decade was something that few companies in the world could claim. The company withstood a 60 percent crash in international coal prices in 2008/09 during the global financial crisis.

Dr Elder believed the company had options to keep generating revenue from New Zealand’s coal resources for decades, even once they were too deep or of too low quality to mine by conventional means. He believed the emerging economies of India and China would continue to keep demand for coal strong.

We asked which of Solid Energy’s diversification projects retained the most value for the taxpayer. Dr Elder said Solid Energy had announced in 2012 that renewables projects, including its biodiesel and wood pallet initiatives, were no longer good or appropriate projects for the company and would be closed or sold. Underground mining had also become too expensive because of the cost of safety considerations. This left open-cast mining and underground coal gasification as the most likely sources of profit.

We asked whether Solid Energy’s plans including open-cast coal mining at the Pike River mine. Mr Ford said it had no plans to do so. Mr Luff explained that as the new permit owner it had been required to outline possible mining methods to the Crown, and that four to eight years of development work were needed in order to decide whether to mine at Pike River.

Restructure

We asked whether the structure of the company was adequate after it was revised in the second half of 2012. Mr Ford said that the board’s business plan included another major restructuring, particularly because the company was focusing on its core business of coal production.

We asked whether it believed the previous restructuring had been carried out as well as possible. Mr Ford said that it was an intermediate step, so not adequate in the sense that further restructuring was required. He did not believe the restructuring had been unnecessarily expensive.

Potential bailout

We asked how much money Solid Energy was seeking from the Government towards its financial recovery. Mr Ford said discussions with owners and banks were continuing, and that KordaMentha had been appointed to review the company’s business plan.

Mr Ford noted at the time of the hearing that the company’s balance sheet showed approximately $390 million of debt. He later noted that “All companies cover some debt. It doesn’t mean it’s a write-off of that debt.”

Lignite development

We asked how much the company had spent on and earned in lignite development. Dr Elder explained that lignite was a very long-term investment, and it was expected to take decades to develop. He believed Solid Energy had invested approximately $50 million in lignite development so far, excluding the cost of land purchases. We noted that Solid Energy was one of the largest landowners in Southland, and asked how much had been
spent on land for lignite resources. Dr Elder and Mr Palmer believed the company had spent an additional approximately $80–85 million on acquiring land.

We asked about the company’s estimated value of its lignite resources, and noted that during its 2010/11 financial review Solid Energy had suggested the value of the lignite could be as high as $1–5 trillion. We asked whether this had been an “overly rosy” picture. Dr Elder clarified that the figures referred to the value of the lignite at the time, rather than projected profits.

**Former chief executive’s contract**

We asked what changes were made to Dr Elder’s contract by the former chair on the day before he left his office. Mr Diack told us that the former chair had asked for an independent review of the contract before his departure to make sure it was in line with recent legislative standards, and believed that only minor wording changes were made, which had no effect on the terms and conditions of Dr Elder’s employment or any aspect of any severance agreement.

We asked Mr Palmer whether he thought it was appropriate to sign off on Dr Elder’s contract on his last day in office, especially when the company was in financial trouble. Mr Palmer acknowledged that it was unusual, and said he had simply intended to make sure the contract was up to date with current law. He had not examined Dr Elder’s contract in six years and was concerned he had been remiss. He said he had specifically instructed that there should be no changes in remuneration arrangements, terms relating to employment, or terms relating to potential exit from the company.

We asked Mr Palmer whether he had advised the Minister at his final meeting that he intended to update Dr Elder’s contract. He said he did not, as the conditions of the contract had not changed, and he did not believe there was anything untoward in his actions. He did not believe he had made the situation more complicated for an incoming board, or placed the company in a situation where it was obliged to pay more money.

We asked Dr Elder about his continued employment with the company, working from home on full salary for two months, and asked how much he would be paid for this work. He clarified that his annual salary was $805,000 per annum, and explained that his remaining employment was his working out his six-month notice period. He said he had been doing substantial work for the company, at the company’s request. He was prepared to have his employment agreement released when the conditions of that release had been agreed between himself and the company.

**Potential conflicts of interest**

We noted that one of the company’s directors had declared an interest in Nepean Mining Limited, a contractor to Solid Energy. We asked what tender process was used to award contracts to the company, and the value of its contract with Solid Energy. The company provided information stating that Nepean had been awarded two contracts under limited tender, with a value of AUD$679,298 and AUD$639,091.

We asked on what date Solid Energy had entered into a contract with Vera Facienda Limited and what tender processes were used. The company provided information stating that it had undertaken a targeted tender process and entered into consultancy agreements with Vera Facienda in February 2011 for a review of its information services strategy and capability, and in December 2011 for a review of the structure of its “new developments”
business. We noted that the interim chief executive, Mr Garry Diack, had been a director of Vera Facienda until April 2011, and asked whether he believed an open tender process would have been more appropriate. Mr Diack said he had declared his involvement, which would have been subject to a full internal review, and had not been involved in the awarding of the tender.

**Campbell Live email**

We asked about an email from Solid Energy headquarters, which had been quoted on *Campbell Live*, suggesting that staff “act sombre”. Mr Diack explained that it was not written under any instruction, and pertained to the attendance of the family members of deceased Pike River miners at a meeting about the recovery of the miners’ bodies. He believed that when the entirety of the email was taken in context it was not inappropriate.

**Hearing of evidence and resulting issues**

In late November 2012, as a matter of course, we contacted Solid Energy about the financial review examination, and requested Dr Elder as the chief executive, and Mark Ford as the board chairperson, to attend the hearing of evidence being scheduled for March 2013. Their attendance was confirmed shortly thereafter.

In early February 2013, following the resignation of Dr Elder as chief executive, Solid Energy contacted us to confirm the line-up of officials expected to attend the hearing. On 14 February 2013 we sent a letter to Solid Energy requesting the attendance of Mr Ford and the interim chief executive Garry Diack, and saying that if Solid Energy chose to invite Dr Elder the committee would have no objection. On 20 February Solid Energy sent a letter confirming the attendance of Mr Ford, Mr Diack, and two other senior officials, and saying that Dr Elder would not be attending. On 28 February the committee considered inviting Dr Elder directly, but decided not to, feeling it was up to Solid Energy executives to decide on the appropriate representatives to attend.

On 7 March the committee conducted its financial review hearing of evidence with Solid Energy. When the current chair was unable to answer a number of questions as he had not been in office when the events in question had taken place, some of us reiterated our concern that Dr Elder had not been brought to the hearing, as it seemed that it would have been appropriate for him to be present if possible.

**Allegations of misleading the committee**

During the hearing of evidence on 7 March Mr Diack and Mr Ford were each asked “did Dr Elder approach anyone in Solid Energy, including the executive team, and offer to make himself available for this hearing—yes or no?” Mr Ford responded “I can’t answer that yes or no, because he certainly didn’t approach me.” Mr Diack said “I’m not aware that he has approached anybody on that basis.” Mr Ford also later stated that he would have no objection to Dr Elder appearing before the committee.

On 11 March we received a letter from Dr Elder’s lawyer stating that on 6 March, the day before the hearing, a letter had been sent on behalf of Dr Elder to Solid Energy’s lawyers, copied to Mr Diack, stating that Dr Elder was available and willing to appear at the 7 March hearing with Solid Energy. Solid Energy’s lawyers were also asked to bring the 6 March letter to the urgent attention of Mr Ford. The letter stated that if Solid Energy were asked by the committee why Dr Elder was not at the hearing, Solid Energy should mention that Dr Elder was available to attend the hearing with Solid Energy, and that Solid Energy
We were informed that Dr Elder had contacted Solid Energy and made himself available to attend, but were only told of the second point during the hearing. Dr Elder felt that Solid Energy had misled us as to his willingness and ability to attend the hearing of evidence. We were surprised and disappointed to learn that Solid Energy officials had not drawn this information to the committee’s attention.

We also received a letter from Mr Diack on 11 March, after he had reviewed the uncorrected transcript of the 7 March hearing. Mr Diack confirmed that he had received a copy of the 6 March letter from Dr Elder’s lawyer, and said that during the hearing “my focus was on briefing those who were attending, and informing myself on the issues and processes, not on those who were not attending, and who would not be being briefed”. Although he had received a copy of the letter stating that Dr Elder was available for the hearing with Solid Energy if required, by that time he felt it had been made clear to Dr Elder by Solid Energy that Dr Elder’s attendance would not be required, as they were following the usual protocol of having current executives attend.

On 11 and 12 March respectively the chair of the Commerce Committee sent letters inviting Dr Elder and former chair John Palmer to attend a hearing of evidence on 14 March. Both agreed to attend. At the beginning of the hearing, Dr Elder was given an opportunity to respond to statements made by Solid Energy officials at the previous week’s hearing about his not appearing at that time. Dr Elder said that he had always been available and willing to meet with the committee and assist with its financial review of Solid Energy.

On 18 March, we sent letters to Mr Diack and Mr Ford, informing them of the allegation made by Dr Elder’s lawyer that they had misled the committee by providing false information about Dr Elder’s willingness and ability to appear at the 7 March hearing. We wrote as a matter of fairness and natural justice, as we are obliged to offer an opportunity for response to anyone who has had an allegation made against them that may seriously damage their reputation. We wrote that we required a response to the allegation.

On 20 March, we received a response from Mr Ford on behalf of Mr Diack and himself. It outlined the events as they saw them, and reiterated that Mr Diack’s focus during the hearing was on providing information to those who were present at the meeting, “not revisiting the issue of who was not attending”. The letter also noted that it had been Mr Diack’s first appearance before a select committee, and he had taken up the role of interim chief executive at short notice. It continued:

With the benefit of hindsight and the transcript, Mr Diack’s interpretation of the question may have been wrong, but at the time he was giving an accurate answer to the question as he then interpreted it. Mr Diack has asked me to convey his personal apologies and confirm that he did not intend to mislead the committee or frustrate its proceedings.

Despite Mr Diack’s explanation, Labour and Green members remain of the view that Mr Diack, having been asked a straightforward question in respect of Dr Elder’s willingness to attend, misled the committee with his response.

**Complaint of contempt**

On 20 March, we received a letter from the Speaker of the House asking us for our comment on a complaint of contempt that had been made by Hon Clayton Cosgrove. The
complaint alleged two instances of contempt: the first was that Mr Diack misled the committee regarding Dr Elder’s willingness and availability to attend the 7 March hearing; and the second related to the fullness of answers given to the committee compared with those Solid Energy later gave to the media.

On 21 March we considered both the 20 March letters from Mr Ford and the Speaker. Some of us felt that the explanation and apology were sufficient, and it was extremely hard to prove that Mr Diack “deliberately misled” the committee. Labour members felt that the excuse was weak, and anyone at that level of seniority would understand the importance of a letter received by a lawyer before the hearing, especially given the intense media and public interest in the matter at the time. We agreed to write back to the Speaker to say that after consideration the committee could not come to a united view on the issue, and that the Speaker should investigate the matter to make a determination. We sent copies of all relevant correspondence, uncorrected transcripts, and emails regarding the hearing and its attendees exchanged by Solid Energy and the clerk of committee.

**New Zealand Labour Party and Green Party minority view**

In 2001 Solid Energy was recognised with a Trade New Zealand Export Award for its record coal exports and record foreign exchange earnings. In August 2012 it was announced that Solid Energy was in serious financial difficulty and that a quarter of the company’s staff would be laid off, and that mines and facilities would be closed or mothballed. On 31 August 2012, the chair of the company, John Palmer stood down. In February 2013, Dr Don Elder, the long-standing CEO, announced that he would be standing down as CEO and departing the company following a “transition” period. On 21 February 2013, the Minister for State Owned Enterprises and the Minister of Finance, as shareholding Ministers, announced that Solid Energy was in serious financial difficulty and was entering into negotiations with Treasury and bank lenders on restructuring the debt levels of the company, which was quantified at $389 million.

**We believe Solid Energy misled and obstructed the committee regarding Dr Elder’s availability to appear**

In early February 2013, following the resignation of Dr Elder as chief executive, Solid Energy contacted the committee to confirm the line-up of officials expected to attend the hearing. On 14 February 2013 the committee sent a letter to Solid Energy requesting the attendance of Mr Ford and the interim chief executive Garry Diack, saying that if Solid Energy chose to invite Dr Elder the committee would have no objection. On 20 February Solid Energy sent a letter confirming the attendance of Mr Ford, Mr Diack, and two other senior officials, and saying that Dr Elder would not be attending. On 28 February members of the committee proposed inviting Dr Elder directly, but were out-voted by Government members of the committee. Individual members of the committee wrote directly to the SOE on 1 March requesting that Dr Elder appear but were rebuffed by Solid Energy.

On 7 March the committee conducted its financial review hearing of evidence with Solid Energy. When the current chair and interim CEO were unable to answer a number of questions as they had not been in office when the events in question had taken place, the Opposition members reiterated their concern that Dr Elder was not present at the hearing. During the hearing of evidence on 7 March Mr Diack and Mr Ford were each asked if Dr Elder had approached anyone at Solid Energy, including the executive team, with an offer to be available for the hearing. Mr Ford claimed that he had not been approached, and Mr Diack said he was not aware that Dr Elder had approached anybody on that basis. Mr Ford
also later stated that he would have no objection to Dr Elder appearing before the committee. Dr Elder and John Palmer, the former chair, were subsequently invited to appear before the committee on 14 March and did so.

On 11 March the committee received a letter from Dr Elder’s lawyer stating that on 6 March, the day before the hearing, a letter had been sent on behalf of Dr Elder to Solid Energy’s lawyers, copied to Mr Diack, stating that Dr Elder was available and willing to appear at the 7 March hearing with Solid Energy. The letter stated that if Solid Energy were asked by the committee why Dr Elder was not at the hearing, Solid Energy should mention that Dr Elder was available to attend the hearing with Solid Energy, and that Solid Energy did not consider this necessary and did not ask him to attend. Dr Elder felt that Solid Energy had misled the committee as to his willingness and ability to attend the hearing of evidence. Opposition members of the committee were deeply concerned that Solid Energy officials had not drawn this information to the committee’s attention.

On 20 March, the committee received a letter from the Speaker of the House asking us for comment on a complaint of contempt that had been made by Hon Clayton Cosgrove. The complaint alleged two instances of contempt: the first was that Mr Diack misled the committee regarding Dr Elder’s willingness and availability to attend the 7 March hearing; and the second related to the fullness of answers given to the committee compared with those Solid Energy later gave to the media. The Government members felt that the explanation and apology provided to the committee by Mr Diack was sufficient. Opposition members felt that the excuse was weak, and anyone at that level of seniority would understand the importance of a letter received by a lawyer before the hearing, especially given the intense media and public interest in the matter at the time. The Government members blocked any conclusive determination of the committee around these allegations and it was left to the Speaker to determine the matter. On 28 March the Speaker wrote to Hon Clayton Cosgrove rejecting the first complaint and did not address the second complaint. The Speaker provided no explanation whatsoever for his reasons.

**Level of debt**

The committee noted a letter from the shareholding Minister dated 28 May 2009, which noted a decline in coal prices and suggested an increase in debt gearing. The letter also noted the Minister’s disappointment “with the forecast decline in Solid Energy’s financial performance over the next three years, in particular the dramatic decline in profitability and dividends”. The Minister’s letter stated that the capital structure of the entity was one of the most direct and effective tools he had available to improve the governance, accountability, and financial performance of state enterprises. The Minister’s letter also said “I would like all SOEs to increase their gearing from current levels, to a level more consistent with a BBB flat credit rating. I urge the Solid Energy board to give serious consideration to this proposal. I note that Solid Energy currently has a gearing target of 35%, including the company’s rehabilitation liability as if it were debt.”

The committee asked Dr Palmer whether during his time as chair of Solid Energy the Crown had requested that Solid Energy increase its gearing. He confirmed that it had, and that the aim of doing so would have been to “ensure that there was more cash available... which would ultimately increase the dividend yield.”

Mr Palmer believed it had been clear that the Government approved of Solid Energy’s plans to expand production, at the same time expecting it to increase its debt. Solid Energy opposed the request, as it believed its gearing of 35 percent (including rehabilitation
liability) was appropriate for the company’s circumstances and the industry. Dr Elder confirmed that the gearing ratio at the end of the 2011/12 financial year could be calculated at over 40 percent (excluding rehabilitation liability and including impairments).


Bonuses

The committee asked why the board had paid bonuses when the company’s debt had been increasing. Mr Palmer said the board had stood by decisions to make payments rewarding staff for effort in line with the objectives of the company and individual contracts.

The committee asked what proportion of incentive payments went to miners relative to management staff. Responses to written questions showed $1,338,095 in bonuses were paid out to 772 employees on collective contracts in the 2011/12 year while $9,735,789 in bonuses were paid out to 660 employees on individual employment contracts in the 2011/12 year. Labour members also noted that over the two-year period from 2010/11 to 2011/12, $2.3 million in bonuses were paid out to employees on collective contracts and $21.2 million in bonuses were paid to employees on individual contracts.

Termination agreement for Dr Elder

The committee noted that Dr Elder was still employed by Solid Energy following his departure as CEO. The committee asked Dr Elder about his continued employment with the company, working from home on full salary for two months, and asked how much he would be paid for this work. He clarified that his annual salary (excluding bonus payments) was $805,000 per annum. It was explained that he was working in an advisory capacity for Solid Energy until April 2013. Evidence later provided to the committee showed that following the conclusion of Dr Elder’s employment in April 2013, along with his holiday and superannuation entitlements, he was to be paid an additional four months’ salary to fulfil his six-month contractual notice period.

Extravagant and wasteful spending

Opposition members of the committee were concerned to find that despite the deteriorating financial position of Solid Energy, the company failed to rein in its spending. Solid Energy spent more than $336,000 on advertising and $170,000 on PR materials and advice, on top of the nearly $1 million they paid their nine communications staff in the 2011/12 year. The company also spent $1.8 million on overseas travel and over $200,000 on private investigators that same year. Despite the change in management and the negotiations with bank lenders in 2013 over the company’s future, Solid Energy paid lobbyists Saunders Unsworth $48,000 to advise the company on “Select Committee protocol”.

Blocking of inquiry by Government members

The brief amount of time given to the appearance of the current management of Solid Energy as well as that given to Dr Elder and former chair John Palmer meant that many questions about Solid Energy were unable to be asked by the committee. The hearing of just two hours of evidence meant that many questions from committee members were not able to be addressed in full. Given the limited time and information to examine the circumstances that led to the near-collapse of a one-time award-winning company,
Opposition members of the committee proposed a select committee inquiry into the management of Solid Energy with terms of reference spanning from 1998 to the present day. Despite the unanswered questions around the circumstances of Solid Energy’s near-collapse and the reported $389-million debt of the company, the Government members of the committee blocked any attempt for further committee scrutiny of Solid Energy.

Due to the intransigence of the Government members of the committee in blocking an inquiry, Hon Clayton Cosgrove wrote to the Office of the Auditor-General on 27 March requesting that she investigate the circumstances around the near-collapse of Solid Energy. At this time, the Auditor-General is yet to respond.

**Conclusion**

The Opposition members of the committee are extremely concerned about the circumstances that led to the near-collapse of Solid Energy, the reported $389 million in debt that the company carries and the loss of more than 400 jobs to date. In carrying out our parliamentary obligation in reviewing the management of this State Owned Enterprise in the interests of taxpayers, many questions are yet to be answered. The surest way to provide that is a formal inquiry. Without a formal inquiry, questions will be left unanswered.

These questions include:

- Why did the Government, particularly the Minister of SOEs, take no practical action to deal with the aforementioned issues even though he was fully briefed?
- Where was the oversight that an SOE requires?
- Why was the Government oversight of the board so lax?
- Why was there no intervention in this company when ministers knew things were going wrong as early as 2009?
- What impact did the Government’s demands for more gearing and dividends have?
- Why did senior management make decisions that were not in the best interests of the company and its employees?

The future of the State Owned Enterprises model is at a crossroads. If Parliament does not execute its duty of oversight, public confidence in SOEs and government will be seriously eroded.
Appendix A

Approach to this financial review
We met on 14 and 28 February, 7, 14, 20, and 21 March, and 11, 17, and 18 April 2013 to consider the financial review of Solid Energy New Zealand Limited. We heard evidence from Solid Energy New Zealand Limited, Mark Ford, Garry Diack, Bill Luff, Anthony Burg, Dr Don Elder, and John Palmer, and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove (Deputy Chairperson)
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

The following members participated in consideration of this item of business:
Hon Ruth Dyson
Gareth Hughes
Julie Anne Genter
Iain Lees-Galloway
Hon Damien O’Connor
Hon David Parker
Dr Megan Woods

Evidence and advice received
Hon Simon Power, State-owned enterprises Minister letter to Solid Energy dated 28 May 2009, received 14 March 2013
Organisation briefing paper, prepared by committee staff, dated 25 February 2013.
Solid Energy, details of grants given, received 22 March 2013
—— details of settlement agreement, received 22 March 2013
—— presentation to committee, received 7 March 2013
—— response to allegation (Mark Ford), received 20 March 2013
—— responses to questions, received 26 February, 18 March, 22 March, 28 March, and 5 April 2013
—— “Structuring Solid Energy for future success”, received 22 March 2013
Appendix B

Corrected transcript of hearing of evidence 7 March 2013

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Gareth Hughes
Peseta Sam Lotu-Iiga
Mark Mitchell
Dr Jian Yang

Witnesses
Mark Ford (Chairman)
Garry Diack, Interim Chief Financial Officer
Bill Luff, Group Manager

Young Ladies and gentlemen, thank you, welcome to Solid Energy. Just before we commence I would like to just mention a declaration of association with a prior member of the Solid Energy board: my sister, who’s no longer a member of the board but served there in some capacity for some time, Adrienne Young-Cooper. So just to be open and transparent about that for the sake of transparency. Thank you.

Cosgrove Point of order. And I just want to put on record—I mean no slur on Ms Young-Cooper at all, nor on the chairman—but I just want it noted for the record our concern and that you have been informally invited to vacate the chair for this period of time. I make that invitation to you again, so that you, sir, are not compromised having to rule on questions and having to navigate through questions that may be difficult. That is a matter for you, but I just want to put on record our concern. No insult or view is expressed in the negative on Ms Young-Cooper or yourself.

Young Thank you, Deputy Chair. Welcome to the—

Cosgrove Sorry, I’ve got a couple of procedural questions. Could I just ask, for the record, firstly, before you make your presentation, if you could introduce who is actually here from Solid Energy and what their role is. I take it—I don’t know if the venerable folks from Saunders Unsworth are part of your party or engaged by you as lobbyists, but if they are, could we have that noted for the record. We’d just like to know who we’re talking to today if that’s possible, please.
Young Thank you.

Cosgrove And I presume—how long is the presentation?

Young We have indicated 5 to 7 minutes.

Cosgrove Because we have a very disciplined chair who keeps us within the time allotted.

Lotu-Iiga The chair will dictate.

Curran Mr Chair, could you clarify how long the presentation is.

Young Look, I can tell that they’re not happy for me to run this financial review.

Lotu-Iiga He’s going to run it anyway.

Curran Point of order, could you clarify the time of the presentation, please?

Young We are looking at 5 to 7 minutes maximum.

Curran And how long is the session going for?

Young We have an hour with Solid Energy.

Lotu-Iiga And it’s 2 minutes in.

Cosgrove Can I just ask for the record, if the committee, sir, determined to extend the sitting, would you be available for another half hour?

Ford That’s up to the committee. It just means some (inaudible) changes.

Cosgrove Thank you. Thank you.

Young Anyway, welcome, Mr Ford and your team. If you would like to introduce them to us as requested and present your 5 to 7 minutes, that would be appreciated.

Ford Thank you, Mr Chair, and members of the committee. Good afternoon.

[Introductions]

Cosgrove Are Saunders with you?

Ford Oh, yeah. I asked Mark Unsworth a couple of weeks ago if Mark would advise us on committee protocol—simple as that.

Young Thank you. We look forward to your presentation. If you could proceed. Thank you.

Ford As I said, my name is Mark Ford. I do recognise the focus of the committee is for the 2012 year. I also recognise that since that time Solid Energy’s financial position has deteriorated beyond that point and is now a matter of wide public concern.

The last formal financial statement for the company was at 30 June 2012, at which time the company published the following results: an underlying operating surplus after tax of just under $100 million, $99.7 million, compared with the 2011 year of $86.2 million. But there was a net loss in 2012 of $40.2 million compared with a profit in the previous year of $87.2 million. This negative result reflected a large write-down—a $150 million write-down—of the carrying value of some of our assets, due to the
softening of the international prices for coal. At that time the company was carrying $295 million in debt from both bank and bonds. Since that time there’s been a substantial fall in the global coal prices, with the hard coking coal price falling from a peak of US$224 a tonne in June 2012 to a low of US$140 a tonne in September 2012. To put this in perspective, on similar coal volumes the total revenue for Solid Energy in 2012 of just under $1 billion—$978 million—is forecast to be $645 million, a drop of $333 million.

With these debt levels and a need to fund a potential $100 million cash deficit for this year, it was clear to the board that the company could not carry on as it had in the past. As a response, the company embarked on a major restructuring plan, which has Spring Creek Mine in Greymouth placed in care and maintenance. Huntly East Mine in the Waikato had its development halted and the workforce reduced. We reduced capital expenditure by $100 million by cancelling or postponing most of Solid Energy’s discretionary capital investments in development programmes. We restructured the workforce with a 50 percent reduction in corporate, support services, and development jobs, which were reduced from 313 to 151, which together with the redundancies at Spring Creek and Huntly East Mines resulted in a 25 percent reduction in employee numbers. We also put in place initiatives to optimise production and minimise costs at Stockton mine at Westport to generate additional profits and cash. The impact of these changes will mean the underlying operating performance of the company will be to break even in the 2013 financial year.

Late last year the existing board was largely restructured, and in January this year the new board settled on a forward plan for the company. In the face of this revised strategy on the current financial situation, the chief executive officer, Dr Don Elder, resigned on 4 February, and an interim chief executive, Garry Diack, was appointed whilst we conduct an international search for an appropriate CEO to lead this strategy for the company.

If we look forward, the company’s focus is now on conventional coalmining, and involves refocusing the business on coal development and mining and selling coal to international and New Zealand markets. We will be exiting all investments in renewable energy technology and products. We will be exiting all commitments to long-term technology-based coal development that require on-going capital and/or cannot return a positive value to the company within the next 12 months. This includes underground coal gasification, coal seam gas, coal to fertiliser, and other lignite investments. We will significantly reduce the cost base of the business to reflect a smaller, less complex coal operations company. We will be moving to a business model that substantially reduces the cost of coal production. We expect this approach to restore the company to profitability by the 2015 financial year—that is, assuming coal prices don’t bounce back considerably.

The current financial situation—as a result of this strategic change, as well as a weak forecast coal market, the company is likely to recognise significant further write-downs in the carrying value of its assets within the half year.
ended 31 December 2012. The balance sheet, as I think the committee members know, contains about $390 million of debt, which is currently being reviewed. It will take 12 to 18 months to restore an acceptable level of underlying profitability, and the company will need to be supported by external—

Young Mr Ford. Excuse me, Mr Ford, we are wanting to get to some questions, so if you could just take 30 seconds to wrap up, that would be fantastic, and we'll continue.

Ford Well, I think the key—and I can do that, chair, in 30 seconds—is the future. I have only been a short time on this board. We developed a business plan, which I am sure is going to convert this company back into a very profitable entity. We're in negotiations with our funders at the moment. I am absolutely persuaded that they will buy into our forward plan, and I think the future looks very good.

Young Thank you very much. Thank you very much indeed.

Cosgrove Firstly, for the record, thank you for your appearance. I think I’ve described you as the person who is now walking behind the elephant with a shovel, trying to sort this out. Just as a Cantabrian, for the record, in the spirit of congeniality, can I just thank you for the work you’re doing unpaid, leading the SCIRT alliance in the earthquake.

Could I ask you firstly, you note from your presentation, “In the face of this revised strategy and the current financial situation the Chief Executive Officer, Dr Don Elder, resigned …”. Is he currently still an employee of the company? And I’ve got a series of questions, so, without being rude, I’d appreciate contracted answers.

Ford Very happy to answer them. Dr Don Elder did resign. I asked him to be available for a transition for questions, because he is quite a repository of knowledge on the company, and in this period of change we needed access to some of that. So Don accepted a 2-month advisory, but he is allowing the current management to get on with things. He’s working from home.

Cosgrove Would it surprise you that this morning on radio—this was read to me by Marcus Lush; it’s a question to me but it says, I’ll read it to you, “Clayton, it won’t surprise you to hear that we’ve approached Don Elder. He responded by saying—blah, blah, blah—’I am still employed and working with Solid Energy but no longer a CEO.’ ” Is that correct?

Ford Exactly.

Cosgrove Right. Given that, can you tell me, firstly, why he’s not here today, and, secondly, can you tell me did Dr Elder at any stage approach anyone in Solid Energy, specifically any of the executive team or others, and offer to make himself available for this hearing?

Ford Don Elder is not here today as a member of the executive team presenting to this committee, because it wouldn’t be usual.

Cosgrove I’m sorry, it wouldn’t be what?
Ford  It wouldn’t be usual. Normally, the chair and the chief executive present to this committee. There is no reason for Don Elder not to be here in a private capacity, and—

Cosgrove  Could I put it to you, Mr Chairman, that the circumstances are unusual—that’s the reason you’re having to clean the mess up. The company is in the hock for $389 million, and the problem I think people watching this have is that there is no one here—yourself included, because you weren’t on board; your acting chief executive who signed off was responsible, was in the room, briefed Ministers, etc., etc., and is directly accountable for the decisions they make. So it puts us in a very imbalanced situation—and yourself, with due respect—that we are asking you and your colleagues to look back at a time when they were not responsible. I just ask you again: did Dr Elder approach anyone in Solid Energy, including the executive team, and offer to make himself available for this hearing—yes or no?

Ford  I can’t answer that yes or no, because he certainly didn’t approach me. I’d have to ask the executive—

Diack  I’m not aware that he’s approached anybody on that basis.

Cosgrove  Well, could I ask your acting chief executive.

Diack  I’m not aware.

Cosgrove  You’re not aware. Did any of you invite Dr Elder, given the circumstance—

Mitchell  Point of order, Mr Chair.

Cosgrove  Here we go again.

Mitchell  Mr Chair, we’ve got the chairman, we’ve got the CEO here—ask them the questions. They have to be able to answer the questions. Just ask them the questions.

Cosgrove  Well, what did I just do?

Mitchell  You’re winding down the clock, talking about Don Elder. What’s that going to achieve?

Cosgrove  That’s what I just did. Are you deaf?

Young  Gentlemen, points of order are about procedural issues.

Cosgrove  Yeah, if we’re going to have your colleagues try to shut us down with this sort of rubbish—

Young  No, no, that’s not the case. That’s not the case.

Cosgrove  Can I ask the question again? Did you or any of your colleagues invite—and maybe the colleague over there is the only person in New Zealand who thinks Don Elder shouldn’t be here—Dr Elder or John Palmer to be present today?
Diack  No, we didn’t invite Dr Elder to be present.

Cosgrove  You didn’t invite—don’t you think that, given that—or John Palmer?

Ford  We have no relationship with John Palmer.

Cosgrove  OK. So Dr Elder is still an employee, still on the taxpayers’ payroll. He’s been there for 12 years. He was critical—the key figure, along with the former chairman—in the decisions that have been made and the state of the company, and you people did not feel it was germane, given the extraordinary circumstances, to even invite him to appear today?

Ford  That’s right.

Cosgrove  Well, could I put to you that that is a disservice to the taxpayers of New Zealand, because we’re going to struggle, I suspect, for knowledge from you folks.

Ford  Through you, Chairman, I’m sorry. I think we need to be given the opportunity to answer the question and then make that observation.

Cosgrove  Carry on. Carry on.

Young  Please proceed. Thank you.

Ford  Well, I have no further presentation; I’m trying to take your questions. We’re responding to questions.

Cosgrove  My second point is in respect of Dr—and I know there are parameters around contractual arrangements—but we have been advised and the words that I think have been used in respect of Dr Elder’s contract, but, in fact, I’ll quote the Minister. Tony Ryall has said that it was updated for “employment law changes”. Now the reason I’m asking this, you will note that golden handshakes are rather germane in the last 72 hours. Could you tell us what “employment law changes” mean, and why his contract was signed off on the last day the former chairman relinquished office.

Ford  I can’t tell you why it was signed off before I came on as chair. I think I’ll ask Mr Diack just to reflect on the changes to modern employment law, but I can’t make an observation on why it was signed off there.

Diack  Dr Elder’s contract, I think, from memory, was first drafted in 2002, and when the previous chairman was leaving the business he wanted to make sure that the employment contract was up to recent legislative standards, and he asked for an independent review of the contract on that basis, just to make—

Cosgrove  So the chairman asked for an independent review, did he?

Diack  Yes, he did, which was undertaken, and my understanding is there were minor wording-related changes to the contract.

Cosgrove  So I’m still mystified as to what employment law changes are. Are they the “90-day fire at will” clause or what? What are minor law changes?

Diack  I can’t—I haven’t got the detail in front of me. My reading of them was there was nothing substantive in it apart from wording-related issues. There was nothing substantive.
Cosgrove: Well, see, with respect, this is our difficulty—I’m not holding you responsible for it, nor the chair—we don’t have anybody who was here at the time. Can I ask you this, then—we’ll keep having a go—did the updating of Dr Elder’s contract on 31 August for so-called employment changes have any effect on, one, the terms and conditions of his employment, and did it have any material effect on any aspect of his severance agreement? I assume there was a severance agreement.

Ford: The answer to both those is no. I think they were just rollover provisions that Dr Elder had already got in his previous contract. I’m more than happy—we’re bound by confidentiality. This is an employment contract—

Cosgrove: I accept that. Indeed. Indeed.

Ford: —and I wonder aloud how appropriate it is to go into the forensic of something when it has confidentiality clauses attached to it.

Cosgrove: With respect, that’s a matter for you and I respect that, but I’m going to pursue a line of questioning. Did that settlement package contain—I presume, well, you’ve just said it, it contained a confidentiality clause—did that confidentiality clause extend, for instance, to this select committee hearing, or was there any offer—?

Ford: No.

Cosgrove: So it didn’t extend to that?

Ford: No.

Cosgrove: So there was no need to waive confidentiality if Mr Elder had wanted to be here?

Ford: No.

Cosgrove: OK.

Ford: Can I just clarify that?

Cosgrove: Sure.

Ford: If Dr Elder wanted to come here as a private individual, he could have done that.

Cosgrove: Well, I’m going to put something to you about his package, and you can choose how you answer that. You will note that Lesley Longstone’s package was half a million bucks and she effectively got a year’s salary.

Lotu-Iiga: 425.

Cosgrove: Sorry?

Lotu-Iiga: 425.

Cosgrove: Well, OK, around 425. She effectively got a year’s salary and a bit more thrown in for chicken feed. If you were to do the numbers—and that was for a 13-month contract—if you were to basically just extrapolate out for 12 years in office with holiday pay, leave, and presumably a severance package, one could argue simplistically that Mr Elder would at the very least be entitled to $1.5 million - odd. Do you have any comment on that?
Ford Well, that’s supposition. I’m not going to go there. He had accrued benefits and that’s a contractual fact. You said it yourself—accumulated leave, etc., that has to be paid out.

Cosgrove Would you be willing to provide us with that information if Dr Elder waived confidentiality?

Ford Absolutely. We’ve got no issues with that whatsoever, but we are bound by confidentiality. Ultimately, we are bound by legislation. We have to put it into the annual report.

Cosgrove Can I ask you, as the incoming chair, you have come into this new. You have seen the history and been briefed on the history. Solid Energy’s alternative business arrangements and investments that it embarked on, including—was it the biofuel one where it projected a 6,900 percent increase in production? You’ve seen the hundreds of millions of dollars that have been lost on that. I would estimate that the core asset, given the coal price movement, is probably going to still be a valuable core asset. But can you tell us where did it all go wrong, in your view, and when?

Ford I can’t make that judgment. There was a whole series of conditions, exchange rates, coal prices—a whole mix that the board must have reviewed at the time they made those decisions. My job is to bring this company back into profitability—

Cosgrove With respect, Mr Chair, and I appreciate your answer. Again, I know it’s difficult, but again, this is the problem we face that the only observation we can realistically ask of you, to be fair to you, is your observation as an outsider coming in. And I, for one, at the very least, would appreciate some detail and observation as to where it all went wrong and when.

Young Right. Not wanting to cut the—is that a question or just a comment?

Cosgrove No, it’s a question.

Lotu-Iiga I’m sure he asked it.

Young In terms of being fair, we’re now going to come to Mark Mitchell. You’ve had a—

Cosgrove Can we have an answer first?

Young Well, I thought he’d previously answered.

Cosgrove Well, I’ve restated the question.

Young Restate it again, please.

Cosgrove I’m happy to. The difficulty we face is no one’s here that was in the chair at the time, right? So all we can ask of you in fairness is your observations, having been in the job a couple of months, as to what went wrong, why the taxpayers are in the hock for $390 million - odd, and if there was mismanagement, bad governance, whatever, what happened. They’re owed that explanation.

Ford I think it would be wrong to say the debt on the company. All companies cover some debt. It doesn’t mean it’s a write-off of that debt. We’re just
trying to get the company back into a profitable basis to be able to
normalise its operations. I'll go back. The one key issue that drove this
compny to where it is today is a 50 percent reduction in coal prices.

Curran  Point of order, Mr Chair. This is a financial review and it's a significant
financial review and we've been given one reason by the chair, who's been
in the chair for a very short time, as to what happened to this company.

Young  Point of order heard. I think that through this process we are fleshing out
some of the answers. I think the Hon Clayton Cosgrove has had about 15
minutes of questions. I know Mark Mitchell wants a question—all right.
We'll come back. We'll come back to you—all right.

Mitchell  In your presentation at the beginning of this submission you were talking
about how you have a very good plan to return the company to profit by
2015, and part of that means divesting any business that isn't actually part of
your core business, which is the production of coal. I'm just wondering,
because of the situation you find yourself having to manage now is largely
around the world coal price, how you are approaching it in your modelling
for your return to profit in 2015—your approach to building in the risk
around the price of coal.

Ford  We've adopted as a board a very, very conservative base case below most
analysts' projections. We're not going to be surprised again in this process.
This business plan is what we're using to get confidence back from both
our shareholder and from the banks, to allow what I think is a very viable
business to be sustained. I do know the Treasury, acting on behalf of the
shareholder, is looking at things like the pricing forward, just to be able to
understand what risk appetite the company is putting forward.

Cosgrove  Sir, you used the words “We’re not going to be surprised again …”. What
do you mean by that? Who was surprised?

Ford  Well, the price—I think I said it before—of coal went from $220-odd a
tonne down to $140 a tonne. If you look at coal production worldwide,
most companies are writing down huge amounts off their balance sheet as a
consequence of that drop.

Cosgrove  But, with respect, was it a surprise—and again I'm asking you to comment
on events that you weren't part of—or was it, as we know in 2010, two
valuations where, to quote the Prime Minister, I think, the company vastly
inflated or just simply would not accept the reduced value of its commodity
product, and there was a dispute between the Crown and the company as to
what the valuation was? That's hardly a surprise; that's incompetence, I
would have thought.

Ford  I can't respond to that.

Cosgrove  There again is our problem.

Lotu-Iiga  Just on the price of coal—I mean, obviously, it's a huge factor in the results
of the last financial year. You mentioned other countries. How are other
coal producers around the world? How have they been affected, in terms
of—particularly Australia as well? Can you give us a flavour for that in terms of—

Ford The first thing is there are two types of coal. I’ve been in the job just a few months and I’m suddenly an expert and I’ll defer in a minute to my colleagues. But coking coal, which is the main ingredient for steel, is starting to bounce back. Thermal coal, which is used for power generation, is very flat at the moment—very, very flat—and there’s been large substitutions in other parts of the world for that.

Well, I’m going to turn it over to you, Bill, to answer the member’s question.

Luff Just to give you some comparisons—from late last year, 2012, to the previous year, 2011, the sharemarket values of Australian coalmining companies were down about 50 percent in terms of their market cap over that period of time, whereas the ASX was up 8 percent. In the US, a similar peer group of US coal companies was down 42 percent of their market cap where the Dow Jones was up 22. And so the consistent write-offs that have occurred as a result of that diminution of value have happened not only with Solid Energy but also in the United States and Australia.

Lotu-Iiga Are you aware that in terms of the equities analysts that looked at coal companies not just here in New Zealand but around the world, would it be fair to say they were surprised as well around the rather quick drop-off in the price of the spot market price of coal?

Luff Yes, I think it is fair to say it caught everybody by surprise, and it all revolves around China. China had some supply and demand influences with the very flat export markets that they make steel into. Also, their domestic infrastructure programme, which had really camouflaged the GFC for 2 or 3 years, came to an end. On the demand side, the higher prices for imported coal into China actually made some marginal production in China come on stream, and also the United States started exporting as their economy had surplus coal. So it really created a fair surplus and the soft demand meant that Chinese steel production was off about 33 percent by the middle of last year compared with the year before.

Hughes Thank you very much for coming in. My question is around over the last period we have seen this $40 million net loss. You’ve lost 38 percent global coal prices, you’re still forecasting weak global coal prices, yet the way forward is coalmining. Can you explain how that’s going to work?

Ford Based on the current export prices, with efficiencies in our mines—and we’re already, by the way, starting to see it in some of our mines in the last month or so—we’re seeing better productivity, better sorting, better realisation for mining.

Hughes Does cheaper mining include open-cast coalmining at Pike River?

Ford Oh, no, that hasn’t factored in our plans at all.

Hughes Have you approached the Government at all, discussing that option?

Ford I don’t know—Bill, do you want to answer that?
Luff I think what might be being referred to, Chairman, is that after the acquisition of the Pike River resource, we were required, as a new owner of a permit is always required, to outline possible mining methods that would be researched in order to give the Crown, whose asset it is, a very clear view of intention and a programme of development of that resource. That was done in July last year. Open cast was one of three mining options that were canvassed in that introductory paper.

Hughes Can I just seek clarification on that. Are you saying that you had no plans to do it; you just put it because you had to do it for the permit, so it was just an on-paper reason, or—

Luff What we’re looking at with the development of a large resource such as Pike is maybe 4 to 8 years’ development work before we would consider making a decision about whether we mined it. This is the first step in that process.

Hughes Can I ask a question about the Spring Creek Mine. This was bought back from Cargill at $64 million, and a month later it was closed. What due diligence did you do before making this very large purchase—in fact, larger than your net loss?

Ford Bill, can you answer that one?

Luff The buy-out of Cargill was really occasioned by a number of factors, one being Cargill’s reassessment of their global priorities, and, secondly, the fact that the development of the mine had proved very problematic. Therefore, we had a decision to make as to whether we, in good faith, took out the other shareholder, to allow us to make a decision in our own right as to whether the mine continued development or was put on care and maintenance. In the event, and during that process of buying out Cargill, coal prices actually turned tail, really in the middle of that process. So by the time the process was completed, we were looking at a very different coal-pricing environment than we had when we went into that discussion with Cargill.

Hughes So you’re saying you spent $64 million buying a mine that within a month conditions changed so rapidly that you hadn’t planned for—you hadn’t, you know, done any scenario planning or risk management—so within a month you had to shut it down?

Luff Well, the process took much longer than a month. The process actually took 4 to 6 months. But the point is we now own 100 percent of a resource that still has value, and we are looking to work out ways to realise that value.

Hughes Just lastly, how much money will you be seeking as a bailout, and could it be larger than $389 million?

Luff No.

Ford No, the answer is no. But that’s a discussion going on with the owners and with the banks at the moment.

Cosgrove Has Treasury made any recommendations to the bankers?
Ford I don’t know. I think there’s still due diligence. That’s the whole point of appointing Macquarie to do their review, and I think the banks—I do know the banks have appointed KordaMentha also to review our business plan.

Clark My question requires a bit of context, but, given that Macquarie and Forsyth Barr independently have valued the company far lower in the last couple of years than the company itself had listed in its SCI, so its value was decreasing but not as fast as independent valuers were recording it, and given at the same time, in some of the questions you’ve answered for us, we find an increasing amount of spend in the company that people would now question—for example, nearly a 50 percent growth in overseas travel in the last 4 years in that budget, 50 percent more people in the coms team in the last 4 years, and $23 million in bonuses paid in the last 2 years. Given that background of increasing spending in the company while the value was dropping, independent valuers said even faster than it actually was dropping, when did shareholding Ministers and/or board raise questions about those two things being at odds, and what questions were asked?

Ford I can’t answer that, because, again, I am not privy to the dialogue with the shareholder.

Cosgrove Our problem.

Curran This is our problem.

Ford But there have been previous committee reviews of Solid Energy, where, I’m sure, you asked those questions.

Young Well, as a supplementary, for example, the bonuses that Mr Clark referred to, were they part of salary packages or were they on top of salary packages?

Diack We don’t have a practice of awarding bonuses; they are all part of a salary package. It is an at-risk scheme—

Cosgrove It’s a payment for performance.

Young Sorry, let the answer come. Thank you.

Diack So they are part of an at-risk scheme. So, you know, we—a bit of context, because it’s a topical area, but we set our fixed remuneration at sort of mid to below mid for what someone would be paid in the market, and then we have at-risk components on variable pay, short term and long term, that people can gain by virtue of the work that they do and the objectives they achieve. So—

Curran So it’s performance based.

Young What you’d consider a performance-based—

Cosgrove You can call it what you like. If it’s a payment for performance, it’s a bonus.

Ford Can I put this in context? A lot of the bonuses go out under the collective agreements. They are productivity bonuses that are given to the miners.

Cosgrove So it is a bonus. Is it a bonus or not a bonus?

Ford Well, I don’t know what—I’d need a lawyer to tell me what the definition of a bonus is. There are—
Cosgrove Let me give you a hand. I’m not a lawyer, but normally if you pay somebody additional money for performance, it’s called a bonus.

Diack Well, in the remuneration world, you’d find a distinction that a bonus—

Cosgrove I’m talking about the real world.

Diack —is discretionary.

Young Yes, I think that’s some clarification, because the member did ask, well, suggested that some context was needed. So is it ad hoc or is it actually part of a contract?

Diack If we take the view of bonus as discretionary and an at-risk as formulaic, based on performance, then that’s the difference.

Cosgrove Can I put this to you, then: how do you think it’s perceived by the shareholders of New Zealand—that is, the New Zealand public—when the company is going down the toilet over at least 2 years, we now find out, and $23 million—you can call them whatever you like; they are bonuses—is being paid out for performance as the company is going south? How do you reconcile that?

Ford Well, again, it’s—

Cosgrove Maybe somebody who—no disrespect to you, Mr Chair, but maybe somebody who was there at the time could explain that.

Lotu-Iiga No, he can answer it; he’s the chairman.

Young Mr Chair, if you would like to answer that, please do so.

Ford Again, putting it in context, these are contracts. These are contracts with people, and most—a lot of the bonuses, not all by a long way but a lot of them—are part of collective agreements. And we were pleased with productivity improvements that occurred there. They won those.

Mitchell I have just a quick supplementary on that, Mr Chair. So if these payments have been received by miners, who actually may be working hard and productivity may be going up but the price of coal is coming down, then, actually, the company performance isn’t necessarily tied to the amount of effort being put in, with the guys actually working in the mines. Would that be a fair statement?

Diack That’s a fair statement.

Lotu-Iiga I have a quick supplementary on that. Through you, the Chair, I just want to come back. So these payments are in employment contracts that you are obliged to pay, because it’s the lawful thing to do, that were based on conditions that were different, obviously, before the price of coal collapsed. So you are obviously just doing the lawful thing under the employment contracts. And a lot of those payments, I gathered, were to union members who were working in the mines. Is that—

Diack Yes, we do have sort of site-based incentive schemes to get productivity up, and these payments are part of that.
It’s not all under the collectives. I mean, there are also—corporate management were on incentive schemes, too.

But they’re all under lawful contracts.

Yes, it’s all in their contracts; it’s not always discretionary.

I don’t expect an answer to this now, but I’d like to have a breakdown of how many went to the poor old coalminers who were actually working their guts out to save the company, for which we all expect them to be remunerated, and how many went to management, who are responsible, along with the former board, for putting the company almost under. I’d like a breakdown of that. Now, could you tell me this, please—

Would you like that now?

No, not at this point, because we’re going to run out of time. You can give it to us in writing. Could I ask you why did it take the company—and I’ve been in the minerals industry; I quite get how it works—why did it take this company so long to react to a restructure and stop spending money and retrench and optimise their mining profile, when the coal price was fluctuating and moving south? Because we’ve had examples in Australia where companies reacted very swiftly and they’re still surviving today. Why did it take this company so long?

Well, I think we moved fairly quickly, but—

You were spending money like water.

The coal price took a dive in August—July last year.

It took a dive before then, too, going right back to 2009, if you look at the profile.

Oh, yes, yes.

It was all over the place.

Last year it took its major dive in our watch in July. By August-September we had completely restructured the business, which we completed in December. That cost us 220 jobs at Spring Creek. It took Spring Creek—

And that is with a new board and a new chair, correct?

No, the restructure was started before the new board and the new chair.

The restructure started after I was appointed.

That’s what I thought.

I announced it.

Yes.

Fantastic. Can I move to this: I see on page 25 of your annual report that you go into great detail about your disclosure policies, your no-surprises policies, and your communications with Ministers. In fact, you say on page 25: “Shareholding Ministers are encouraged to make their views known to the board and to raise matters of concern directly with it.” You talk further:
“The board adheres to a no-surprises policy, which ensures that shareholding Ministers are provided with regular information and updates on the business.” Can I ask you this: what actions did shareholding Ministers take to make their views known to you over the period, given that in 2009 they rejected your request for a billion dollars, yet the board at the time marched ahead, if not slowly but marched ahead, with those projects, given in 2010 there was a dispute between yourselves and the Crown, too, over two valuations—2011, where the Government’s own scoping study to sell you showed there were major problems, and then in June 2012 you were put under month-to-month close monitoring and Ministers received monthly reports, and then on 21 or 22 August—forgive my memory—just prior to the former chairman leaving, there was a final no-surprises meeting with Ministers Ryall, Joyce, English, and, I believe, the former chair? I don’t know if Dr Elder was there. What information did you provide and what was the reaction of Ministers? What action did they take over that period of time, given that you were heading south pretty rapidly?

Ford  
I can’t answer any of that, because my mandate was to turn the company around.

Cosgrove  
Well, is there anybody in Christendom, or in this room, who could answer that for the people of New Zealand? As you say here, did Ministers offer a view to the board in 2009, 2010, 2011 as to your activities to move, to halt them, or to change them—or 2012?

Diack  
I’m not in a position to answer. I don’t have that knowledge.

Cosgrove  
Did you provide information to Ministers, apart from the month-to-month close monitoring beginning June last year? What information did you provide to Ministers about your financial state?

Diack  
We do our regular quarterly reports and then we report to the board, and what happens from there, I guess there is some—

Cosgrove  
Did at any time any of the shareholding Ministers ask of you, when the coal price moved, decreased—communicate with you—as to what the strategy was to ensure that the company didn’t end up in a dire financial position?

Diack  
I am unaware. It just wasn’t a role—

Cosgrove  
Did at any time Ministers provide instructions? No? Under section 13? No?

Diack  
Unaware.

Cosgrove  
Did Ministers at any time, as they did just after the 2008 election, invite all of the board and the chair in, as they did then, to ask for more money and more dividends? Did they haul in the then board and chair and chief executive and express any sort of disquiet as to the direction of this company?

Ford  
I’m not aware of that, but—

Cosgrove  
It’s a simple question.

Ford  
I’d like to answer the question in a slightly different way. The shareholder and the Ministers were that exercised that they changed the board.
Cosgrove: Well, no, is that actually accurate? Because the board resigned. No one got sacked. Is there any one of the board that got sacked?

Ford: No, they—

Cosgrove: No. Is it correct that the then chair and the board all resigned? Is that correct?

Ford: Yes, they resigned because they felt they’d lost the confidence of the shareholder.

Cosgrove: Well, that’s interesting, because the Minister waxes eloquently as if he changed the board. He sacked no one. He didn’t exercise any instructions under section 13 of the SOE Act, and we don’t know from any of you gentlemen whether the Ministers even offered a view as to the dangerous situation financially you were in.

Ford: But, with respect, I think the Minister—Ministers—conveyed their concern—

Cosgrove: When was that?

Ford: It would have been—I don’t know in the case of the previous chair, but I certainly do know when I took over that—

Cosgrove: Could you provide us with the date and the meeting of when Ministers first communicated their concern to you and your executive?

Ford: I don’t think it would be through me; it would have been through COMU.

Cosgrove: OK, could somebody please come back to us—not today, but if somebody could provide for us, please, the date, either through COMU or otherwise, when Ministers personally expressed any concern to you about your deteriorating position? I take it, given you were in the chair, that that is only since you have been in the chair.

Ford: Yep, that is right.

Cosgrove: See, again, the problem we have, gentlemen—and this goes back to my original question regarding Dr Elder, for the edification of my colleague across the aisle—is that we have put a series of questions to you, and in fairness to you I say again we can’t really expect answers from you. Therefore, I would have thought that it would have been appropriate to invite Dr Elder to appear. Can I ask you this question: if this committee chose to exercise its subpoena rights, would you have an objection to that?

Ford: No.

Cosgrove: If this committee chose to write formally to Dr Elder and Mr Palmer and ask them to appear, would you have an objection to that?

Ford: No.

Cosgrove: If this committee decided to embark on a formal parliamentary inquiry into this matter and associated matters, would you have an objection to that?

Ford: I don’t have a position on that.

Cosgrove: Why not?
Ford Because that’s your call.
Cosgrove No, would you have an objection to it?
Ford I can’t object to it.
Cosgrove Would you cooperate with it?
Ford Oh, we’d have to cooperate within—of course we would.
Cosgrove Because the problem we’ve got is 390 million bucks is down the toilet, and we can’t get answers because the people who made those decisions and the people who could provide answers are not here. I think that’s unacceptable, totally unacceptable.
Young Mr Ford, I think you’ve made some comment that if we wrote to you, you would—because the member did ask that—furnish some information around this particular area that he is wanting some answers to. So that might be the course of action that we proceed with.
Cosgrove I’ve got a series of information requests as well, for the record. I’d like you to provide us, not today, with a list of all meetings, going back—and, before anybody objects, we can go back 4 years; it’s in the written questions accepted by this committee—all meetings, dates, and who was present that representatives of this company have had with Ministers and/or their officials and/or COMU, the time line going right back to 2009. I’d also like a list, please, of all sponsorships that Solid Energy has engaged in—community and otherwise—who they went to, how much was spent, and for what purpose, going back for the last 4 years. Could I ask another question: who was responsible for the “Let’s act sombre.” email that was put out by the company yesterday and broadcast on Campbell Live? Which one of you wrote that?
Ford Do you want me to go through each—
Cosgrove The clerk will give you a list, to save time.
Young The clerk will—you’ve recorded that?
Cosgrove Who wrote the “sombre” email?
Ford Mr Chair, all I was going to say was we’ve already responded to the sponsorships, I thought, in the written answers we’ve given.
Cosgrove Not as detailed as I’ve asked for. Who wrote the “Let’s act sombre.” email?
Ford I’m not familiar with this at all. I have no idea.
Cosgrove Could I ask the acting chief executive?
Young Excuse me. It would be better if you just asked for the email, rather than characterise and put a slant on it.
Cosgrove OK, I’m happy to rephrase: who wrote an email that requested that people lingering around the corporate office—known as “The Palace”—at 15 Show Place, act in a sombre manner? I’m paraphrasing. It was broadcast on Campbell Live last night. Who wrote it and why?
Diack It was written by one of our communications staff.
Cosgrove  On whose instructions?

Diack  No one—no instructions. It was written over a week ago and pertained to the attendance at the office of the Pike River mining—what do we call it—the families were coming into the building to have a meeting on the exploration of the drift and the recovery of the bodies.

Cosgrove  Do you think that was an appropriate email to write, given the circumstance?

Diack  When you read the whole email—the whole email, and not what I understand was read out—it was an appropriate email.

Cosgrove  Have any other instructions in a similar vein been issued to staff by the executive team?

Lotu-Iiga  Thank you, Mr Chair. I think, you know, we accept that obviously you weren’t there for the period in question that the financial review was taking place, and, you know, I suppose that what we’d like is there are questions and we ask you to answer those to the best of your abilities, and I presume that you will do that.

Ford  Absolutely.

Lotu-Iiga  OK. To the best of your knowledge and—

Ford  Yes, absolutely.

Lotu-Iiga  OK, and we accept that.

Ford  We’ll totally cooperate with this committee.

Young  Thank you very much.

Lotu-Iiga  Yeah, just coming back to coal price, you know, and I think most people accept that when the spot price does change like that significantly, there are financial implications and consequences to a, you know, business’s operation. I suppose the question is what was done around some of the risk management. You know, again I accept you weren’t there, Mr Chairman, Mr Ford, but my understanding was that, in how the contracts are negotiated, Rio Tinto—I think they had them out at yearly contracts and then at some point that changed to sort of quarterly contracts for fixed supply where the price wasn’t necessarily, you know, well known going forward. So can you just comment on that? Are you able to elaborate? What makes this market distinctive and why maybe you couldn’t mitigate those risks around price?

Luff  The norm is that we have long-term contracts with our main customers, but the pricing is set quarterly, and therefore we have a negotiation during the quarter of delivery as to what the fixed price will be for cargoes that are committed. Some companies have that on a monthly basis, and some companies simply use the spot market. We tend to use what we call a benchmark, and that is set by some large competitor companies who trade in our markets, particularly in India, where 60 percent of our export volumes go. What we are seeing in the market typically is that the spot price leads that benchmark price by about 2 months, and what we’ve seen since
September is the spot price move from about 140 to 168 today, and we are looking at the benchmarks moving up from 155 just before Christmas, they’re 165 for this quarter, and our aspiration is that they will be at 175 for the fourth quarter of the financial year.

Cosgrove Given, Mr Chairman, what you’ve heard today—and again I acknowledge that to the best of your ability you and your acting chief executive have attempted to answer questions for which you’ve had no responsibility, certainly you, Mr Chair—given what you’ve heard today and the serious nature of it, would you be prepared to request of Mr Elder that he attend before this committee if he is willing to do so?

Ford If Dr Elder wants to come to this committee and you want him to come here, we will not in any way intervene.

Cosgrove Could I just signal to you, at least from this side of the table, that we will be putting forward resolutions, one, to discuss the subpoena options and, secondly, we will be seeking a select committee of inquiry. Both those issues are triggered by the majority of which you see here. But, just to be clear, you would have no objection if this committee was to write to Dr Elder and ask him to appear before it to answer questions you are not able to answer?

Ford We have no right to object to that.

Cosgrove Thank you very much, sir.

Young Supplementary. David?

Clark Before you do that, Mr Chair, could I move a motion, please—

Young No.

Clark A point of order. Could I please move a motion that we extend time, given the chair has indicated his willingness to entertain further questions, given that I know I’ve got a few, I know that Gareth’s got some, and there are also a few questions from over there. I move a motion that we extend the time by half an hour.

Young No. Well, you can move that motion. Of course you can.

Clark Can I please move that motion?

Cosgrove And I’ll speak to that briefly. This is an issue of incredible moment to taxpayers. I can’t think of an SOE falling over in this way—

Lotu-Iiga They haven’t fell over yet.

Cosgrove —in my lifetime. This is $389 million down the toilet. Now, I think we have a duty to actually exhaustively question these individuals. If those opposite feel otherwise, I’d like to hear their rationale for it, because we do not have any pressure of time on us with other business—

Lotu-Iiga Yes, we do.

Cosgrove —nothing that can’t wait—

Young Yes, there is.
Cosgrove —and nothing that’s more important. The Crown minerals bill is not that important compared to this. And we’ve also had the acquiescence of the chair, who’s willing to stay.

Young Speaking to that point of order, we started at 7 minutes past 2. We’ve actually got another 7 minutes with the members here, the delegation here. You’ve put a motion in terms of another 30 minutes. We will take a vote on that motion. Those in favour?

Opposition Aye.

Young Those against?

Government No.

Young We will go with the—

Cosgrove Can we have a show of hands on that?

Young I put my hands up. OK?

Cosgrove So you guys think 60 minutes or thereabouts is appropriate, given that—

Lotu-Iiga We think you should ask questions.

Cosgrove You guys are Government toadies.

Mitchell Point of order. At the end of the day, you know what, Clayton? If you hadn’t spent half the time grandstanding and actually asked some questions—

Cosgrove You’re absolute Government toadies.

Mitchell —we’d have had plenty of time. You’ve run the clock down doing that.

Cosgrove You’re Government toadies.

Lotu-Iiga Ask some questions.

Clark I didn’t even know what the answer was till I looked at the chair.

Young Gentlemen, you’ve already talked about the desire you want to have a motion to subpoena Dr Don Elder—all right?

Cosgrove I didn’t mention names.

Young That will be discussed by this committee in due course. We have got 1 hour. The time is still clicking. If you have got a question, Mr Clark?

Clark Yes, certainly.

Young Away you go.

Clark I’ve got a series of questions starting with, in respect of the report mentioned in question 3 of your response, the Boston Consulting Group’s report. You have chosen to withhold that at the stage in which the questions were answered, because it contained individual employee details. I’m wondering whether you would be willing to release that, have another look at that question and release it with sections withheld that are sensitive. It seems to me that this is a significant reorganisation that’s talked about here, presumably to bring in a significant external consulting agency, and
the details of that will tell us something about the understanding of the nature of the business at that time. I appreciate that it’s prior to your time in your current roles, but it’ll give us a sense of what was going on in the business at that time and how it saw itself going forward. So are you willing to release that report with the individuals’ information withheld?

Ford: With the personalised information taken out? Yeah, I don’t see a problem with that.

Clark: Great, thank you. Following on from that, this question for Mr Ford, there’s been a significant restructuring of the company subsequently. I’m interested in Mr Ford’s view of that and whether that task is now complete and what issues remain—

Young: Can I just interrupt a moment? Sorry, David, I will come back to you straight away. Look, I have looked at our business that we’ve got to do, which is very important. We can probably take some time out of that, so if we go to, say, 4.15, we’ll put questions to your side. We won’t take them—all right? That will give you some leeway in terms of your request. Carry on.

Clark: Right, I appreciate there will be questions left and we’ll intend to put any that are left over into our subsequent inquiry. I mean, that will be, I guess, our approach. So my question is around the nature of future restructuring and also the structure that you’ve inherited and its adequacy or otherwise.

Ford: Part of the board’s business plan going forward is another major restructuring. Obviously, when we’re just going to focus on coal operations, it is a very different dynamic than before. Committee members, you’ve got to understand, these are people. I don’t want to announce what’s going, today. We have to go through a consultation. We have to treat people with respect. I think the business has changed, and we will need to take the appropriate action for that.

Clark: Do you think the previous restructure—perhaps we’re better to talk about that—was carried out as well as it could have been?

Ford: I don’t think anybody is satisfied when they lose their job, and so there was obviously a lot of concern. I think in hindsight it was an intermediate step. The board had to decide, and the new board, its strategy going forward. It has done that and it has determined, with the help of management, the structure that will support it. The previous one could not have done that.

Clark: Can I be clear? What I hear you saying—and I want to be clear whether I’m hearing it correctly—is that the short answer would be no, it wasn’t adequate to where the business finds itself now.

Ford: I agree with that statement. It was an intermediate step.

Clark: And, therefore, you know, there’s a question around the costs involved in a restructuring if it hasn’t been an adequate full restructure, if it was an intermediate step. Do you feel that that money spent on the restructuring was unnecessarily excessive in places?
Ford No, there is no duplication in that process. It was an intermediate step. Any of those staff that weren’t in the first tranche would not be the required staff in the new business plan, so, no, I don’t agree with that statement.

Clark Can I take another tack? The bonuses paid in the last couple of years, in hindsight do you think they represent value for money?

Ford That’s a value and an opinion. I can’t give you that opinion. All I can tell you is there are contractual obligations that have to be met. I can’t go any further than that.

Clark So you’re saying that the way in which the structure was set up was what was flawed because the—

Ford No, I’m not—

Clark No, the contractual obligations—essentially, that’s saying the system was flawed and you had to abide, or the company had to abide—with respect, it was before your time—by the decisions it had already made, and those proved to be inadequate.

Ford I’m not saying it was flawed. I’m saying we had to abide by the contractual obligations.

Hughes Can I just ask, you’ve got a headquarters known as “The Palace”. You’ve got $23 million in bonuses when the company’s going down the sink. You’re buying a coal mine for $64 million and closing it a month later. Something obviously was flawed. Was it a culture of excess at Solid Energy?

Ford Look, there were decisions made at the time, which I was not part of. I was brought in by this Government to turn this company around and make it profitable. I am absolutely persuaded that this has got a good future, this business.

Hughes If you’re going to turn it around, though, you’ve got to look backwards and ascertain what the problems were. Was it an individual or was it the culture?

Ford I don’t think it was either of those. It was the market. It was the price of coal.

Hughes So all the decisions that had been made—

Ford The benefit of hindsight is very easy. You might have made a wrong decision here or there. I don’t know. I’m not looking at that. I’m looking at the state of the company today, the state of the market today, and making that company fit the market today and be a very profitable company.

Hughes Just to go down this line a little bit more, you’re saying that the problem was just the market, as if it was an act of God. This is a financial review where we’re trying to ascertain decisions that were made by individuals, by the company. Whose fault was it? Was it the culture or an individual within Solid Energy?

Ford It starts off with the board. It goes down to management. It goes down to delegations. It goes down to a whole host of things which I’m not privy to. I know I walked in and we faced a lack of confidence from our owners. We
had to turn this company around and come up with a business plan which I
think has impressed them, impressed our bankers, and I think this company
will very quickly convert back to being a very proud, profitable company
focusing on coal operations.

Curran Will you be ceasing the way that those bonuses are paid out? Will you be
cessing that structure? You’ve said that it wasn’t satisfactory, in hindsight.

Ford No, I didn’t say that. I haven’t made a value—I don’t—

Curran Will you be ceasing it?

Ford If that’s the question, I think in the restructuring of the company we’ll be
looking at all jobs and all salaries attached to those jobs.

Clark What drove the increases in communications staff numbers in recent years?
Up 50 percent in the last 4 years.

Ford Can I defer to management?

Luff I think there was a view that the business was getting much more complex
and it had to deal with a whole increased dimension of stakeholders,
particularly in respect of the gas projects and the lignite project, as well as
conventional coal projects. That drove the underpinning of needing more
people who were directly related to those stakeholders. I have to say that
since year end the numbers that you’ve been presented, the communication
numbers, have more than halved. They stand at just under four now, and
that is a result of the post-review period restructure.

Clark Much smaller staff numbers. Can I ask what drove the 50 percent increase
in costs for overseas travel in the past 4 years?

Ford Probably most of that was international marketing. I mean, we rely so
heavily on it, but let me let management tell you.

Diack The chairman’s answered the question ostensibly. In that period we’ve
moved off annualised contracts to monthly pricing regimes, so our need to
visit the markets has increased substantially, and the relationships we have
with our customers are now an on-going issue.

Cosgrove Could I ask you, given that Mr A J Broome, a former director, declared an
interest in NEPEAN Mining Ltd—forgive me if I’m pronouncing it
incorrectly—what tender process was undertaken in awarding contracts to
that company, formerly known as MI Power Pty Ltd? If you don’t have that
information, could you provide it to us in writing.

Ford We will.

Cosgrove Secondly, what is the value of Solid Energy’s contract with NEPEAN
Mining Ltd?

Ford We’ll supply you with that information.

Cosgrove Mr Diack, on what date did Solid Energy enter into a supply agreement—
and, again, forgive my lack of linguistic skills—with Vera Facienda Pty Ltd?

Diack Vera Facienda?
Cosgrove: Yes, sorry. My Spanish ain’t that good. Some would say my English isn’t that good, either.

Diack: I can’t give you a date, but it’s probably sometime in 2012.

Cosgrove: OK. Could you come back to us with the exact date. What tender processes were undertaken in awarding contracts to that entity?

Diack: We ended up talking to a couple of people in the local market and then went for the Australian-based people because they had a greater ability to deliver to the contracts that we had at the time.

Cosgrove: What is the value of Solid Energy’s contract with that entity?

Diack: I’d have to give you a—

Cosgrove: Are you or were you a director of that company?

Diack: I was.

Cosgrove: Up until what time, what date?

Diack: Up until April 2011.

Cosgrove: And how did you manage the actual or perceived conflict of interest in respect of those arrangements with Solid Energy and that entity?

Diack: They were fully declared at the time, and they have been subject to a formal internal review.

Cosgrove: And was there a tender process—an open tender process for contracts with that company?

Diack: It wasn’t an open tender process.

Cosgrove: What sort of tender process?

Diack: They were targeted. Two or three firms were targeted.

Cosgrove: So you were a director of this entity at the time, and you and your executive didn’t feel that an open tender process would have been appropriate.

Diack: I wasn’t involved in the awarding of the tender.

Cosgrove: But you were a director at that time, an employee of the company—correct?

Diack: Yes.

Cosgrove: The chief executive, I presume, or the board at the time didn’t feel an open tender process was appropriate, given your involvement in both entities?

Diack: These are quite specific skills, and so you can identify the available market for those skills fairly easily.

Cosgrove: Finally, would you do us a favour—it would save me a postage stamp—and convey a message to Dr Elder that at least those of us on this side of the table, and I assume my Green colleague, would be very happy to entertain any meeting with him and any explanations he could provide, given he’s still an employee of yours, prior to or during, or if he’s not called before the select committee?

Diack: Yes.
Ford: Can I make one amplification, though, Chair, on these questions. I just asked the chief finance officer. I think there was a review by the company’s internal auditor direct to the audit and risk committee of the board just to ensure there was no probity issues at all in this—

Cosgrove: That’s fine, but we’d like some formal—given that it’s—

Ford: Yes. Some context.

Cosgrove: I appreciate that. We’d like some formal clarification and answers to those questions that I posed.

Hughes: I just want to quickly look at the impairments. You wrote down $149 million. The smallest was the biodiesel project, but this is what I’ve heard from various commentators saying it was one of the reasons for falling over. Was this Government policy? Because unlike the coal price, which you’ve got no control over, the Government had direct control, and here we see them removing the grant scheme, a carbon price going down so far as a dollar a tonne of CO₂. Was this a case of the Government just pulling the carpet from beneath you?

Luff: No, not at all. The business was unprofitable with the subsidy. And it was even more unprofitable without it. We were really suffering from two effects. One is the cost of supply of the raw materials, because we were competing for high-value land use in Canterbury, and we were basically looking—and I know it doesn’t feel like this—at a relatively cheap hydrocarbon alternative in diesel that we were competing against. There was just not the margin there for us to make money.

Hughes: What was the effective carbon price that you needed to be competitive?

Luff: Well, the carbon price that was factored in long term to the justification of getting into this business was $25. Obviously, it simply never ever got to that level in recent times.

Clark: Mr Palmer was paid, I think, $80,000 during the last remuneration period. Does that number include any additional payments for directors preparing assets for SOE sales?

Ford: Can I ask the chief financial officer?

Diack: I’m not aware of any other payments.

Clark: So—can I just be clear—members of the previous board haven’t been paid additional remuneration as part of a responsibility to prepare assets for an IPO?

Ford: Can we get back to you on that?

Cosgrove: Can I help? I think you got an extra 30K.

Ford: Who did?

Cosgrove: I think Solid Energy, along with— You got an extra 30K.

Ford: Oh, I though you said me.
Cosgrove  No, you’re an unpaid recipient of this mess, but I think they got an extra $30,000.

Young  Gentlemen, I want to thank you for appearing today. We have gone over another 15 minutes to accommodate the request of some members of the committee. Thank you for your appearance.

Cosgrove  You’ll be able to get a list of the questions from the clerk on the way out.

Young  Yes, you will be able to. Indeed. Thank you.

conclusion of evidence
I’d like to welcome Dr Elder and Mr Palmer. Thank you for attending. Members of the committee, we want to have a really good hearing with these gentlemen, so we want to have a good, fair opportunity for each member to ask their questions. We’ll be working through that. This is a rare occasion, in having a former chair and former chief executive speak at a financial review. We are still within the context of the financial review of Solid Energy, but we know that these are unusual circumstances.

I’m going to ask Dr Elder shortly to do your initial presentation, then I will come to you, Mr Palmer. Dr Elder, you may wish to address some comments that were made by Solid Energy at last week’s hearing and which you have expressed some concern over, and we would invite you to do that if you would so wish.

Point of order. And forgive me, just two procedural matters: one, Mr Chair, I simply again, as I did at the last hearing, want to place on record my invitation to you, given your conflict of interest, to step aside from this proceeding, but that is a matter for you; and, secondly, without invading Dr Elder’s space to answer questions, I think before we start the presentation could we have some clarification, Dr Elder, if you are under any constraints to answer any and all questions—

Sorry, what’s—

It’s a procedural issue, with respect. I think we owe Dr Elder that. Are there any constraints to answer any and all questions in respect of this hearing? So
Mitchell Well, that’s not a point of order.

Cosgrove It’s a procedural matter that I alerted the chair to beforehand.

Young Thank you.

Elder Only the constraints of normal good faith, confidentiality, and loyalty to the company that every employee is under.

Cosgrove So you have no legally binding clause that prevents you from being free and frank with us?

Elder There may be areas where that does apply, but not with regard to comments about Solid Energy that the committee would have.

Cosgrove Could I just invite you, if that is the case—we’re not asking anybody to breach contractual arrangements—that you may wish to alert us to that.

Elder I will do that if the time comes up.

Young All right. Thank you, Dr Elder. Thank you, sir. If you’d like to make your presentation.

Elder Mr Chairman, could I suggest—your decision—that perhaps Mr Palmer would go first. His comments will be slightly briefer than mine, but both will be very brief.

Young That would be fine.

Palmer Mr Chairman, thank you. I just want to briefly traverse a little bit of history and to make one or two points. I joined the Solid Energy board in November 2006 and took over the chairmanship in January 2007. In May last year—May 2012—I notified both Treasury and the Minister that I was going to step down as the chairman, and that was made public in June 2012, and I resigned in 2012 after the publication and presentation of the 30 June annual results. I was not pressured, certainly that I was aware of at any stage, to make that decision. That was a personal decision, as explained, I think, in the press release at the time.

I wasn’t asked to come today. I’m here because I think it’s important as chairman during that period that I’ve outlined that I can answer some questions that nobody else can answer. I think it’s the right thing for the company and, hopefully, for Parliament and the public that I am here. I am here, I hope, to explain why the board made some key decisions, to acknowledge that the board bears responsibility for the consequences of those decisions for the things it has in its control, and that’s a responsibility that we as a board took seriously.

A lot of the issues for discussion today are complex. The answers, to be credible, will need some time to ensure that the proper background and issues are understood, and I hope we will be given the opportunity in the answers to do that, in order to clarify a number of the issues that have been raised about Solid Energy in its current state. My hope is that the questions

that you can guide us as to where you will be able to go and where you won’t.
today will get to the heart of the big and controversial issues facing the company that I think we have a responsibility to provide some explanation for. That’s why I’m here. Thank you.

Young

Thank you very much, Mr Palmer. We’ll come to you now, Dr Elder.

Elder

Thank you, Mr Chairman. As you are aware now, I’ve always been available and willing to meet the select committee to assist your financial review of Solid Energy. And I will answer, as I said, to the fullest extent I’m able, all your questions to me as the former chief executive. It has always been my view that this committee is the proper place to first answer these questions.

I grew up in Christchurch, spending much time in and around the South Island, particularly on the West Coast, and I’m passionate about the same places and people where Solid Energy does most of its business, and the opportunity that those places and people could offer to New Zealand. I remain proud of what we achieved in the 12 years I was chief executive, but I also accept that there are decisions that we would make differently in hindsight and with the benefit of hindsight. And I’m truly sorry for what many people in Solid Energy are going through right now as a result of what’s now happening with the company.

Solid Energy, though, is like no other company in New Zealand. As I’ve said before, as a coal company it’s uniquely exposed to some of the most difficult geology and geography in the world. Most coal companies globally would have, and, in fact, did, walk away from the challenges that we faced and that the company still faces. Solid Energy could easily have been, and, in fact, nearly was, wound down to closure from 1999, when after 100 years of mining it only had 2 to 4 years of readily accessible, available, shallow, high-quality coal left to it.

Instead of that, over 12 years, Solid Energy doubled production and sold about 50 million tonnes of coal, generating about $7 billion of revenue for New Zealand. In 1999 the expectation was less than $1 billion. It generated 10,000 years of direct employment and probably 30,000 or more years of indirect employment. In 1999 that number was probably 1,000 to 3,000.

It achieved a 30-fold reduction in our lost-time injury rate. That’s something we were all very proud of. We achieved a turn-round in environmental performance from unquestionably one of New Zealand’s worst environmental performers by far to one of the best, with a measured, positive net effect on the environment achieved almost every year for the last decade and reported as such. That’s something that no other company, to my knowledge, in the world, let alone in New Zealand, can claim.

We withstood a 60 percent crash in international coal prices through the GFC in 2008-09 and came out strong. We contributed $1 billion—$1 billion—of direct revenue, or thereabouts, to the Government through that period from taxes, royalties, levies, and dividends. We’ve set up options to keep delivering value to New Zealand from New Zealand’s huge coal resources that decades into the future, even after they’ve become too deep
or too shallow and too low quality to mine using conventional means, we sell.

So these are the things that I and everybody else at Solid Energy was proud of, but we also made a number of decisions along the way. In the second half of 2012, last year, the coal industry around the world—the coal industry around the world—received a stunning blow from an unprecedented collapse in international coal prices. Coking coal prices, our primary export, fell very fast, far, far below the range anyone was forecasting anywhere in the world. Unlike the previous two downturns in 1999 and 2008, this time the Australian and New Zealand dollar stayed very high. Our export prices in New Zealand dollars dropped back to 2004 levels. It may not sound that significant, but we were now mining coal in 2012 that was at least three times deeper than the coal we had available to mine in 2004. What that means in mining terms is that the cost of mining three times deeper is likely to be six or nine times higher, and, in fact, the achievements we’ve made on productivity meant the cost was only four times higher. But the price was still back at 2004 levels and our mining was three times deeper and four times more costly. Even Stockton mine was cash-negative during the low part of the price period in 2012. So for us, like almost every other coal company in Australia, this was the perfect storm. The global industry, which had been very strong, fell from strong to struggling in the space of less than 3 months. Every company everywhere is closing high-cost mines. Solid Energy was, and still is, no different.

In conclusion, I’d like again to say sorry to Solid Energy people everywhere. To Trevor and the guys on the Coast and to the guys in the offices everywhere—sorry to all of them for what they are now going through. I know it’s no comfort that they’re not alone, that you’re not alone, in the industry outside New Zealand. Every single one of you—every single one of them—has been passionate about our business and has been making major efforts for a very long time to deliver the success that it had.

Solid Energy, in my view, as the chairman said last week, still has a very strong future. Coal prices will continue, as they are doing, to rebound, but it will continue to be a very challenging period for the company as the company works through this period of very low prices, and the company will need to manage very aggressively and very, very carefully, as it has done in the past. I’m sure it will do that.

The company deserves and needs the support in the fullest way from everybody who’s involved. I’m here today to answer all of your questions to the maximum extent I am able that you will ask, I know, on behalf of the people of New Zealand who want to know those answers. Thank you very much.

Young

Thank you, Dr Elder, and thank you, Mr Palmer. I’ll start off and then we’ll come to Mr Cosgrove. Yes, I want to acknowledge the turn-round that happened in 2000 and what you presented. In terms of this perfect storm in 2012 that happened around the world, can you give us a breakdown of all the elements of what created this, in terms of export markets, etc., etc.,
perhaps what was happening in the US at that point in time, so we get some
understanding of what’s contributed to that.

Elder Yes, it’s complex but can be summarised fairly simply. The global coal
market had been kept strong and will be strong in the future due to demand
from emerging countries, particularly China and India, whose economies
are both growing at 6 to 10 percent a year. China’s economic growth had
been somewhat disguised for 2 or 3 years through the GFC by the major
financial impetus that it made. When that was removed, the demand side
for the period of late 2012 caused the demand for copper steel, the demand
for coking coal, and therefore the prices of coking coal and demand to
collapse temporarily.

On top of that, for reasons that are related to the stimulus measures and the
printing of money, if you like, in Europe and the US, I guess, the Australian
and New Zealand dollars stayed very strong. That created a perfect storm
for Australian and New Zealand coalminers that was very different to the
downturns that occurred the previous two times when the US dollar prices
fell as demand fell, but so did the Australian and New Zealand dollars.

Young In terms of the US market, in terms of their export volumes, was that static
or did that increase during, say, the last 2 or 3 years? What’s your
understanding around that?

Elder US coal companies are in serious trouble because they, many of them, are
exposed to the thermal coal market, the electricity market, in the US. That
market has been swamped by the availability of cheap gas from shale gas,
which I’m sure everybody knows what that is. As a result, thermal coal
producers in the US have struggled. Those who had coking coal
production—and not all of them did because some of them simply went
under—needed cash flow from the coking coal and started dumping it into
the Asian market at costs well below their cost to keep cash flow going.
While that is not sustainable, it appears to have lasted now for 3 to 6
months, and that’s the primary reason why even in a slumping demand in
Asia, the supply that came in was unprecedented in terms of global
dynamics of coal.

Cosgrove Thank you, Dr Elder. Before I get to some substantive matters, I’d like to—
you will realise there’s been some procedural issues before this committee,
and I’d like to ask you about your attendance. There’s been a lot of
commentary on that. Is it correct that you offered—well, firstly, are you still
an employee of Solid Energy?

Elder Yes.

Cosgrove Is it correct that prior to last week’s meeting you offered to attend this
meeting and testify, if you will, or provide information to this committee?

Elder Essentially, yes.

Cosgrove And who did you make that offer to, and was it formalised, and if so, how?
Elder My lawyer provided in writing to Solid Energy’s lawyer a letter saying that I was available and willing if required to attend the select committee as I had previously indicated doing.

Cosgrove And is it correct that that offer was made 24 hours before last week’s hearing?

Elder It was made the previous day. I haven’t counted the hours.

Cosgrove Was your lawyer’s letter copied to anyone, and who was it directed to by Solid Energy’s lawyer?

Elder It was sent to the lawyer acting for Solid Energy for the chairman, and it was copied to the acting chief executive.

Cosgrove Mr Diack?

Elder Correct.

Cosgrove And what was the response you received to your offer to attend?

Elder Solid Energy’s lawyer advised me that they had received it but they did not require me to attend.

Cosgrove They did not require you to attend?

Elder Correct.

Cosgrove And are you aware that Solid Energy did not advise this committee, one, that you had made that offer and that they had declined at the time of last meeting, and that they’d declined your invitation?

Elder I became aware of that the next day through the media.

Cosgrove Could you tell us why you think the presumably—correct me if I’m wrong—the acting chief executive turned down your invitation to attend?

Elder I accepted that. That’s their decision.

Cosgrove Pardon?

Elder I accepted that. That’s their decision.

Cosgrove And are you aware that Solid Energy did not advise this committee, one, that you had made that offer and that they had declined at the time of last meeting, and that they’d declined your invitation?

Elder I became aware of that the next day through the media.

Cosgrove Could you tell us why you think the presumably—correct me if I’m wrong—the acting chief executive turned down your invitation to attend?

Elder No. I’m sorry. I can’t. You’d have to ask him, indeed.

Cosgrove Could I press you on that? I put a question to the acting chief executive as to whether you’d offered. And I’m paraphrasing—he said he was not aware any offer had been made on any basis, I think were the words he used, which I find very hard to believe given that you’ve told us you put it in writing to him the day before, and there wasn’t, shall we say, any more pressing issue than your attendance at that meeting, which I would have thought would have been uppermost in the acting CEO’s mind. So could I ask you again, given that none of those people could answer any questions, why would they not accept the invitation from you as a 12-year veteran of Solid Energy as CEO?
Elder My understanding is that what they advised was that it was normal for the current chair and chief executive to attend, and that was the decision they made. Beyond that, I can’t judge, I’m sorry.

Cosgrove Were you aware that this committee had asked Solid Energy if they felt it was appropriate to include you on the guest list, and were you further aware that I wrote directly to the acting chief executive and the chairman to ask them for you to attend?

Elder I think I would have to say I may have been generally aware of that through the media, but I don’t believe I was specifically aware through formal lines.

Cosgrove OK. To Mr Palmer, same question. Could you tell us why you think the chairman or the acting CEO in those circumstances, with an inability to answer any questions because they weren’t in the role, would have declined an offer from the 12-year veteran CEO to attend this meeting? To attend the meeting and then—

Young It’s quite a difficult question for—

Cosgrove Well, Mr Palmer’s been around. I’m sure he’s capable of answering.

Palmer I had not been anywhere close to the loop on that. From the time that I exited the company, as you’re probably aware, I have no made no public comment. I thought it was best—there are a lot of problems facing the company. I thought it was best for the company that they should be given the opportunity to get on and deal with the issues in front of the company, and I didn’t think it was helpful for me to get involved in any way, and I haven’t.

Cosgrove Would it surprise you to learn that Solid Energy has since advised us that they wrongly answered the questions to your availability and have advised us that they did indeed, as I understand it, refuse your invitation to attend?

Elder Is that addressed to me?

Cosgrove Yes.

Elder I’m sorry. I think I may have heard or seen something like that in the media but I’m not specifically aware of that, I’m sorry.

Cosgrove OK, because I’m of the view that we have been misled by those executives. Could I just turn to some of the sequence of events around Solid Energy’s financial position. Mr Palmer, is it correct that the Government requested of Solid Energy that they increase their gearing to a uniform gearing of around 40 percent?

Palmer I’m not sure—

Cosgrove Under your stewardship.

Palmer I’m not sure whether in actual fact whether the 40 percent, but certainly there was a request from the shareholder to increase the gearing. Yes.

Cosgrove And was there a request to increase dividend yield from the shareholder?
Palmer Well, the point of increasing the gearing, if necessary, was to ensure that there was more cash available, I guess, which would ultimately increase the dividend yield. Yes.

Cosgrove So what was your response to the Minister in respect of the request to increase that debt?

Palmer Well, I think we should bear in mind that effectively all of this discussion took place with officials. I may have—I can’t recall whether I had a specific discussion with the Minister, but certainly because in the preparation, as you’ll be aware, of the statement of corporate intent, this is a key component of it, that discussion was between the company and often the board was involved—

Cosgrove —and I was personally involved, and that was a discussion with officials—

Palmer —and I was personally involved, and that was a discussion with officials—

Cosgrove Sure. OK. Can I rephrase it, then. What was your response to the Government request, and what was the response to the Government’s representatives?

Palmer We opposed that.

Cosgrove So you opposed the increase and the request for debt increase?

Palmer Well, we opposed it on two grounds. We had a very well-thought-through approach to the dividend policy for the company, and that was that for a company like ours, subject to volatility, and those of us who’ve been in volatile markets for a lifetime know that the protection of the balance sheet is critical, so we had adopted a policy of two things. Firstly, we thought that any dividend discussion that we should have and evaluation should be based on a forward look at the balance sheet gearing, and that the 35 percent that we had decided on we thought was an appropriate level of gearing given the nature of the industry that we were involved in.

Cosgrove Is it correct, then, that you felt the request for an increase in debt would have been a risk for the company?

Palmer Well, it increased, I guess, the level of gearing beyond what the board was naturally inclined to think was appropriate.

Cosgrove And what was that level?

Palmer And that is because we took quite a conservative view, and we had a lot of people who were very experienced in these sorts of businesses.

Cosgrove And, sir, what level did the board think was appropriate? What gearing percentage?

Palmer Thirty-five.

Cosgrove Thirty-five.

Lotu-Iiga Just on dividends, you’ve paid out dividends in the past. I read your 2006 annual report, for example, and you paid out $20 million worth of dividends there. I know you joined the board in December 2006. So this is not new
where you’ve paid out dividends, where, you know, the company’s performance justifies the payment of dividends. Correct?

Palmer Correct. And the basis on which we paid dividends, as I said, was a forward look at our balance sheet gearing for the next 12 months, and what level of cash we expected to have that would sustain a dividend.

Lotu-Iiga Sustain it.

Palmer Yes.

Young Can I just a question before we come back to Clayton, for some context. What was the value of the company around that time? I think it was back in 2009 that that letter my colleague is referring to.

Palmer Chairman, I don’t have that number off the top of my head. I am sure that the company records will answer that, but I can’t accurately answer that question.

Cosgrove So, sir, just for the record, the board felt that appropriate gearing levels at 35 percent were conservative and appropriate and the risks were manageable.

Palmer At that stage, yes.

Cosgrove And the request was for in excess of that. Correct?

Palmer Yes.

Cosgrove Right. Can I also ask you what did you do to action the Government’s request for an increase in gearing? Did you adhere to the request?

Palmer Well, let’s be clear that decisions around dividend are made by the board.

Cosgrove I understand that.

Palmer So I guess we did increase the gearing, and in our future discussions around dividend I think we went from 35 percent to 37 percent, from memory.

Cosgrove But not 40?

Palmer It certainly wasn’t 40 at that stage.

Cosgrove Could I take you back—

Palmer And we continued to use the approach of gearing on a forward look at the balance sheet.

Cosgrove Could I take you back? So the Government requests an increase in gearing. You express concern around risk.

Palmer Yes.

Cosgrove When did you adhere to the— When did you increase? And did the Government instruct you to increase after you had said that you felt that wasn’t appropriate?

Palmer There was certainly a clear view from the Minister at that stage, and that was, I think—

Cosgrove Which Minister?
2011/12 FINANCIAL REVIEW OF SOLID ENERGY NEW ZEALAND LIMITED

Palmer
This was Minister Power at that stage. —about what the Government wish was. There was no instruction.

Cosgrove
So by “clear view”, what do you mean by that?

Palmer
Well, what their request was as the sole shareholder was quite clear.

Cosgrove
OK. Can we move to another matter?

Young
Can I just ask a supp around this before we move to another matter. Dr Elder, the question I asked Mr Palmer in terms of the value of the company at that point in time—I think you’d have a fairly rounded figure that you would know what it was worth. Was it $1 billion, $2 billion, or $2.5 billion, or $3 billion, around about 2009?

Elder
There is an explicit number in our statement of corporate intent each year, as I’m sure the committee are aware, and I don’t have with me. The more important point is that there is no clear value for a State-owned enterprise with a single shareholder. What I can tell you, and Mr Palmer may wish to comment, is that each year it was a subject of massive discussion. What assumptions should be made, what future value projects that are still options should be included or left out, because if you include them or leave them out, they cause a massive difference. You have to form a view on the possibility or the probability of those succeeding and lay that out very clearly as the qualification to any number put up, because there is no clear number. If you take a very conservative view, leave out future coal projects, future diversification projects, and you take a very conservative view on coal pricing, you arrive at a number well below what the analysts would say. If you include all those in, you arrive at a number much greater. It is as simple as that.

Lotu-Iiga
So you’re saying 35 percent, yet when I look again—I will go back to 2006, and I know it’s prior to you being chairman—we’ve got figures here of a $20 million dividend payment and a gearing ratio of 46.94 percent. So it is clear that—

Cosgrove
That’s not correct.

Lotu-Iiga
Well, I’ve got some figures here.

Cosgrove
Well, ask them if it’s correct.

Lotu-Iiga
I need to ask Dr Elder. You were there at the time. Did you have those sorts of gearing ratios?

Elder
No, I’m sorry, I don’t know where that number comes from. But unless my memory fails me completely, our gearing in 2008 was absolutely not 46 percent.

Lotu-Iiga
OK. Well, maybe we can get that figure.

Mitchell
Can I ask a supp on your question?

Cosgrove
Sorry, I missed the answer. So the figures that the colleague quoted are incorrect. Is that your understanding?
Elder  I believe they are, but I’m not sure which particular numbers he may be quoting from.

O’Connor  Have you checked the ones that Tony Ryall gives you?

Lotu-Iiga  Hang on. Excuse me. Look, I’m just looking at your annual report. I’m doing some quick off-the-cuff numbers. I can give you, if you want a quote—

Parker  Can I ask a supp on that?

Lotu-Iiga  Well, we’ll have to get these figures, Mr Chairman.

Mitchell  Thank you both for appearing in front of the committee today. Can I just ask, you’ve just been talking about you opposed the request by the shareholder in relation to the amount of leverage that was going to be accepted by the company. If we go back, this is more a question to Mr Elder, if you go back through your history as a CEO of Solid Energy, were there any other requests? Because you made a fundamental change in the way you’re doing business when you started to go outside and invest in other renewable energies outside of your core competency or your core business, which is the production of coal. During that period of time, were there any other instructions that you received from shareholders that you opposed or you didn’t agree with in terms of the strategy and where the company was going?

Elder  So let me be very clear. The communications from the company to the shareholder are through the board and the chairman, so my answer would be that I received no direction of that kind to me. John, I am happy for you to answer. I don’t believe there was any of that nature, but John you would have to answer that, I think.

Palmer  Not that I can recall is my answer.

Hughes  Can I ask a supp on that? Thank you very much. We’ve heard that you opposed the debt gearing increase. What was your position on the dividends over the last 4-year period? Was this set by the board and were you pressured by the Government in any way, or was this set through a notice by the shareholding Minister?

Palmer  The dividend decisions were decisions of the board.

Bakshi  Can I ask you, has ever a shareholder asked you to borrow to pay the dividend?

Palmer  No. There was no request for that.

Bakshi  Ever?

Palmer  Certainly none that I can recall. I’d be pretty certain on that.

Cosgrove  Are the following gearing ratios correct—and I am happy to table this if anybody has any difficulties—2005: 14.1; 2006: 16.1; 2007: 5; 2008: 9.4; 2009: 13.8; 2010: 34.4; 2011: 29.6; 2012: 41.7?

Elder  John, I can answer that. I don’t know on an absolute basis, but I would believe those numbers are almost certainly correct.
Thank you, sir. And I would also qualify that in 2012, if you took the day before year end and the day after, because of the impairments that were taken last year, that John Palmer’s earlier statement was correct that the gearing was well below 40 percent the day before. As a result of the impairments, it did go over 40 percent.

Thank you, sir. Just one other question. Over that period, Mr Palmer, that you were requested to increase gearing, what were the forecasts for coal price at that period, and did you advise the Government’s representatives at the time they were requesting an increase in gearing? Were they heading north, were they heading south, were they—what were the forward forecasts?

Within the volatility—the normal market volatility—and given some of the issues post GFC that we were concerned about, the company had had a view for some time that the long-term price path for coal was upward, and particularly for hard-coking coal. We were also cognisant that within that there would be fluctuations, and in our annual budgeting cycle—and I think Dr Elder referred to it earlier—we would do budget forecasts, and we would do different cases around that, including, I think, from memory, two up cases and two down cases, to actually assess what the effect of volatility was on that.

Sorry, forgive me, but you’ve lost me. What did you tell the Minister? Did you say to the Minister at the time he was asking you to increase your gearing, did you advise the Government that the forward forecast for coal was positive or was negative or was a risk or was going to be fantastic?

Well, I simply can’t answer the question because I don’t recall. But the answer I’ve just given is the basis on which the company drew its conclusions.

Mr Chairman, may I add a bit of information to that. It is on the public record—I think in Solid Energy’s 2009 or 2010 annual report and in the public document of our first annual meeting in, I think, 2008—where we showed the very wide range of our possible forecast for future prices, which ranged from a 20 to an 80 percent probability. In other words, we said “That’s only 60 percent likely. They will be in a very wide range from downwards to upwards. There is a 40 percent likely it could be higher than the upside or lower than the downside.” And, in fact, that’s exactly what happened. At times it was above our upside; last year it was below our downside.

The Prime Minister said that you asked for a billion dollars—$1 billion—and you turned him down. Is that correct?

Well, if you’re referring to the Prime Minister’s comments the other day—

Yes.

—there are two issues around that. As we developed some of the coal resources, and specifically as we looked at the opportunities for lignite, the
attitude of the company—and the board endorsed this—was to say the company is the custodian of the largest energy asset in New Zealand, a very significant part of New Zealand’s energy resource. Particularly as it related to the coal resource, and specifically the lignite, we had a responsibility to see how we could monetise that resource for the benefit of all of New Zealand and, specifically in our case, our responsibility to the company. That required projects that could utilise that lignite resource. It’s well known that we were, for example, looking at—

Cosgrove Sorry, Mr Chair—

Palmer Well, this is a very important answer to the question.

Cosgrove With respect, sir, we’ve got limited time. My question was pretty simple, and I am happy to enlarge on it.

Mitchell Let him answer the question.

Cosgrove I would be grateful if—

Mitchell He’s answering the question. Let him finish.

Palmer Chairman, I think this is an important answer, because I’m getting—so we had developed, as you know, options, for example, for lignite to urea. To do that required a very large capital injection. We had spoken to a number of overseas companies about possibly partnering that in a project sense. So we had had discussions with the Crown about the options for us, because it made no sense to us to think that the Crown as the sole shareholder should finance that. So, yes, we were having discussions with the Crown about large-scale investments that would have had a billion plus dollars attached to it.

In relation to the national resource strategy paper that was presented as a discussion paper to the Government, my clear recollection is there was no dollars attached to that proposal; it was an outline of a strategy for national resources that the company felt it could take part in. We discussed that with the Government. The Government said “No, we think that you should—you’ve got enough issues to deal with, you should deal with those.” We accepted that and did not action it any further.

Cosgrove So could I come back to my question, with respect. The Prime Minister has stated that Solid Energy requested $1 billion of capital injection, and he, his Government, refused. My questions are: is that correct, and, secondly, if it is not correct—if the figure is not correct—what is the figure?

Palmer Well, I’ve outlined the different discussions, and I’m not sure, because I haven’t seen an exact transcript of the Prime Minister’s comments, but I think if you take those two pieces together: were we talking to the Government about the possibility of capital and were we seeking that from the Crown? The answer was no. But we were—

Cosgrove So at no time did Solid Energy request a billion-dollar capital injection, a specific billion-dollar capital injection from the Crown?
Palmer  A specific billion-dollar capital injection? I’m reasonably sure that we did not ask for it in exactly those terms.

Cosgrove  Did you ask for any monetary injection, and, if so, how much?

Palmer  We did say that there were—for these projects to work they were going to require large capital, particularly the projects I have just referred to, and we needed to think about ways in which that capital could be raised, and that we didn’t think it was necessarily appropriate for the Crown to participate in that, or certainly to take all the risk.

Young  I have a supplementary on that, Mr Palmer, in terms of raising capital. How much surplus cash flow did Solid Energy generate over the last 5 years—or maybe Dr Elder could answer that question. Do you have that figure?

Palmer  The surplus operating cash flow?

Elder  I think the word “surplus” I don’t know how to answer. In terms of operating cash flow—

Young  Operating cash flow.

Elder  The number that I do know is about right is over $900 million in the last 12 years or 11 years, which is almost exactly how much was reinvested in the company as well. Over the last 5 years it would be over half of that, because of some very major investments, particularly in the coal business and particularly at Stockton.

Young  And adding to that the debt that was raised, is that part of the operating cash flow in terms of that 900 you’re talking about?

Elder  No, no, that’s $900 million of cash generated by the business from sales of its products during that time.

Cosgrove  Just on that point, do you find it interesting, given that the Government requested you increase your gearing, that the Prime Minister on 25 February cited that “The third problem was that they”—that is Solid Energy—“added gearing to a company that historically had not had gearing”. Do you find that strange, that a Government would ask you to increase the gearing and then cite that as the problem for your downfall, or one of them?

Palmer  I suspect that it’s difficult to link the two things. It’s easy to do that now, but I suspect that it’s difficult to link the two things. I think that—

Cosgrove  I’m sorry, sir, there are two facts on the table: the Crown came to you and said “Increase your gearing”, and it also said “We want more dough”, as of the letter of 2009, yet, using hindsight, the Prime Minister, the same Prime Minister at the time and now, cites the third major problem for your financial difficulty as that you as the company added gearing that historically you didn’t have.

Palmer  Well, that’s factually correct. We did add gearing, and it was unrelated to any decision by the Crown to increase the gearing. The particular components of gearing—and I think it’s important that we talk factually about this in relation to the current level of debt, or the level of debt when I left—most of that debt relates very specifically to Stockton. We decided to—
Cosgrove  I appreciate that, sir, I’ve got that.
Palmer  Well, I think it’s important, Chairman.
Cosgrove  I appreciate—
Young  Please, let Mr Palmer finish his answer.
Cosgrove  Well, we have limited time and he has given me an answer. I want to—
Young  Excuse me. I do think that we do owe Mr Palmer the courtesy of hearing his answer. We want the information that this committee has requested.
Cosgrove  Well, I’d like the information I’m requesting.
Palmer  The issue, then, on the debt was the $125-odd million to build the coal processing plant at Stockton. Essentially all of that was funded by debt. In addition, we changed the nature of the operation at Stockton, which meant that we purchased or acquired new equipment on Stockton, which was $150 million. Essentially, all of that—$270 million—went on the balance sheet. We did that knowingly and deliberately. That was for two reasons: firstly, under any scenario that you could do at the time, having that debt on the balance sheet—and that is about $7.50 a tonne—that would be easily cash positive.

Now, as we got to late 2012, of course, that wasn’t quite the case, but any reasonable scenario said that that was a good investment. The coal processing plant extended the life of the mine considerably and the value of the mine considerably, and the new operation at Stockton increased the safety record, which was a major requirement of the company, by some margin. We were not happy to continue with a suboptimal plant and a suboptimal safety record, and that was a very big driver for us to do it, and I don’t regret that for one moment.

Young  I’d like to come back—if I can take a question, and then come back and throw it over to you; we’ve gone for a considerable period of time. Coming back to Dr Elder, you made some comments about the geology of New Zealand and difficulties around what you face as a miner. In terms of the Spring Creek investment that you continued on after purchasing from Cargill, you came upon some, I guess, geological difficulties. Do I understand that to be correct?
Elder  Spring Creek has always had very significant geological and geographic difficulties. That’s why it has been through seven owners since it was first conceived back in the 1970s.

Young  So over the last, perhaps, 5 years, Spring Creek lost in the vicinity of $100 million. Is that essentially because of the geological challenges?
Elder  In the year 2000 Spring Creek was opened as a compromise between the then joint venture partners, and the mine was opened in the wrong place, under the wrong conditions, with the wrong mine plan. That set the future of Spring Creek for the next 13 years and does today. There is no question that from the beginning the mine was going to be extremely challenging. It was a mine that might have succeeded if it had performed well in good
times when the prices were high. Without performing well and when the
prices are not high, then it has, and had, little chance of succeeding, and in
fact the cash loss for Spring Creek over the period since it opened
cumulatively is not $100 million; it is probably, by my estimate, above $150
million.

Young

Thank you.

Hughes

Given those factors—that you’ve said the cumulative loss was probably
more than $100 million—why on earth would you spend $64 million
purchasing this mine given the perilous financial situation, given the coal
prices, given the mine’s history? You paid $64 million for it and you closed
it a month after purchase.

Elder

That bit of information, Mr Chairman, has been repeated in the media
although I am fully aware that last week the company stated that that wasn’t
correct. I understand the purchase price for Spring Creek, from memory,
from Cargill, for their 50 percent, was under $30 million, of which virtually
none was paid up front, and it was not closed the next day, as the member
has said.

Hughes

The next month.

Elder

In fact, a long-negotiated purchase was concluded in February. The mine is
still not closed. It was put on care and maintenance in, from memory,
November, which is 10 months later, when the whole world, for coal prices,
had changed. So the substance of the question, I have to question.

Hughes

In response, Mr Chair, given the question that Mr Elder has posed, you’ve
written it down—$64 million. Those factors still exist don’t they? The
history of the mine, your perilous situation—why would you purchase 50
percent of Cargill’s shares?

Elder

Mr Chairman, there are two parts there, and we have a problem with the
$64 million.

Hughes

This is what you’ve written down.

Young

Right. Dr Elder has clarified that amount, Mr Hughes. Can we go to Mr
Parker.

Parker

Mr Palmer, can I first acknowledge that you have a distinguished record,
that you went in at a very, very difficult time for Air New Zealand, and were
fundamentally successful in turning around what is an incredibly important
company for New Zealand, and to respect the view that you expressed
earlier to us that the protection of the balance sheet is critical, particularly in
industries that are volatile. I think that fairly paraphrases your—

Palmer

Yes.

Parker

And if I’ve got that wrong let me know. Against that background the letter
of 28 May—if I could just give you copies of this, because, you know, you
might not have seen it for a while.

Cosgrove

It’s not committee correspondence.
This is a publicly available document. The letter of 28 May 2009, addressed to you, Mr Palmer, and I’m sure that you, Mr Elder, would have seen it also, which was sent on behalf of shareholding Ministers—

Young

Excuse me. Just a moment. Is it possible that other members of the committee might get a copy.

Cosgrove

Somebody can run one off. It’s our evidence.

Parker

You can have that copy. Could you just give him my copy?

Young

Can we get a staff member to run some copies off?

Parker

Could you just give them one of your copies? There is nothing (inaudible) here. I thought you might have seen this.

Cosgrove

It was in the House yesterday.

Parker

28 May 2009, the second paragraph. It records that there is already a significant decline in forecast coal prices, at least as far as the Minister was concerned. I don’t know what Solid Energy’s view was, but it seemed the Minister thought that. Then, the next paragraph, two paragraphs down, it says: “I would like all SOEs to increase their gearing from current levels”. Then, if we look at the top of the next page it says: “I wish to outline an expectation that all SOEs pay two dividends per year”. Can I suggest that that, together with the antics that we had from Mr Brownlee and others at the time, gave you no doubt that you were being encouraged to both increase debt and expand. And before you reply to that, Mr Elder will recall some testy exchanges we had when I was Minister of Energy in respect of lignite developments, and I’m not going to go there. But we had Mr Brownlee putting out a video before the election, entitled “Sexy Coal”. We had Mr English and the Prime Minister turning the first sod of lignite development in Mataura region—

Cosgrove

That’s the photographic evidence—

Mitchell

What’s the question?

Parker

Well, I’m just saying—were you in any doubt that the Government, one, wanted you to expand your coal operations, and, two, wanted you to increase your borrowings in order to pursue that strategy?

Mitchell

Point of order, Mr Chair.

Parker

What’s wrong with that question?

Mitchell

I’ve got no problem with hearing the answer to the question, but you have just put documents out—you’re using documents for your question that we haven’t even seen.

Cosgrove

We’ve just given them to the chair, and they’re our documents. Read the paper.

Mitchell

Maybe we could come back to it and—

Cosgrove

There’s no rule that says we’ve got to throw the game for you.

Parker

This was tabled in the House yesterday, Mr Chair.
Thank you. Look, we’ll let the question proceed.

We’re prepared to help you. We’re not going to throw the game, mate.

Sorry, I’m now distracted. If Mr Parker would just rephrase the essence of the question.

The essence of my question is that there seems to be no doubt that the Government wanted you to expand coal production, including into the use of lignites, as well as expanding your West Coast coking coal capacity, and that they were wanting you to increase debt levels. It seems to be clear from that historical record.

It’s self-evident that if you increase gearing, then you will increase the debt levels. That’s—

You had no doubt that the Government both wanted you to expand your coal operations—that they wanted that?

They were supportive of the plans, I think, that we had at the time, otherwise they wouldn’t have signed the SCI.

Including both lignite and hard coal?

Yes, I think so. Yes.

And they wanted you to increase debt, as is evident from these letters?

Yes. Whether those two things are related is perhaps a separate question.

Was it obvious to you as chair that in order to do this you had to spend more money that you had to borrow?

Correct.

And was it obvious to the Government as well?

Well, I assume so. The issue for us, though, was that—let’s be clear that the decisions around dividend are decisions of the board, and the board takes responsibility for that. And it’s fair to say that over a period of time we had a reasonably testy relationship, particularly with the Treasury officials who we were conducting it with, about the extent to which we would move the gearing on the balance sheet up and to pay dividends.

OK. We had the Minister making clear his expectations in the letter of 28 May. Were there subsequent meetings with the Government’s officials that said the same thing?

I can’t in all honesty answer that. But I suspect there were, as we arrived at a position, firstly, around what the statement of corporate intent would say, and then what was the likely effect of that in dividend flow.

The officials, before they get all the blame here, said in a paper dated 26 May 2009: “A blanket 40 percent target risks being seen as simplistic and unrealistic.” And then in the table to it they show what was being proposed, which was 40 percent gearing for all SOEs, being no differentiation between the position of Solid Energy in a volatile export-dependent market exposed to both price and exchange rate fluctuations, compared with a
generator. Would you agree that Treasury’s advice that a 40 percent rule across all SOEs was imprudent? Actually, I shouldn’t use the word “imprudent”, because they didn’t. Would you agree that a 40 percent rule across all SOEs would be wrong?

Palmer Yes, I do.

Young I want to come to this expansive mind-set or culture of Solid Energy that we’ve been talking about here. I want to just read out a quote to you, and I want to hear from you how this thinking was resonating through the boardroom. It’s a quote by previous Prime Minister Helen Clark, who said in a speech—

Cosgrove You’re not going to quote from Trevor’s speech this time? Another speech.

Young —thank you—that our nation had developed an unsustainable way of life but that “policy decisions, proposals, and initiatives to help us pull our weight on climate change and on sustainability more broadly are pouring out”, and we can now move to develop biofuels. She said: “I want New Zealand to be in the vanguard of making it happen.”, and “I believe it’s time to be bold in this area.” Was that a signal to Solid Energy to say: “Come on, be expansive. Start looking at other alternative—you’ve got this huge resource, how are you going to use it?”. And this was political permission?

Elder The initial start of thinking about biofuels was before Mr Palmer’s time, so I’m prepared to answer that. Can you give me the date of the speech, please?

Young That was in 2006.

Elder I’m sorry, I don’t recall the speech. What I can tell you is—

Cosgrove It was that influential.

Elder Sorry?

Cosgrove It was that influential.

Elder I can tell you internally that would not have been the driver. We may well have noted that it looked like it was supportive of our strategy, but that would not have been the driver.

Young Well, following up on that, in terms of Solid Energy’s submission to the ETS, updating New Zealand’s emission trading scheme in 2012 report, you said: “Solid Energy’s business requires investment decisions to be taken over long time horizons. Among these investment decisions are multimillion dollar projects for emissions mitigation …”. Can you expand what they may be? Because I believe I’ve read somewhere in your documentation that the regulatory environment that you’re now operating in is, in a sense, creating the necessity to have expansive developments and projects.

Elder Yes. New Zealand has about 10 billion tonnes of coal. Even at good prices, only about 100 million tonnes of that, maybe 200, will ever be mined conventionally, and that’s somewhere between probably 20 and 40 years at
the current rate. So New Zealand doesn’t have a long-term sustainable, conventional coal mining business. At current or last year’s prices that drops to probably 10 million tonnes, if that.

Solid Energy has always recognised that, and recognised that coal is a transition to a future globally without coal. All the signals globally, throughout the last decade, were that coal companies and companies with options, as Solid Energy had, should be considering diversification to protect themselves against the risk of the coal market.

Solid Energy—[Interruption]. May I finish please, Mr Chairman? Solid Energy looked at those signals and each year debated very extensively hundreds of options and narrowed it down to a small number of options that reflected what our view was of the policy and market environment going forwards. Biodiesel was one of those that at the time, with a mandate of 3.5 percent of New Zealand’s fuel to be biofuels, looked like a good decision. In hindsight, I’m the first to admit it was a terribly wrong decision.

Young OK, following up on that, Forsyth Barr.

Cosgrove How many supplementaries is that?

Parker And none of these are related to my primary—

Cosgrove Well, it’s a supplementary—

Young OK—one more question, thank you, because this is in terms of the expansions that Solid Energy has done. Forsyth Barr in their evaluation made a comment—this is in November 2011. In future Solid Energy’s planned new energy projects have the potential to create very significant upside, but it went on to state that equity markets were reluctant to prescribe to these. So out of the expansion of these new projects, which ones do you feel retain the most value for the taxpayer?

Elder Solid Energy stated clearly, when John Palmer and I presented our 2012 profit announcement in August last year, that the company over the previous year had reviewed its strategy and all its projects, and had concluded that renewables projects were no longer good or appropriate projects for Solid Energy and would be closed or sold. That included biodiesel and the wood pallet business.

We also said that in New Zealand’s geological conditions, given where the coal price was going, that underground mines in New Zealand, especially with safety considerations were probably too hard and we would not continue those in our core strategy, except in special circumstances considered on an ad hoc basis. Therefore, what we said was the core opportunities for Solid Energy in the future are conventional, open-cast mining, underground coal gasification, which is a way to access that 20 percent of New Zealand’s coal that’s deep, and monetisation of the 70 to 80 percent of New Zealand’s coal that’s lignite, but too low quality to otherwise monetise, and monetisation of that, again, open-cast mining and converting. In summary, open-cast mining, underground gasification, monetisation will increase.
Young    Thank you very much.
Cosgrove  I'll yield my supplementary for my colleague.
O'Connor  Thank you, can I just—there are two times that I know that Solid Energy’s been in real trouble. One was in 1998, when the National Government was indicating it wanted to sell off Solid Energy, and the second has been now. Both times, as I say, the instructions have been from Government that Solid Energy is up for sale or partial sale. Some might say that the projects you refer to, that in hindsight may not have been the best projects, were part of a grandiose scheme to build this SOE up to something that was worthy of partial listing—and Mr Palmer, I know you’ve been a supporter in that. So the question is how much did that focus on partial listing contribute to misjudgments or directions from Ministers that ran this company into the corner.
Palmer   Zero to both of those.
O'Connor  Zero?
Palmer   Zero.
O'Connor  How can you say that?
Palmer   Well, because we were running the company as an SOE. We did have, as Dr Elder has just explained, aspirations for what this company could do for New Zealand. At some point, external capital would be needed—we knew that. But this was not being run in order to prepare it for partial privatisation. It was being run because that was the right thing to do.
O'Connor  Well, that’s incorrect. I have a document dated the end of August 2012 that clearly states that two of the key three objectives are around the partial sale of Solid Energy, and maximising the value of the Crown’s asset for that listing: MOM—the mixed-ownership model.
Palmer   That was subsequent to the decision to proceed with partial privatisation and in our statement of corporate intent delivered, I think in the middle of 2012, it was modified on the understanding that this company would be prepared for partial privatisation. But my answer to your question is still zero.
O'Connor  Well, I can’t accept that. If the driver since 2009 when the Government came in through the statement of intent, through clear public statements from Ministers, is that Solid Energy was one of the four State-owned enterprises that was going to be on the block for partial privatisation—are you saying you ignored those directions?
Palmer   No, I’m saying that we were running the company in much the same way and that we felt, and as you know I have felt very strongly and been very public about—
Cosgrove  Indeed.
Palmer   —why this process is a good process, to say that this would assist Solid Energy to achieve its already clearly stated objectives.
Mitchell  Right, I’ve got a supplementary. I’ve got a supplementary.
Hughes  Can I ask a primary question some time soon?
Mitchell  OK, right, I just want to come back to the comment the chair made about
2006 and the fact that, I think, most people clearly see that the situation that
Solid Energy finds itself in today was a combination of probably
diversifying away from the core business into investments that haven’t
performed and the price of coal, obviously.

I just want to come back to what you were saying, Mr Elder, that the
comments the chair made had no direct—he didn’t remember them—
relation to any decisions that were being made within Solid Energy at the
time. However, when the decisions were taken to diversify within the
company to go into these new investments outside of your core
competency, surely the shareholder must have had some input or some say
in terms of the complete change of direction on that. There must have been
some input.

Cosgrove  Your finance Minister turned the first sod on the lignite.
Lotu-Iiga  No, just let him finish.
Young  Let him answer, please.
Cosgrove  That’s the input he had.
Elder  I apologise, I get the general gist, but I’m not actually quite clear what the
question is, I’m sorry, Mr Chairman.
Mitchell  The question is that—I’m just trying to seek clarification, because in your
answer to the chair you intimated that the decisions around a diversification
within the company solely sat with the board and, of course, the CEO then
rolling out the strategy. But it just seems strange to me that the shareholders
wouldn’t have had some sort of input or oversight into that decision to
diversify.

Young  Was there dialogue with the shareholders on those issues?
Elder  I think I understand. It was Mr Palmer, I think, that stated that
responsibility sat solely with the board. My understanding from the board
was always exactly consistent with that—that the board expected that we
would put up strategy options and manage for long-term value. In achieving
long-term value, we would at some point become capital constrained and if
that capital constraint continued, the project simply wouldn’t proceed
through a very long development path that wasn’t one day “No”, next day
“Yes”, a succession of milestones.

Parker  Point of order, Mr Chairman.
Elder  May I finish, Mr Chairman, please? So we always operated on the
understanding we should move those projects forward on the assumption
that at some point the capital issue would have to be addressed. Not
knowing how that would be addressed, partial privatisation represented a
possible way to do that. Therefore, as the chairman has said, that was
Parker

Point of order, Mr Chairman. About 20 minutes ago you took a supplementary on my line of questioning. I’ve only had one line of questioning that I hadn’t finished. I have not made any supplementary questions and you have not yet come back to me, and I would ask that you do, as you indicated you would.

Young

Yes I did indicate. Would you like to go back to that now?

Parker

Thank you. Mr Palmer, earlier you averted to the fact that this is a company with one shareholder. The direction of one shareholder, as opposed to a diversity of shareholder view, is pretty clear to a board of directors. I want to again put this assertion to you that the expansionary direction of Solid Energy, which required an increase in debt, as well as an increase in dividends at a time when the Government believed the coal price was going down, was wanted by the Government, and you knew that.

Palmer

Well, the Government will speak for themselves. Did we understand—

Parker

Well, the Government did speak for itself in terms of written letters to you followed by meetings that said they wanted you to do that, even when you said you were uncomfortable with the erosion of the balance sheet.

Palmer

Did we very clearly understand the expectation of the shareholder in terms of dividends? The answer to—

Parker

And growth in the coal business.

Palmer

The answer to that is yes. Did we ourselves have—

Parker

And growth in debt.

Palmer

—readily defined plans about growing the coal business? The answer to that is yes. Did we expect that we would be able to do that within what we considered a reasonable gearing ratio to do that, with the exception of the two pieces that I’ve talked about, the very specific investments in Stockton? The answer to that was also yes.

Parker

So you anticipated, and the Government knew you anticipated, an increasing risk profile, because you had said this would be riskier because you would be undermining, as you said, this critical balance sheet metric that you referred to earlier.

Palmer

I think it’s self-evident that there would be more risk—yes.

Parker

Thank you.

Cosgrove

Just on that, in your time as chief executive and chairman from 2009, did you at all times keep the shareholding Ministers well informed, to the best of your abilities and adherence to the law, of all your activities in respect of your no-surprises policy, in respect of the quote in your annual report, page 25, I think, that talks about your willingness to have shareholding Ministers’ views expressed? Were Ministers fully informed and aware of your activities at all times?
That might be a matter of opinion, quite frankly, whether they felt they were fully—

No, no, sorry, the question is did you fully inform them from your point of view? I can’t ask what’s in Tony Ryall’s head. I’m asking did you fully inform, in your view, the Ministers?

I felt a prime responsibility for me as the chair was to ensure that at no stage did the shareholding Minister or Ministers get surprised, so that I should inform them of key events, key changes. And I’d like to think that I have done that diligently.

And at any time from 2009 to 31 August, because that is when you left office, did Ministers direct you, one, to alter course? Did Ministers express a view that your strategy should change? Did Ministers threaten to sack the board in order to gain a strategy change? Did they express or act proactively to change your direction of the company in any way?

Certainly I can say the answer to that is no. Was I aware during—

So no direction, no statement of view to alter course—

No.

—no sacking of you. You weren’t elbowed out; you resigned. You weren’t asked to stay on.

I’m about to finish the answer, because this is an important question. I think it was either in late 2011 or early 2012, when it was very clear about what was going to happen, when I had a conversation with the Minister that we were very—

Sorry, which Minister, sir?

—this is Minister Ryall —rapidly facing a $200 million revenue hole, and that was, at that stage, about twice our annual profit and this was going to have a profound effect on the company. We were working through responses to that. It came, I think, clear during the course of the development of the statement of corporate intent in 2012 that certainly I think officials were developing a view that was different from our view about where long-term value resided in the company. So I was aware of that. Whether that was actually the Minister’s view, I cannot comment—

Did the Minister ask you to stand down?

No.

Did the Minister ask to retain you?

No. I had a meeting with the Minister to inform him that I was standing down, and to tell him that I would cooperate with him to stay in the role until such time as they found a new chair, and I did that.

And he didn’t ask you to stay on at any point?

I didn’t give him that option.
Lotu-Iiga: Coming back to the letter that David Parker has tabled for us on 28 May 2009. I mean, you’ve talked about the gearing, you’ve talked about the dividend policy, but there’s also a paragraph in here that says that the adoption of these capital-related expectations is on the understanding that if Solid Energy is unable to fund a significant commercially viable investment from its own cash flows, from those debt markets—so if you are unable to raise that capital—then you can seek an equity injection. I mean, are you aware that this option was available to you to go back to the shareholder? Would that be fair to say?

Palmer: That we could receive an equity injection? And the date of the letter is?


Parker: It doesn’t say that in the letter, does it?

Lotu-Iiga: Yeah it does.

Parker: Where?

Lotu-Iiga: Page 2 of your letter. I mean, you tabled it.

Parker: Not as you characterised it.

Cosgrove: Not as you characterised it. You already made up the gearing figures.

Palmer: I’m trying to recall correctly, but I think the attitude, I can say with some confidence, at the board table was that we were not doing this on the basis that we would expect additional capital.

Lotu-Iiga: I mean, that was available to you. It’s part of the letter. It’s one of the options.

Palmer: Clearly, the letter states that when I read it now, yes.

Yang: I understand Solid Energy started actively investing in alternative energy between 2003 and 2007. My question is whether the shareholders endorsed that kind of investment or decision.

Elder: Well, I’d need to answer that, because John Palmer wasn’t here for the first part or most of that time. We need to differentiate—as everybody will appreciate—between Government policy and shareholder direction, and clearly they are very different. Our strategy, we believe, was consistent with Government policy, which was based on good international understanding of the direction of the energy market. It was not based on shareholder direction. It was developed in the company, approved by the board, and we believed it was consistent with both markets and with Government policy at the time. In hindsight, looking back, it turns out we made too many assumptions about those things, and in, for example, biodiesel, we got too many of those assumptions wrong, and we accept that.

Yang: So because it’s in line with Government policy, you didn’t receive any warning from the Government about your decisions?

Elder: It’s a very, very broad question, but I would have to say, in general, I don’t think so, no.
Cosgrove: On biodiesel—Canterbury Biodiesel—did you do due diligence before it was purchased?

Elder: Yes.

Cosgrove: And is that available?

Elder: You would have to ask, obviously, the company for that. The point I would make is that Canterbury Biodiesel was simply a manufacturing process, which is a successful, proven process elsewhere. The issues with biodiesel are not related to the technology that we got from Canterbury Biodiesel; they’re related to the market.

Parker: And to the removal of the sales obligation, which removed the market.

Elder: You’ll know better than I do.

Young: Excuse me. Through the chair, please. We do have a backlog of questions to come. Thank you.

Bakshi: Mr Palmer, the letter which Mr David Parker tabled mentioned that the Government had instructed you to increase the coal production. Did the board have the intention to decrease the coal production or continue on the same pattern?

Palmer: I’m not sure whether the language is correct. I don’t recall—and Don will correct me—I don’t think we were ever instructed by the Crown in relation to our production. We may have been encouraged, but not instructed, and we weren’t instructed either way.

Bakshi: So the board had the same decision, were on the same line, or it was a different—

Palmer: The operating framework for both the conventional coal business and the coal development, both the strategy and the operations, were company decisions, and where they were investment decisions they were board-approved decisions. Those were our decisions, and, as Dr Elder said earlier in relation to biodiesel, even in hindsight now we say it was a decision that was a bad decision, and we acknowledge that and we take responsibility for it.

Hughes: Yet in July 2011 the Prime Minister said “We want Solid Energy and companies like them to expand in areas like lignite.” The finance Minister turned the first sod at the briquetting plant, and you, Mr Elder, have been a very vocal advocate for the lignite. How much money has this cost, approximately, and how much has it earned?
The lignite developments? Well, the first point to make is that when you have a resource of the size of the—

No, how much have you spent and how much have you earned?

Yes, I’m answering your question, if I may. For any development in the coal business, especially one of the size of the lignite resource, it’s a very, very long-term investment. You don’t get your money back the year after you invest. The expectation was that this was a 10, 20, 30, 50-year investment. So, having said that, the total investment in lignites to date, if I exclude land—because that’s just required to purchase lignites and can be sold again very easily in a liquid market. So if I exclude land, I believe the total investment in lignites must now be of the order of probably $50 million.

Plus land?

Plus land, which is a liquid investment.

And how much is that liquid investment currently valued at, or will cost you? I mean, you’re one of the largest landowners in Southland.

That’s what it cost. That’s the cost to date.

And how much have you spent on land?

So that $50 million includes the land?

No, no, land is on top of that. Land is a liquid investment. You can buy and sell at market prices.

This is the financial review of the SOE that you ran for 12 years. How much have you spent on land to date? You’re one of the largest landowners in Southland, Mr Elder.

Solid Energy purchases land and has always purchased land for coalmines, and the land we purchased in Southland was for coalmines.

How much did it cost you?

The number in Southland—I’m sorry, I don’t have the CFO with me anymore, obviously. I believe the number that was spent on land was perhaps $80 million. I don’t recall the exact number.

The number I have in my mind is circa $85 million.

And in addition to that, Solid Energy at the same time purchased land throughout the country for conventional coalmining in a range of places as well, always on the basis, of course, that you can buy and sell land but you can’t mine the coal under it if you haven’t got access to it.

We didn’t have as many people in this room as we did last financial review. Mr Elder, last year—can I read a quote back to you that you estimate the value of the lignite resource. We got a very rosy picture of your company last year, despite what we now know about the state of this company. You were talking about $1 trillion in revenue, and when I questioned your assumptions you said that in fact we could be looking at $5 trillion. I’m actually quoting from the transcript from last year’s financial review. Were you painting an overly rosy picture to this committee last year?
Elder  Mr Chairman, may I correct that. We did not say that could give us $1
trillion in revenue. I may be corrected for being wrong. It is clearly stated, I
think, in our 2009 or 2010 annual report, which includes a clear diagram of
this, that the value of the lignites, if you could mine it all at today’s prices, is
a simple calculation—10 billion tonnes at around $100 a tonne is $1 trillion.
That was not a statement that we are delivering projects to achieve that; it
was a statement that that’s what New Zealand’s lignite resource is very
simply worth at today’s prices.

Cosgrove  Dr Elder, I want to touch on a sensitive subject, and I acknowledge it is, but
it has been canvassed within the media, and that is your pay and rations. I
acknowledge if you can’t answer the questions, but I’ve got to put them to
you, bearing in mind that your payment will be publicly available in the next
annual report. The chairman signed your contract on his last day, and my
first question is to you, Mr Palmer. Do you think it’s appropriate to sign off
a contract—I’m told by the Minister it’s for legal changes, whatever that
means—on the last day you leave office, or should that be quite rightly the
purview of the incoming chair, especially in a situation where there is a
precarious financial position in respect of the company?

Palmer  I acknowledge it’s unusual, and—

Cosgrove  It’s almost unheard of, isn’t it?

Young  Let him answer, please.

Palmer  Well, I acknowledge it’s unusual. The relationship that I’d had with Dr
Elder during the 6 years that I’d been there is if I sighted the contract as I
entered, I had not consulted the contract at any stage subsequent to that. I
felt that as I was departing and as I had been effectively responsible for that
during my time, I should make sure that the contract was a current contract,
as all other contracts in the business, I think, are renewed every year or
every second year—reviewed every year—and that I had perhaps been
remiss.

I wanted to ensure that there was nothing in the contract either from the
company’s end or Dr Elder’s end, and I very specifically instructed there
were to be no changes in any of the remuneration arrangements, in any of
the terms of the contract that related to his employment, his potential exit,
or any of those things. It was simply to be updated for current law. That
was my very specific instruction. There was no benefit either to the
company or to Dr Elder, and I did that very specifically, and I thought that
I had a responsibility to do that.

Cosgrove  Thank you for your full answer. Can I put it to you, Dr Elder, that there is
some public angst, and some would call it a golden handshake, for you to be
effectively at home, as it were, on 2 months’ worth of an annual salary of
$850,000 base, we are told—we don’t know—which equates in the order, I
think, of about $170,000 to $180,000, which has been termed as
“transitional arrangements”. Now, being a cynical politician, if there were
no changes in terms of conditions, one could argue that the way around that
was to have you pull a few weeds for 2 months on $180,000. Are you prepared to tell us what you got, start to finish?

Elder Two comments in response to that. The first is I’ll correct the $850,000 to $805,000, which is documented fully and openly in our annual report last year. That’s simply been an error in somebody picking up a response from the company the other day—a minor point. With regard to the so-called garden leave, my obligation is to work out my notice period for the company, which I have been doing. Where I’ve been doing it is able to be directed by the company, and I have been doing that as well. I’ve been doing substantial work for the company, and at times it’s been in the office. That’s been a decision for the company to make from time to time.

Regarding the overall question, I am willing to have that agreement released, provided that—and when—I am able to reach agreement with the company on the terms and conditions of that release, because it is a confidential document.

Cosgrove So you are prepared to have it released?

Elder Subject to those very clear conditions that I want to have in writing an agreement with the company about when and how it will be released, so that I am not blindsided by it.

Cosgrove Would you be aware that at last week’s hearing—no, forgive me, to be accurate, it may well have been outside with the media. My recollection is that the current chairman, Mr Ford, in answer to a question, expressed the view that he was quite happy to release that, with your agreement. So are you saying that if you—what would be the conditions you would want for a release? Time, date, and place, and you’d get to do it, rather than them, or something like that, I presume?

Elder Those sorts of things, and what was said around it, for example.

Cosgrove Indeed. Mr Palmer, can I ask you, given that you’ve conceded it’s highly unusual to sign off a contract the day you leave—two points. Did you, at your exit, final, no-surprises meeting on 22, I think it was, of August, advise the Minister you were going to do that?

Palmer No, I didn’t, because there was no change to the conditions and therefore I didn’t think that there was anything untoward in what I was doing, and I still believe that.

Cosgrove Do you believe that your action, re-signing a contract for a 12-year veteran CEO, would have placed the incoming chairman or board in a difficult situation, because we know there was a mediation around your exit package on—I can’t recall the date; I think it was 4 February or somewhere around there—would have placed that incoming board or chair in a situation where they would have had to pay out more than if they had had a contract that was not re-signed and had it had a chance to view that and make a decision themselves?

Palmer Can you be explicit about the question?
Cosgrove: OK, I'll shorten it down. You signed it up. An incoming board comes in and says “Hang on, this has been signed on the last day.”, then there is a resignation, then there’s a mediation. Is the board placed in a situation, because they have not had a chance to look at the legal changes and sign it themselves, that the taxpayer could be up for more money as a result of your action?

Palmer: Well, unless the incoming board and chair were going to do something illegal, the answer to that is no.

Cosgrove: So you take no responsibility for that?

Palmer: My answer is clear.

O’Connor: Can I—moving on from the statement, Mr Palmer, that basically you didn’t want any changes in terms and conditions of employment for Mr Elder or, I guess, other senior managers. Those terms and conditions allowed $23 million in bonuses to be paid out over 2 years, many to senior managers, at a time when the company was going down the toilet, in hindsight, you might say. Can I, on behalf of the hundreds of miners who have lost their jobs, ask a question: how is it that they perceive a culture of excess in terms of expenditure in lignite, expenditure in biofuels, expenditure in the Christchurch head office, and, indeed, expenditure at Stockton itself? How was that able to occur if the board and senior management had a handle on what was happening?

Palmer: Well, I assume you’re referring to the miners at Spring Creek.

O’Connor: There’s Spring Creek and Stockton. You know full well there’s been a large number of people laid off at Stockton.

Young: What’s the question?

O’Connor: The question is—

Palmer: Well, I think I now understand the question. So it’s important to understand that of all the investments made by the company during my time, including up until 2012, essentially I think it’s 80 percent—Don might correct me—80 percent at least of that went into the conventional coal business. So when you go to Stockton and see how we’ve improved the operating conditions, how we’ve improved the life of the mine, how good people feel about what we’ve been able to do with the coal processing plant, the people who are working there feel really good about it and I think they understand that when markets are difficult you have to adjust your business footprint accordingly. That’s just one of the rules of business.

What is perhaps not quite so obvious in relation to Spring Creek is that for a mine that is technically difficult, geologically challenging, and had a safety record that we were not happy to perpetuate, one of the reasons why the debt level particularly in the last 12 months went from a level that we were satisfied about, which is largely the investment in Stockton, to the $389 million, the biggest contributor to that was in fact the annual monthly spend at Spring Creek as we endeavour to find a way to make that business
economic. That is a function of issues at every level including at the mine level.

My message to those people on the West Coast is that we could have taken a shorter cut to that. When we said that we were going to have a safety culture of zero harm, we meant that. That is why on many occasions we closed the mine at great expense in order to retrain the mine and the miners to a safety culture that was acceptable. I think if you ask those wives and families would they sooner have had their men come home, even if there was the prospect that they didn’t have a job, or end up like Pike River that is no question and we are proud of that.

O’Connor I was not wanting to get into Spring Creek itself, but if you wanted to debate that, I could say to you the safety standard at Spring Creek was about equal to that of Pike River. I want to move on—

Palmer Mr Chairman, that is clearly not correct.

Young We have got—we are actually out of time, but we’ve got two more questions from Sam Lotu-Iiga and then from Mr Cosgrove.

Hughes Mr Chair, you said I could have one as well.

Young No, I’m sorry. We’ve gone over time—

Hughes You said I could have one before Mr Cosgrove asked.

Young No, sorry, and then we’re going to give our two visiting gentlemen here a final minute each, if you’d like to make a final statement.

Lotu-Iiga It’s a couple of questions. I come back to coal prices. Dr Elder, you’ve identified the plunge in coal prices as being quite damaging to the company’s financial performance—

Parker And the rise of the dollar.

Lotu-Iiga Let me finish. I was looking at coal prices—this sort of volatility and you did state where it has gone significantly up, down, up and down over the last 4 or 5 years. You talked briefly about how you project coal price. Can you just talk through the sorts of analysis that you do in terms of the robustness of that?

Elder Yes, we are very well connected to the global coal industry and we talk to all our colleagues in the global coal industry. We listen to the market analyst forecasts. We look at the past behaviour, we look at information by research organisations such as ABARE, the Australian something or other research organisation and their projections. On the basis of that what we find is there is an enormous range of uncertainty about the future. We project a wide range of possibilities and plan to be able to live within that and on a number of occasions in the last 12 or 13 years our prices have gone outside that.

Lotu-Iiga So it’s gone outside the 20 percent to 80 percent range. And what do you do—in terms of the hedging around the currency, which David Parker referred to, how do you manage that risk around exchange rate as well as the coal price? Are you hedging forward?
Elder  The company has had a policy for recent years where it hedges the foreign exchange rate only for the period that prices are set, which is now down to 3 months ahead or in fact 1 month. If you go beyond that, you’re not protecting yourself; you’re potentially creating risk because you’re locking in one variable and allowing the other one to vary.

Lotu-Iiga  And those contracts have changed from 1 year contracts down to 3 months in recent years—correct?

Elder  Correct.

Cosgrove  I've got a very short couple of parts to this question. But just on the same risk—Mr Lotu-Iiga’s point. In the Forsyth Barr evaluation—correct me if I'm wrong—2010 you valued the company at $3.5 billion in June 30. In November 4 it was valued at $1.6 billion by Forsyth Barr. Forsyth Barr also said, if I'm correct, that if there was a decrease in coal price and an increase in currency—New Zealand currency—the valuation could be zero. Now my first question is simply this: where was the duty of care, why was there such a gap? You had a dispute with the Government, of course, around valuations. Where was the duty of care around that and where was plan B? Either one; you toss a coin.

Elder  I’ll happily say the first couple of things. If you read the wording that is taken with that statement in whatever that year was, you’ll find that it lays out the assumptions very carefully and says these are just assumptions. We were completely able to reconcile the $1.6 billion from Forsyth Barr and the $3 point—whatever our number was—simply by saying if we use those assumptions we get their number; if we use other assumptions, we get our number; we use other assumptions still, we get lower or higher numbers.

Cosgrove  Well, could I just put this to you? This is a quote from Forsyth Barr, because they said your valuation was very aggressive. They say: “This suggests that expectations of a very strong coking coal price path may be over-optimistic with high prices since 2009 having their expected effect on supply albeit with a delay. There remains a very substantial global resource although there is a shift to high-cost mines as demand increases. The point is this: they say you were aggressive with your evaluation and over-optimistic. And if I just finish, I’ll be efficient. My other question is: would you be willing to come back to this committee—because there are other questions—and would you be willing to submit yourself and be part of a select committee of inquiry if we went that way?

Elder  So, there are three questions there for me. I would—and John may too—like to address the first one. We noted the Forsyth Barr report, their comments that it was aggressive. Both I—and John can speak for himself—in hindsight probably regret using a $3 point-something billion number—

Cosgrove  $3.5 billion.

Elder  $3.5 billion. It was based on assumptions that were perfectly reasonable for those assumptions but it included too many things that were uncertain. So putting that number in served the purpose of saying: “Here’s what the
Regarding your second and third questions, I have always made myself available and willing to the select committee and to support Solid Energy in any way I can. That hasn’t changed and won’t change.

Hughes Mr Palmer, between 2009 and 2012 the company’s debt ballooned from $313 million yet Mr Elder received over $2 million. What would he have had to have done not to—including actually refusing a large chunk of the last year’s bonus? Was your board providing oversight and why was it paying bonuses and what would it have taken not to have received a bonus in any one of those years?

Palmer Was the board providing oversight? The answer to that is certainly yes, because the determination of the at-risk pay—and I don’t use the term “bonuses”, there are two components of at-risk pay. I’m quite happy to take ownership of the fact that on my arrival at the company the performance pay framework is something I both strongly supported and insisted that we tier right through the company so there was clear line of sight between what were the objectives of the company and the reward for effort. If you look at our annual report it is very clearly outlined in there what the criteria were for earning and what the relative performance was. Those were assessments made by the board and ultimately were the result of discussions between myself and Dr Elder, for me as chairman of the board. As the front of that I take responsibility for it.

Cosgrove Would you be willing to participate in an inquiry as well—I didn’t hear your answer—and willing to come back?

Palmer If there was further information that I could assist on, I am willing to do so.

Cosgrove Because we did have other questions.

Palmer I’ve got nothing to hide, Chairman.

Young Just before we close this session, are there any kinds of comments you would like to make?

Elder May I just say, as I said before, thank you for the opportunity to attend. It’s really important for this company that has a huge challenge that it gets the maximum support from everybody going forwards. It can succeed very well but it needs support and it needs to be able to focus without distraction on what it has to do now. If it is able to do that, then it will succeed and I remain, as I said before, very sorry to the people in the company that have been affected to date. The best remedy for all of those people is that the company succeeds going forwards under its new management and board.

Palmer Chairman, I came along today to hopefully help with understanding the issues and decisions of the company during the time that I was chairman. I hope it’s achieved some of that. It may not have answered all of the questions. If I look back on my time as chairman, I am both proud to have been associated with the company and the growth of it during that time. I am also willing to acknowledge that we made some mistakes. It is very
important for New Zealand that we have a risk culture that says taking risk in business in order to grow the wealth in the future of this nation is crucially important. For someone who’s been in business and volatile businesses for a lifetime, when you take risks they don’t always work, and in some case for Solid Energy that is the case. There’s no question that that responsibility rests with the board, but I have no regrets about the path and the strategy that we set out on. I have some regrets that we didn’t perform in some of those aspects as well as we did.

Young

Well, thank you gentlemen. I think you have been able to assist us as a committee. I wish you all the best. Thank you indeed.

**conclusion of evidence**
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the South Canterbury District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Southern District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2011/12 financial review of the Tairāwhiti District Health Board

Report of the Health Committee

Contents
Recommendation 2
Introduction 2
Financial and service performance 2
Population-based funding formula 2
Emergency department 2
Workforce issues 3
Health Benefits Limited 3
Learning centre 3
Immunisation and whooping cough 3
Rheumatic fever 3
Oral health 4
Appendix 5
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Tairāwhiti District Health Board, and recommends that the House take note of its report.

Introduction

The Tairāwhiti District Health Board (DHB) delivers health services to a large area of the East Coast of the North Island, with an estimated population of 46,900 people, of whom 47.8 percent identify as Māori. The population is proportionally young and has the highest rate of deprivation in New Zealand, with 65 percent living in quintile four or five deprivation categories.

Financial and service performance

In 2011/12, the DHB had a total income of $154.693 million, and its total expenditure was $155.043 million (which includes finance costs), resulting in a surplus of $25,000, its best financial result since 2000. The DHB is forecast to break even for the next three years, but is operating in a financially challenging environment.

The Office of the Auditor-General (OAG) rated its management control environment and financial information systems and controls as “good”, an improvement from last year. Its service performance information and associated systems and controls were assessed as needing improvement, as they were in the previous year. The OAG recommended that the DHB ensure it has robust systems, procedures, and controls to ensure that its non-financial performance is reliable. The OAG also advised us that the DHB needs to update its asset management plan. We expect to see improvements in these areas.

Population-based funding formula

We recognise that the DHB is one of the smallest in the country, and asked if the DHB felt that the population-based funding formula was meeting the needs of its population. The DHB considered that the formula could benefit from some revising as it needs more funding to ensure that the needs of its entire population are met. The DHB acknowledged the extra 20 percent they received in recognition of its high Māori population and rural geography.

Emergency department

We were pleased to hear that the DHB has successfully reduced its acute admissions via the emergency department. One strategy has been co-operation with local general practitioners to ensure, that as many patients as possible see a general practitioner where appropriate instead of using the emergency department as a first point of contact.

An example of the success of this strategy was apparent during the annual Rhythm and Vines music festival, which brings 30,000 people to the Gisborne region and usually places high demand on the emergency department. Thanks to alignment with local general
practitioners, the festival saw the lowest admissions rate for the last three years, with no reduction in services.

**Workforce issues**

We asked about the increase in part-time nurses over the last four to five years. The DHB said this is a reflection of the ageing workforce, and from the preference of many nurses to work reduced hours. The graduate nurse programme employs nurses on a part-time basis, which is also a factor.

We are pleased that the DHB maintains a full complement of medical specialists, and we heard that the specialist workforce has recruited more New Zealand graduates. The DHB emphasised the importance of clinical staff focusing on clinical duties rather than administration. Management and support staff have also increased with the implementation of new programmes and clinics.

**Health Benefits Limited**

We are aware that the DHB is transitioning to the Finance, Procurement, and Supply Chain shared system and services for all DHBs in late 2014. We asked about its engagement with Health Benefits Limited, the agency tasked with delivering the programme. The DHB acknowledged the significant changes that the change will bring, and at present it is investing money with Health Benefits Limited.

The DHB told us they have already made savings in banking and procurement arrangements, with further benefits expected in the streamlining of processes, and reductions in back-office staff and operating costs. We will monitor the transition with interest.

**Learning centre**

We heard that the DHB has opened a new learning centre for Otago University students on the Gisborne Hospital campus. This will give students working in five disciplines opportunities to participate in mobile clinics and work in rural areas, and promote inter-disciplinary collaboration.

**Immunisation and whooping cough**

We recognise that the DHB has been struggling with the immunisation target for 8-month-olds. The DHB told us that part of the difficulty can be attributed to the population demographics, as many people are transient and difficult to reach. However, the local iwi providers are committed to achieving the target, and improvements are expected with the launch of a campaign in schools and community areas promoting the importance of immunisation.

We asked how the DHB was handling the high number of cases of whooping cough in the region. The DHB explained that it has been promoting adult immunisation for hospital staff and those working and living with children, to reduce outbreaks amongst children and babies, who are affected much more severely by the infection.

**Rheumatic fever**

We are aware that the incidence of rheumatic fever is 10 times as high in Tairāwhiti as the rest of New Zealand. In early 2012, the Rheumatic Fever Prevention Programme was launched in the region in collaboration with Turanga Health and Ngati Porou Hauora. The programme provides throat swabbing services through schools, and antibiotic treatment
for throat infections to reduce the incidence of acute rheumatic fever. The DHB said that the programme is expected to significantly reduce the region’s high rates; in addition to health-sector initiatives, home insulation has been an important component of it.

**Oral health**

We note that the DHB has seen an increase in enrolment in oral health care for pre-school aged children but a decrease in attendance at appointments. The DHB told us that they are working with parents and the community and engaging with iwi to stress the importance of early access to oral health care. Services are also being delivered in more areas with the launch of mobile clinics, which are also expected to be used in rural schools to help reach the adolescent population.
Appendix

Approach to this financial review

We met on 13 March and 27 March to consider the financial review of the Tairāwhiti District Health Board. We heard evidence from the Tairāwhiti District Health Board and received advice from the Office of the Auditor-General.

Committee members

Dr Paul Hutchison (Chairperson)
Shane Ardern
Dr Jackie Blue
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Scott Simpson
Barbara Stewart
Louisa Wall
Dr Jian Yang

Evidence and advice received

Tairāwhiti District Health Board, responses to questions, received 8 March and 26 March 2013.

Office of the Auditor-General, Briefing on Tairāwhiti District Health Board, dated 13 March 2013.

Organisation briefing paper, prepared by committee staff, dated 14 January 2013.
2011/12 financial review of the Takeovers Panel

Report of the Commerce Committee

Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation</td>
<td>2</td>
</tr>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Takeover activity</td>
<td>2</td>
</tr>
<tr>
<td>Financial performance</td>
<td>2</td>
</tr>
<tr>
<td>Staffing and risk management</td>
<td>3</td>
</tr>
<tr>
<td>Performance measurement</td>
<td>3</td>
</tr>
<tr>
<td>Appendix A</td>
<td>4</td>
</tr>
<tr>
<td>Appendix B</td>
<td>5</td>
</tr>
</tbody>
</table>
Takeovers Panel

Recommendation
The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of the Takeovers Panel and recommends that the House take note of its report.

Introduction
The Takeovers Panel was established as a body corporate by the Takeovers Act 1993. The panel reviews legislation relating to takeovers and the application of legislation to specified companies. It enforces the Takeovers Code, which came into force on 1 July 2001, and ensures that shareholders are well informed before deciding whether to accept a takeover offer.

The Takeovers Panel is funded by an appropriation and by fees paid by the users of its services and parties to its enforcement actions. The panel had an operating surplus of $44,786, after a deficit of $90,399 in 2010/11. Its total operating revenue was $1.64 million, the bulk of which was derived from a Government grant for baseline funding of just over $1.49 million (the same amount as in 2010/11).

The panel comprises 11 members, appointed by the Governor-General on the recommendation of the Minister of Commerce. Its chief executive is Margaret Bearsley and its chair is David Jones.

Takeover activity
For the first time since the establishment of the Takeovers Code, no takeovers were announced in the seven months from December 2011 to June 2012. The panel told us takeover activity had been busiest in the 2007/08 financial year, after which the next four years had been very quiet. Since November 2012, however, it had been considerably busier. It estimated that it had regulated seven takeovers in the past two years, and was now overseeing six takeovers concurrently. The panel pointed out that it also regulates transactions in which significant parcels of shares are allotted or passed between shareholders. During the quieter period the panel balanced its resources between enforcement and its policy and public education functions.

Financial performance
We asked about fluctuations in the panel’s financial performance over the past five years, and how it had managed to generate a surplus when its baseline funding had been static since 2008/09 and its third-party revenue had been falling. The panel explained that many transactions do not require much work by the panel, and so do not make much money. The only part of simple takeovers that attracts fees is the application to the panel to approve an independent adviser, which is usually an easy decision entailing relatively little time and cost. The only other activity generating revenue is deciding applications for exemption from the Takeovers Code, which is charged at a statutory rate.

If the panel has to undertake an enforcement proceeding for a breach of the Takeovers Code, however, it can make costs orders against the breaching parties. Panel members are
2011/12 FINANCIAL REVIEW OF THE TAKEOVERS PANEL

paid an hourly rate set by the Remuneration Authority of $200 to $250 for hours worked only, plus a daily rate of $1,200 for formal panel meetings. The panel believed that private practitioners would charge upwards of $550 per hour for comparable services.

We noted that in the 2010/11 financial year the panel had spent $92,358 on litigation, on which it had spent nothing in 2011/12. We asked why, and whether such expenditure on litigation was likely to recur. We heard that the panel had been sued and a decision judicially reviewed. Such events were entirely unpredictable, but the panel did not expect them to occur in every financial year. The panel said that when it was first established ten years ago many people tested the Takeovers Code, but had come to understand it better, so there have been fewer enforcement meetings and less litigation.

**Staffing and risk management**

We asked the panel how public-sector funding constraints had affected the panel’s work. It told us that the main difficulty was retaining lawyers capable of undertaking the panel’s complicated work. The panel said staff turnover was not an issue, but it was concerned that funding might be cut in times of lower demand. It emphasised the importance of maintaining a skilled executive, as otherwise panel members would have to do a larger proportion of the work, which would prove more expensive. The panel recognised the risk, but said it had not raised it with the Government, as it was confident the risk was being managed adequately by improving efficiency and cutting costs. We would be concerned if the panel’s funding were reduced because of some periods of lower demand, as recent history has shown dramatic fluctuation in its workload.

We asked about the panel’s staff succession planning. It told us it had maintained its staff during the recent quiet period in anticipation of work picking up again. To ensure continuity amongst senior staff, the panel endeavoured to make sure they were trained to be able to cover other crucial positions in the organisation as needed. Turnover in the junior staff pool tended to be higher; it consisted mainly of new graduates seeking experience before moving on to corporate or financial law.

**Performance measurement**

The panel described its objective as providing integrity and confidence in the capital markets. We asked what the panel’s work contributed to New Zealand’s capital markets, and how we could measure the outcomes. The panel told us that outcomes were difficult to measure, but it believed that it would be much more difficult to attract capital from overseas if there was no regulation of shareholdings. We heard that an analysis by the Capital Markets Task Force found in 2009 that the panel operated efficiently and provided confidence in the market. The panel told us that all leading markets have a takeovers panel, including Australia, Hong Kong, Singapore, and the United Kingdom. We suggested that the panel might wish to determine whether the effectiveness of those panels had been measured.
Appendix A

Approach to this financial review

We met on 31 January and 14 February 2013 to consider the financial review of the Takeovers Panel. We heard evidence from the Takeovers Panel and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Hon David Cunliffe
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received

Organisation briefing paper, prepared by committee staff, dated 17 December 2012.
Takeovers Panel, Responses to questions 3, 17, 52, 87, and 88, received 24 January 2013
—— Responses to written questions, received 24 January and 8 February 2013
Appendix B

Corrected transcript of hearing of evidence 31 January 2013

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Chester Borrows
Hon Clayton Cosgrove
Hon David Cunliffe
Clare Curran
Peseta Sam Lotu-Iiga
Mark Mitchell

Witnesses
Margaret Bearsley, Chief executive
David Jones, Chairman

Young Good morning, Ms Bearsley and also Mr Jones. Welcome to the Commerce Committee. Thank you very much for being here today. If you could just give us a verbal presentation, that would be good. We have received, of course, all the documentation, and then we will ask questions. Thank you very much for that.

Jones Thank you. I am David Jones. I am the chairman and Margaret Bearsley is the chief executive of the Takeovers Panel. The Takeovers Panel's main job is to regulate takeovers. That seems to be a very wide type of approach, but we are rather limited in that our takeovers are limited to listed companies and companies that have more than 50 shareholders. Our job is to ensure that market participants who are in takeovers comply with the rules that are set out in the Takeovers Code. The Takeovers Panel's main job, I suppose, if we look at what our objective is, or our ultimate outcome, it is to provide integrity in the capital markets and confidence in the capital markets, which is important both nationally for investors generally but also internationally, because people look to our capital markets to see whether we have rules in place that are at least consistent with other jurisdictions.

As regards the panel itself, we are a market-based panel, so we are rather unusual in that the board are all market participants. So in terms of our board, we have a total complement of 11 members. One is an Australian member from the Australian Takeovers Panel, under which we have reciprocal arrangements where I sit on their panel and they sit on our panel. That has been very, very useful in terms of ensuring consistency between our jurisdictions in terms of takeover law, and learning lessons from their
jurisdiction in terms of applying our code, although we have got significant differences.

The executive is small. The executive is eight members. They can—not trying to be deprecatory in this sense at all—almost be regarded as a secretariat, because the panel members make all decisions. So the executive can’t make decisions. What it does is operate at an operational level in dealing with takeovers as they arise, in dealing with policy issues that the panel requests them to look at. So the final decision on any matter is made by market participants. Margaret, do you have anything else to add?

Bearsley No. I think that is a very good summary. Thanks, David.

Cosgrove Given the level of takeover activity has been, what—nil?

Jones No, that’s not quite right. I am happy to talk to that. This is why the panel is relatively small and the executive particularly is small. The panel members get involved, which is where cost is incurred, only when takeovers or takeover issues arise. In terms of takeover activity, the busiest period would have been 2007-08.

Cunliffe Why was it a busy time?

? Heading into a recession, that’s why.

Cosgrove And the last 4 years?

Jones The last 4 years have been very low. We are now back at the busiest time we’ve had in 4 years. The last 3 months have significantly picked up.

Cosgrove I would really like to see a bit of a definition around “busiest time in 4 years”.

? Yeah, they found a takeover!

Cosgrove Over the last 4 years, what have been the numbers?

Jones We can give you the numbers.

Bearsley I think the lowest we had in one year was only four takeovers that we were regulating, although you must recall that we regulate not only takeovers but also transactions that require shareholder approval and are not a takeover, so where a parcel of shares is allotted or passed between shareholders.

Although in the quietest takeover year we might have had only four takeovers, if I recall correctly, there were something along the lines of 15 shareholder meetings that were also regulated under the code where parcels of shares—significant parcels of shares, obviously, for us to be involved—were traded. So that was the lowest point. In each of the last two financial years, if I recall correctly, there have been seven takeovers that we have regulated, and probably around 12 or 13 shareholder meetings.

In the 6 months of the current financial year, however—which, of course, we haven’t yet reported on—there has been a significant increase, and at the moment there is six takeovers running concurrently. So the way transactions are going at this present point in time are very like they were back in 2007. That pickup occurred effectively from about November.
Cosgrove  Could I ask you, without being impolite—I’m just trying to get a handle on workload and costs. I accept that your secretariat, if you will, is pretty lean, with seven full-timers. But in terms of panel remuneration, could you just outline for us whether it is an hourly rate, a meeting rate, a project rate—how does that occur?

Jones  It is an hourly rate that is set by the Remuneration Authority, and that is $200 an hour for most members. I think I’m on $250 an hour. But it is all based, apart from formal panel meetings, on hourly rate. So on a formal panel meeting, there is a daily rate of $1,200.

Bearsley  More or less.

Lotu-Iiga  But you compare that rate to the market rate the board members otherwise earn in private practice—in fact, it is actually a good deal, isn’t it?

Jones  My rate on takeovers is $550. Most practitioners in our area—there are only a small number—would be charging that upwards. So it is a public service.

Lotu-Iiga  It’s good value for money, isn’t it, really?

Young  Coming back to your mentioning there are six takeovers concurrently running since November. In terms of that third-party revenue that will come into the Takeovers Panel, what do you estimate that will be? Any idea?

Bearsley  Well, we won’t necessarily generate third-party revenue from the takeovers themselves, aside from the fact that every takeover and every kind of transaction that is regulated by the code requires an application to the panel to approve an independent adviser. That doesn’t generate a great deal of income for the panel because it is generally a relatively easy decision to make, just to ensure that they are completely independent. The only other funds that we would generate from the takeovers would be if some parties to the transaction required an exemption from the code, they would have to apply to the panel for an exemption and we would charge them at the statutory rates for that.

Cosgrove  Your financial performance has fluctuated over the last 5 years. You’ve managed to generate surplus, but your baseline funding is static since 2008-09. Outline your fluctuation for us. How have you managed to achieve surplus?

Bearsley  The reason it fluctuates is precisely because not every transaction requires anything other than the approval of an independent adviser. Some exemptions would be one of the big money earners if they are very, very complicated, and we’ve had some years where the panel has granted a lot of exemptions. But the wildcard in the whole process is if the panel has to hold a section 32 meeting, so a formal hearing, an enforcement hearing, because there has been or may have been some kind of breach of the code. If the panel determines that there has been a breach of the code, then it can make costs orders against the breaching parties to cover all of our costs charged at the statutory rate.
If there are no formal hearings, then we don’t generate that income, but obviously with all of the secretariat all on salaries, we have to be paid anyway. The panel members are paid for the work that they do, so if we have those formal hearings, our expenses go up significantly, but so does our income go up significantly.

Cosgrove You’ve noted that you’ve got public sector funding constraints, which have made maintaining appropriate remuneration difficult. Can you go through that in detail?

Bearsley The real difficulty arises from the fact that most of our staff are lawyers and the work we do is very complicated. So we employ good lawyers in order—

Cosgrove You’ve certainly got two.

Bearsley We’ve got five lawyers—sorry, six lawyers. I’m one. And because the work we do is very complicated, obviously we try to maintain the staff as well as we can. We often employ our lawyers as new graduates, and for those of you who are lawyers, you’ll realise that as lawyers go up the grades they have significant increases, otherwise we couldn’t keep them.

Cosgrove Chester knows about that.

Bearsley So that’s our real constraint—trying to maintain good lawyers.

Cosgrove So what’s the impact on that in terms of your work and the quality of your work? Generally, is there a high churn? If there’s a high churn, you’re not getting continuity of experience and skill. What’s the negative impact on what you’re doing?

Jones Well, we haven’t got a high churn. I think we’ve got the figures—the figures are in here in terms—if you looked on a percentage basis it might look high. One year we had 50 percent—I think it was—turnover, and that was four people who went—

Cosgrove OK, if that’s not the issue—you’ve raised this as an issue. OK. What’s the negative impact? Is it impacting on your work or is it because you need more money or what?

Bearsley We’re not asking for more money. We manage. I guess we really just want it to be noted. I suppose the subtext is we don’t want to have money taken away. The impact, really, would be on the quality of the advice given to the panel members. If the panel members aren’t given good analysis by the secretariat, then they’re going to spend more time doing the work themselves, effectively, and then they would have to be paid the same.

Lotu-Iiga Just looking at the financial performance, I don’t think you’ve done that badly at all. I mean, over 5 years you had one year where obviously the litigation expenditure was high, and I’ll come to that. But I added it up over 5 years. You’ve made net $260,000, which averages out at about $50,000 surplus per year over 5 years. So, you know, for me, I think you’re doing a good job on the financial front. I take your point around the pressures, and, you know, I think we’re all feeling it in Government departments and SOEs and Crown entities. But I think you’re doing well. I suppose the question is what made 2010-11 an extraordinary year in terms of the litigation
expenditure? Can you just talk to that. And the supplementary to that is could that happen in 2012-13, 2013-14, going forward? Because I think that is the item that sort of could lead to a little bit of financial stress, if you like. 

Jones Often when we have a judicial inquiry—I call them a judicial inquiry; it’s an enforcement proceeding—the costs that we will impose could be $100,000. And so that’s a large chunk when you look at what our revenues actually are. It’s very disproportionate. In that year we had two hearings—three?

Bearsley No, we had one. It was Horizon, and then we were sued, and that’s what made it a tough year. We ended up in the High Court. We were judicially reviewed. So could that happen? Yes, it could happen at any time.

Lotu-Iiga But it’s not something that, you know, will happen every year, is it?

Bearsley Hope not. If we do our job well, it should not. 

Lotu-Iiga Well, I don’t know. Going back 10 years, what does it look like? I mean, 5 years is a nice snapshot.

Jones I can help you on that. When we started, we had everyone testing the code, as you might expect, and over the period of 10 years people have grown to understand the code and how it works. And you have market practitioners who actually want to work with the panel. They’ll want certain outcomes for their clients. They don’t want to go to a section 32 enforcement meeting; they want a smooth takeover. So they’ve learnt, as we’ve learnt, where the boundaries are. So if you asked us what the likelihood of an enforcement meeting was now, it’s remote because people have accepted the way the code works.

Bearsley That’s absolutely right. And then sometimes there’s just somebody who wants to litigate.

Cosgrove Could I just go back to the issue of risk. You’re absolutely right in that if panel members aren’t getting appropriate levels of advice, then either they’ll be called upon to do the job themselves—and I don’t know which would be cheaper—but do you consider that, especially given this possibility of litigation, do you accept that as a risk? If you can’t attract or maintain, because of pay and remunerations, appropriate levels of advice, do you accept, one, that that’s a risk, and, two, have you made any submissions to the Government around that? Because the truth is it does come down to money. I presume if you could offer X dollars, which makes you slightly more competitive, you’d retain that level of expertise. My concern is if you are getting—if people are sort of churning in and out and in and out, there’s no continuity of experience or skill.

Jones We recognise it as a risk. We’ve always tried to work within our budget, and we’ve made it work. We’ve been fortunate in that the GFC has meant that a lot of people have been in law firms, and, by attrition, people have either left or they’ve been pushed out, we’ve been able to pick up, in particular, graduates—people who normally would’ve gone into law firms who are high quality. So the GFC has had a bit of an advantage to us.
Cosgrove  7.3 percent unemployment works. I’ll just come back to it. Like any organisation—I mean, I take your point—the question is if you accept it as a risk, have you approached the Minister to say: “Look, yeah, there’s plenty of lawyers on the cheap we can grab out there who are redundant or whatever.” But in terms of the specificity of skill and advice you need, you’ve said it’s a risk. What have you done about mitigating that? Have you approached the Minister? Have you made the Minister aware of it? Why not?

Bearsley  Because for the time being at least we’re managing by continually improving our efficiency and cutting our costs.

Cosgrove  But that may, you know, as you say, four last year, six at the moment—that fluctuates. Surely you’d have a long-term plan to mitigate that risk. I mean, why wouldn’t you approach the Minister—OK. Have you briefed the Minister that you consider this a potential risk?

Bearsley  In the sense that our annual report notes that it remains challenging, yes. We’ve not raised it as a specific risk for the panel, because we manage.

Cosgrove  Well, that’s good on you. Thanks for your diligence, but I would have thought that’s a rather strange way of mitigating a risk. Surely—I know there’s a reluctance to go and ask for more money—but wouldn’t the Minister want to know if you consider there’s a risk going forward, so that the Minister can perhaps lobby colleagues for more money, if that was the answer, or suggest other mitigating strategies?

Jones  Two things—we’ve identified in our strategic planning our risk. Employees is very high as one of the potential risks. Part of that has been addressed by implementing a succession plan for our employees. So we’re constantly looking at what the risks are and how we would address those risks. Money hasn’t been an issue for us, because we’ve been able to, in terms of our own budgeting, ensure that the cost of getting the right people in can be covered.

Cosgrove  So how do you succession plan for—normally, succession planning is about promotion up the ladder and who takes over, but—

Jones  It’s not just promotion; it’s people who leave. You see, we recognise—

Cosgrove  —that people will leave. It’s what actually happens if, for example, Margaret leaves or the proverbial bus runs her down?

Jones  So how are you doing it?

Cosgrove  So what happens?

Jones  So in that case, part of our plan is that the general counsel has been mentored to understand what the requirements of the chief executive are, especially in an emergency-type period, and he works closely with her. And we have similar plans in relation to senior staff.

Cosgrove  You see, the thing that worries me—I mean, you’re lean, and there’s a good side to that, but if you drop down to your legal advice, it’s harder to, especially if there’s an increase in work, succession plan there. So a lawyer leaves, well, either you’re constantly keeping an eye on the market to see
who are the people who you could grab if they’re available or who you could shoulder-tap and pull out and attract across from somewhere else. OK, that’s a strategy.

But, you know, if the economy did start to move in the next hundred years and you had four or five lawyers who said: “Right, I can make more money elsewhere. We’re out of here.” at once, then you’d have a huge strain on the panel members. Now, you could pull out a hundred lawyers, but whether they’ve got that special skill or whether they’re sort of, you know, wet behind the ears graduates, they’re the people who’re advising the panel. So it all seems a bit sort of glue, rubber bands, and string. I mean, I’m not blaming you guys—

Young

Well, you faced that when you had a 50 percent churn one year, where you lost four and had to replace them.

Jones

All four didn’t go at the same time.

Cosgrove

Getting away with it once doesn’t mean it’s a good strategy for the future.

Bearsley

I guess there’s several things, really. The panel doesn’t want to cry wolf, and I think we have the confidence of our monitoring policy agency and hopefully the Minister that if we needed something and we asked for it, it would be clear that we were asking because we needed it, not because we were provisioning—

Cosgrove

But you haven’t briefed the Minister, though.

Bearsley

Well, we haven’t raised that as a particular issue on which to brief the Minister, that’s correct.

Cosgrove

Don’t you think you should?

Bearsley

Well, I guess the nature of our work has changed significantly. One of the reasons why we insisted on maintaining our staff during the quiet period was precisely to be prepared when the market picks up again, so that we have the staff available who are building up their understanding of the takeovers market. They’ve been employed during the quiet period by progressing the panel’s policy work. Through doing that policy work, the code has become more efficient for the market, and that means that we are processing less exemption applications now than we ever used to, and will ever have to again.

Cosgrove

Would it be helpful for you, and this committee’s subsequent report, if we highlighted the fact, because I’m sure the Minister will be hanging out to read the committee report, that you’ve identified this as a form of risk?

Jones

Well, it’s true. We have identified it as a risk, but we think we’ve got it in hand at the present time.

Mitchell

I notice that the chief executive, you mentioned earlier that—and I think it’s good that you have flagged a risk. Every business carries a risk. You see it as a challenge but you’re comfortable that you’re managing the challenge.

Bearsley

Yes.
Mitchell But I guess you have signalled that rather than wanting more money, it’s actually quite important that there wasn’t a reduction in funding.

Bearsley That’s correct.

Mitchell And that’s basically where you see it and how you’re managing it.

Bearsley Yes.

Mitchell And the succession planning in terms of— you’re always going to get staff lawyers coming in. They start to upskill and it’s natural that they start to look for other opportunities, but you’ve sort of identified maybe a pool of where these young lawyers can come from that you’re tapping into, and that’s part of your succession planning.

Cosgrove On that, have you identified the pool?

Bearsley They come out of law school. We’ll take new graduates by preference. What we do try very hard to do is have continuity amongst our senior staff, and that’s really where the expense arises—so work with our senior staff. Like me, I came up through the ranks. I started as a senior solicitor for the panel and I’ve stayed with the panel for 8 years, and now I’m the chief executive. Some of our other senior staff can see a career path for themselves. I won’t stay working for the panel for ever. It’s the junior staff who tend to turn over, and that’s because as lawyers in our field of work it’s highly specialised and so if they stay with us for too long, they’re actually locked into it—well, and then they might stay with us and become chief executive one day. So our junior staff tend to turn over maybe every 2 or 3 years, and then they will go and work in law firms in the corporate and financial area. So there’s always new graduates coming from law school, and we give them a good work experience and train them up.

Mitchell So you’ve done the right thing and just flagged it up as something that is part of your risk profile, but you’re very comfortable where you are managing it and dealing with it under the current funding.

Jones Part of our pool also is secondment from law firms, but in the last couple of years we’ve not needed it, and that’s quite a useful pool to draw on as well.

Lotu-Iiga You talk in your report about the cost-effectiveness of the panel and everything. I want to get away from the operational stuff, and look at the big picture and what the panel does for capital markets in this country. We know it’s a small capital market. We know there are a small number of takeovers, but we also know that if a takeover is done well it promotes economic growth and promotes economic activity. If it’s done badly it probably leads to monopolies and, if you like, market inefficiencies. So I’m just wondering how we measure the effectiveness, the overall effectiveness, of your role within that bigger picture of promoting confidence and the integrity of capital markets in this country. I know you’ve said in your annual report that you’re really unable to provide evidence that the services have contributed to that big outcome. Have you looked at how takeovers in foreign countries—and I know we’re a different type of market, but I mean, can we measure that outcome? Because it would
be good to know if what you’ve done—and I know it’s hard, but
anecdotally you can look at some of the takeovers and what they’ve done.
Great jobs; obviously some of them create efficiencies across industries.
Can you give us any benchmarking, perhaps, of how we can measure the
effectiveness of your organisation in its big picture kind of way?

Bearsley  Well, I think realistically—

Lotu-Iiga  I know it’s a hard question, but if you could do it, it would be great.

Bearsley  I think we can’t. I think what you would probably be looking at, if there was
no Takeovers Code and no Takeovers Panel, is an impact on foreign
investment in New Zealand, and you would have the likes of Brian Gaynor
writing about New Zealand as the Wild West and how much more difficult
it is to attract capital from overseas when people are investing in a market
where they know there’s no rules around what happens to their
shareholding.

Jones  This goes back to the essence of why we have a Takeovers Panel, at the
very beginning, in the debates which started in 1988 and went through. It
might be useful for you to remember that the Capital Markets Task Force,
which I think started just before the National Government came in two
terms ago, was undertaken by Rob Cameron. He looked at the Securities
Commission and the Companies Office, and looked at us at the same time.
He did an analysis on us and he said: “You operate so efficiently and
provide confidence in the market, that we don’t think you should be
changed in any form. I think it would be quite wrong to try and put you
with the FMA.” I don’t know whether that gives some sort of signal from
some independent. I think that sort of answers your question in part.

Lotu-Iiga  What was the rationale behind making that statement? He must have—

Jones  Well, he spoke to all the market participants and said: “What is the
Takeovers Panel doing? How do you see it fits in with what we’re looking
at, in terms of the task force?”.

Lotu-Iiga  That’s fair enough, and I know you’ve talked about stakeholder
relationships, and I think that’s important because ultimately if you can’t
hold to some sort of evidential test then, you know, maybe those are the
sorts of variables or tests that maybe we should judge you on—putting
aside all the operational stuff, which we dealt with earlier today.

Jones  Perhaps your question is answered in part by saying all leading capital
markets have a Takeovers Panel, whether that’s Australia, Hong Kong,
Singapore, the UK. All Commonwealth countries have had to implement a
Takeovers Panel, and it’s one of those things. You know what it is, but you
can’t explain it sometimes.

Lotu-Iiga  That’s good. But I think for the future maybe you should look at whether
those larger markets and their panels and the takeover activity in those
markets have been studied at all or have been tested in terms of their
effectiveness, perhaps using a counter-factual, as you have said. You have a
growth in takeovers, and then maybe post the Takeovers Panel you’ll assess
what happens in that period. It would need to be a substantial period to
have any sort of measure put in place. It’s something maybe for your future work programme, while the activity is lower.

Young: Thank you very much indeed for appearing today. We appreciate your time. Thank you.

**Conclusion of evidence**
2011/12 financial review of the Taranaki District Health Board

Report of the Health Committee

Contents

Recommendation 2
Introduction 2
Financial and service performance 2
Funding 2
Project Maunga 2
Emergency department 3
Youth health 3
Māori health 3
Privacy management 4
Rescue helicopter services 4
Appendix 5
Recommendation

The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Taranaki District Health Board, and recommends that the House take note of its report.

Introduction

The Taranaki District Health Board (DHB) delivers health services in Taranaki and the Mokau area to a population of about 104,280 people, of which 15.2 percent identify as Māori. The population is ageing, with a higher than average proportion of people over the age of 64.

The area covers over 7,000 square kilometres, with a few densely populated centres, and the rest of the population is scattered in and around small rural centres. The DHB operates the Taranaki Base Hospital, Hawera Hospital, and five community health centres.

Financial and service performance

In 2011/12, the DHB had a total income of $318.861 million and its total expenditure was $318.852 million. Including surpluses derived from associates (entities such as providers of radiology and laundry services, over which the DHB has influence, but no financial and operational control) this resulted in a surplus of $198,000.

Hospital provider costs

It was brought to our attention that the DHB has forecast deficits in 2013/14 and 2014/15, because its costs as a hospital provider significantly exceed its funding for this purpose. The DHB realises that the deficits in hospital services are not sustainable, and they are working with clinicians, providers, and communities to design services within resources, with a regional focus. We will monitor the DHB’s financial performance with interest.

Funding

We heard that the DHB is expecting its share of the country’s population to fall from 2.8 percent to 2.73 percent within five years, with a multi-million dollar impact on government funding, resulting in cost pressures. In the light of this, we asked the DHB if they thought the population-based funding system for DHBs was effective. The DHB said that they like its transparency, and support reviewing the formula in the hope of improvement, but feel it is probably as fair as possible.

Project Maunga

Project Maunga, a redevelopment of the Taranaki Base Hospital, began in 2011, and is being funded by borrowing and capital reserves. The new facility will house six new operating theatres, day-stay services, and a new inpatient ward block. We were pleased to hear that the $80-million project is on budget and on track to be completed in August 2013.
We heard how the DHB has done logistical planning and made physical arrangements to ensure there will be no disruption to service delivery. We understand that the DHB will run deficits in future years, partly because of interest and depreciation costs resulting from the project. The DHB assured us that it is well placed to deal with the cost pressures, and is forecasting small deficits for the next two years before returning to surplus.

Project Maunga also includes initiatives to improve performance and efficiency: the Productive Operating Theatre, for example, is expected to improve the patients’ experiences, safety, and outcomes, and to make more effective use of theatre time and staff experience. Releasing Time to Care is designed to help nursing staff spend more time on patient care, and improve safety and efficiency. E-medications management is intended to reduce adverse events, while improving efficiency and value. The DHB also expects better productivity as off-site services are brought on site.

We were pleased to hear that in the redevelopment the DHB has taken into account its static, elderly population, and the resultant high and rising demand for elective surgery. We congratulate the DHB on the thorough planning of the design and implementation of Project Maunga, and its successful implementation to date. We look forward to hearing of its progress.

**Emergency department**

We asked about the DHB’s 5–6 percent increase in emergency department admissions over the past year. The DHB said it is trying to determine its origins. We were assured that it has a programme for dealing with the increase, and is increasing inpatient and outpatient services accordingly. We will monitor this issue with interest.

**Youth health**

We asked about the DHB’s response to the collapse of Waves, a youth health and development support service, which ceased operation in October 2012 because it could not secure funding from the DHB. We were pleased to hear that the DHB’s Youth Health Strategy involves the same people, with a focus on integrating education, health, social services, and youth development services.

**Sexual reproductive health**

We are aware that the Taranaki region has a high incidence of teenage pregnancy and abortion. The DHB told us it will cover the cost of offering the morning-after contraceptive pill free at pharmacies to people aged from 12 to 24; this will be implemented later in the year. The morning-after pill usually retails at $25 to $35. The strategy also involves reducing the costs of contraception at general practices, improving access to services, and encouraging and educating young people about healthy sexuality.

**Māori health**

In April 2012, the DHB released Whānau Ora Health Needs Assessment, a report on Taranaki Māori health needs using a Whānau Ora framework; the report is being used by the DHB and non-governmental organisations to guide planning and service delivery. We understand that this is the first time a DHB has used this approach, and we look forward to reviewing its results.

We heard that the plan has helped mobilise the sector to improve health outcomes, and the DHB is predicting positive results. The DHB said it is working with Māori and the
community to provide culturally appropriate services and develop initiatives to strengthen the Māori health workforce. We would like to see the DHB use this opportunity to address type two diabetes in Māori, and the oral health of Māori children.

**Privacy management**

We asked about the DHB’s approach to privacy, and were told that it is taken very seriously; a recent external audit of information technology services found no problems. We also heard that new staff are routinely trained about the importance of privacy management and the relevant protocols and procedures, with a refresher course every two years.

**Rescue helicopter services**

We were interested in the relationship between the DHB and the local rescue helicopter services; we heard how they maintain an inter-hospital transfer service, with 75 percent of transfers provided by fixed-wing aircraft, and 25 percent by helicopter.
Appendix

Approach to this financial review
We met on 13 February and 27 February 2013 to consider the financial review of the Taranaki District Health Board. We heard evidence from the Taranaki District Health Board and received advice from the Office of the Auditor-General.

Committee members
Dr Paul Hutchison (Chairperson)
Shane Ardern
Dr Jackie Blue
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Scott Simpson
Barbara Stewart
Louisa Wall
Dr Jian Yang

Evidence and advice received
Taranaki District Health Board, responses to questions, received 11 February 2013.
Taranaki District Health Board, responses to additional questions, received 25 February 2013.
Office of the Auditor-General, Briefing on Taranaki District Health Board, dated 13 February 2013.
Organisation briefing paper, prepared by committee staff, dated 5 December 2012.
Report of the Māori Affairs Committee

The Māori Affairs Committee has conducted the financial reviews of the 2011/12 performance and current operations of Te Reo Whakapuaki Irirangi (Māori Broadcasting Funding Agency) and Te Taura Whiri I Te Reo Māori (Māori Language Commission) and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Hon Tau Henare
Chairperson
2011/12 financial review of Television New Zealand Limited

Report of the Commerce Committee

Contents
Recommendation 2
Introduction 2
Strategic review 2
Studio location 3
Igloo pay television service 3
Freeview 4
Target audiences 4
Current affairs 4
Appendix A 6
Appendix B 7
Television New Zealand Limited

Recommendation
The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of Television New Zealand Limited and recommends that the House take note of its report.

Introduction
Television New Zealand (TVNZ) is a Crown entity company and is subject to provisions of the Crown Entities Act 2004, the Companies Act 1993, and the Television New Zealand Act 2003. The shareholding Ministers of TVNZ are the Minister of Finance and the Minister of Broadcasting.

TVNZ is governed by a board of directors, with Wayne Walden as chair. The chief executive is Kevin Kenrick, who took up the position in April 2012.

TVNZ generated $381.84 million of revenue for the year ended 30 June 2012; profit after tax was $14.21 million. Earnings before interest, impairments, remediation expenses, financial instruments, associates, subsidiaries, and tax were $27.92 million, $3.89 million less than the previous year. Increases in the costs of television programming, particularly that sourced from overseas, were the principal cause of lower earnings.

TVNZ told us that for the current financial year its spending and revenue were broadly in line with the budget expectations set out in its statement of intent, and it remained committed to delivering its budget targets. In 2012 the Minister of Broadcasting wrote to TVNZ expressing an expectation of a return of at least 9 percent.

Strategic review
TVNZ explained that it now had to view itself as being in the video business, rather than simply the television business. It had needed to think about how to engage New Zealanders with the most-watched content, not only relative to other television providers but to all video content providers. It told us that its most popular television content also tended to be among its most popular online; though occasionally a large online-only event, such as Sir Paul Holmes’ funeral, would attract even higher online ratings.

We asked about growth and opportunities for advertising in online, mobile, and digital formats, and asked how revenue was generated from popular online content. It told us that competition was much stronger for online advertising than for television advertising. Its main focus for online advertising was selling slots in online streams of video content. Revenue from this form of advertising was accelerating.

TVNZ told us it had secured 92 percent of New Zealand’s television advertising growth over the past year, but this figure referred to television advertising, and did not include advertising online. Its digital revenue started from a very low base, though it was increasing quickly.

We asked how TVNZ was dealing with the increasing cost of overseas content. It told us that the increase over the past year was considerable, but it was working to make the
organisation as efficient and lean as possible in order to afford more content. It had recently renegotiated and extended a content supply agreement with Disney, which it believed was a good deal.

We asked whether TVNZ’s move away from a public broadcaster model to a commercial focus affected the organisation and New Zealand’s public broadcasting. TVNZ said that New Zealand On Air provided contestable funding for public service programming, which it supported as a method for providing public service content.

Staffing

We noted the resignation of the head of news and current affairs and of the chief executive of Igloo. TVNZ told us that it is usual for staff to come and go from any business, and personal circumstances could affect peoples’ employment decisions. It planned to replace both staff members. The majority of us accepted TVNZ’s word. However, some of us expressed concern at these resignations from these critical positions during this time.

Studio location

We asked whether TVNZ was discussing with the Government the use of studio land in Auckland that potentially overlapped with the proposed Skycity national convention centre. We heard that a news story in the New Zealand Herald about the issue had resulted only in a general discussion at a board meeting. TVNZ said that its chairman had had a conversation with the Minister of Commerce on 16 May 2012 in which the Minister had indicated that he did not know about the issue. TVNZ presumed any discussions would occur between TVNZ and Skycity on a commercial basis. It told us it was not discussing the issue with any Government Ministers, other politicians, or officials, and had not asked the Government for any concessions.

We asked TVNZ to provide us with the estimated cost of relocating the studio facilities if the property were sold. It told us that it had had tentative conversations with an architect, in response to the newspaper article, but had not quantified the potential costs of moving or undertaken any risk analysis. The discussions had also examined potential methods for reconfiguring the studio space to make it more efficient. TVNZ said it had made a preliminary assessment of whether all of its Auckland staff could be accommodated on the main TVNZ premises.

We asked why more planning had not been done on this issue. TVNZ told us that as the potential issue was so far confined to speculation, it did not yet see the need to take further action.

Igloo pay television service

TVNZ told us about Igloo, a joint venture with Sky Television launched on 3 December 2012. We heard that Igloo was a low-cost pay television service for consumers who wanted more choice than was available on free-to-air television but did not want to pay for the premium Sky Television service.

We asked whether TVNZ thought Igloo was on track to meet its subscription targets. It told us that pay television services typically take some years to build a subscriber base and to reach a break-even position, but it believed the service was on track and felt confident of its direction. TVNZ said it was not constrained by its relationship with Sky from entering into other joint-venture agreements. It was restricted from involvement in other digital pay
terrestrial television services, which would be in direct competition with Sky, but did not see this as a major constraint.

We asked whether TVNZ had set a target for the number of digital set-top boxes to be sold in the first year following the switch from analog to digital television, in relation to the launch of Igloo. It told us it had not specifically linked targets for Igloo to the digital switchover.

**Freeview**

TVNZ told us that Sky Television subscribers in New Zealand spent 61 percent of their total television viewing hours watching programmes available via the free-to-air FreeView platform. We asked whether TVNZ therefore thought it would be necessary after the digital switchover to continue to advertise the FreeView platform as an alternative to paying for Sky. It told us that as a significant participant in the management of FreeView it would endeavour to ensure its continued success, marketing it appropriately as circumstances changed.

We asked how TVNZ made money if it provided its free-to-air programming to Sky at no cost. It explained that the programming still carried advertising; making the programming available via Sky extended its reach to audiences and consequently its appeal to advertisers.

**Target audiences**

We asked whether TVNZ’s focus on maximising performance and revenue meant that groups who were unlikely to be target audiences for advertisers might be less likely to be catered to. TVNZ believed it was a matter of finding a balance. It said that its most-watched content had a broad appeal, but there was room at off-peak times and in online programming to cater to smaller niche audiences. It did not believe that older audiences were likely to be under-represented among online viewers.

We asked about TVNZ’s commitment to Māori and Pacific Island television programmes. We heard that it had recently appointed a new, experienced general manager to this division, who had a very good understanding of and insight into the needs of the Māori and Pacific Island communities. It was seeking to incorporate more Māori perspective into mainstream programming. It recognised its legislative requirement to reflect Māori perspectives, and welcomed the opportunity to reflect the unique influence of Māori and Pacific Island people on New Zealand.

We asked whether there were plans for Asian programming to reflect the changing demographics of New Zealand. TVNZ said it constantly monitored ratings in a broad cross-section of audiences, and needed to understand what people considered to be compelling content.

**Current affairs**

We asked TVNZ to define its understanding of current affairs. It told us that it viewed current affairs as events that were current and newsworthy, and “conversations of the day that are taking place in society”. It believed that criticism of its new current affairs show, *Seven Sharp*, came mainly from a small group of commentators who tended to reinforce a more traditional idea of current affairs. It observed that people obtained their news from a much wider variety of sources than they did previously, and suggested that traditional television news formats were not holding the audience’s attention. TVNZ told us that consumers were “looking for short, sharp sound bites”, and that delivering the content that
viewers wanted would create subsequent opportunities with advertisers. It believed that it was also still leading the market in the more traditional, in-depth current affairs genre with *Sunday, Q+A, 20/20*, and *Fair Go*. 
Appendix A

Approach to this financial review
We met on 21 February and 28 March 2013 to consider the financial review of Television New Zealand Limited. We heard evidence from Television New Zealand Limited and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Evidence and advice received

Organisation briefing paper, prepared by committee staff, dated 18 February 2013.
Television New Zealand Limited, Responses to questions, received 24 January and 28 February 2013.

Corr ected transcript of hearing of evidence 21 February 2013

Members
Jonathan Young (Chair)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Hon David Cunliffe
Clare Curran
Julie-Anne Genter
Peseta Sam Lotu-Iiga
Mark Mitchell
Dr Jian Yang

Witnesses
Wayne Walden, Chair
Kevin Kenrick, Chief Executive Officer
Rodney Packer, Chief Financial Office

Young  Well, welcome to Television New Zealand, to Mr Walden, Mr Kenrick. Welcome. This is your—Mr Kenrick, especially—first appearance before the committee. If you’d like to introduce your team, that’d be most appreciated, then we’ll go into a presentation from you, and then, of course, the committee will be wanting to ask questions. Thank you, sir.

Walden  Thank you. Thank you, Chair. I’ll just quickly introduce the team, as you’ve suggested, and then I’ll make some very brief comments about the year that has been, because you’re all clearly very up to date with that, and then really I’ll just hand over to Kevin, and he’ll talk a little, perhaps, about the strategic review that we’ve just completed, and maybe touch on just how we’re going in this current year. Then really we’ll be ready for your questions. [Introductions]

So just some brief comments about the year 2012. I mean, it was—I think you could describe it as being a satisfactory result. Operating earnings were $27.9 million, and net profit after tax was $14.2 million, and that was up from $2.1 million in the year before. That gave shareholders a return on shareholders’ funds of 9.2 percent against an expectation of 9 percent. So we managed to just exceed that. And a dividend of $11.3 million was declared for that year. I think that’s paid in September of this year.

Television market—that grew by just over 2 percent, so certainly a softening there, with Television New Zealand capturing 92 percent of that growth. So we were quite pleased with that performance in a softening market. The company’s market share increased from 61.6 percent to 62.2
percent, so an increase there. Again, quite pleasing, with advertising revenues at $313.7 million, up by just under 3 percent on the previous year.

In relation to performance against Television New Zealand’s priorities as set out in the 2011-12 statement of intent, the company met or exceeded all the goals that were outlined. The board conducted a strategic review late last year, essentially recognising that rapid changes are occurring in what is now a converged and much wider media market, and, of course, the transition of the company from a chartered broadcaster to a more commercially focused participant. So what I’ll do is I’ll now get Kevin to perhaps talk in a little more detail, perhaps at a fairly high level, on that, and then briefly to talk about just how we might be faring, again at a fairly high level, in this current year.

Young

Great, thanks, Mr Walden. All right, Mr Kenrick.

Kenrick

Thank you. The strategic review is very much building on where the organisation has been up until this stage. The primary shift for us is to think less about ourselves as being in the television business and more about being in the video business. One of the reasons that television has been so successful over many years has been the video format of that content, and the great thing is that consumers, in general, worldwide are seeking more and more content in video format, and that is showing up on TV, and it is also showing up in many online websites and various other places. So for us it’s an evolution in terms of how we manage and run the business, but it’s something of a revolution in terms of how we think about the business that we’re in.

We think the vision is all about how we engage the hearts and minds of New Zealanders with the most-watched content, and that needs to be the most-watched content not just in a comparison with other free-to-air or pay TV providers, with video content providers in general. And then the broad themes that we’re focused on for the organisation are around how do we make sure that we create and source the most compelling content, because, ultimately, we’re a content business. From there what we need to do is to expand the accessibility of that, and that’s principally about how we build and strengthen the online area to marry up with the strengths that we’ve historically had in TV.

The third point for us is about how we can turn that audience reach into valuable opportunities for advertisers, for them to be able to tell their stories in a video format.

The fourth thing for us is around consumer paid-for content, where we think the smartest thing for TVNZ to do is to partner with others where we bring our content and we marry up with their customer bases and in many cases their ability to actually have a paid-for content model.

And then finally the fifth area for us is how do we match the cost base of the business to the market reality? So if you look in the online world, then typically things are lower cost than historically the way that the TV business has been operated, and we need to ensure that our cost base reflects the
future more so than the past. Very broadly, that kind of gives you a flavour of the strategic direction we’re taking.

If I comment on directionally how we’re tracking this financial year, we are broadly in line with the budget expectations that we set out in our SOI. The things that are showing up differently to what was originally expected are that the advertising market for TV is a bit softer than what we originally planned. We’ve been successful in growing our share of that market, but it is still less than what we originally planned, and we’ve managed to offset that with above-target expectation of performance in our digital area, particularly with our Ondemand service, and by tighter cost control some of the more overhead areas of the business.

So we remain committed to delivering on our full-year budget targets. It will be challenging in the market, given the softness of demand for TV advertising, but we believe that there are enough levers for us to pull to try and make sure the business delivers on that outcome.

Young

OK, let me start off, and then we will come to the other members too with questions. In terms of the discussion that you’ve presented regarding the online versus, perhaps, broadcasting in the conventional sense that we’ve known TVNZ in the past, presuming that obviously broadcasting television is always going to be the mainstay, what sort of growth are you measuring in terms of the online, mobile, digital formats that are increasingly becoming part of just everyday use for New Zealanders? And in terms of advertising and maximising those opportunities, what sort of things are happening in that space?

Kenrick

What we’re focused on is how do we maximise the reach across New Zealanders? So, in total, TVNZ would have connections with about 2½ million New Zealanders every day, and yet the make-up of that, we’re seeing growth in online video consumption, and that’s the area where we need to increasingly put our focus. So, for example, if you take a programme like Shortland Street, which is an incredibly high-rating programme on TV, it also happens to be one of the highest-demanded downloads in terms of our Ondemand video. We also are finding, for example, the coverage we had for Sir Paul Holmes’ funeral, which was solely provided in an online setting, surpassed what we would expect to get normally for Shortland Street. So what we’re seeing is that’s something that’s purely online, as opposed to TV followed by online, and increasingly what you’ll see is a combination of first on TV followed by online, things that are solely on online, and there will be some things that are solely on TV.

Lotu-Iiga

Quick supp on that. In terms of—and I know where you’re going with it, and I think it’s a good move, and you’re trying to keep your viewership up. But how do you generate revenue? What’s the revenue model around that, that will, you know, increase your revenue-generation ability? Can you just talk through that. How do you get that in terms of dollars going forward? I mean, are there models you’re looking at overseas that you’re basing this sort of strategic move towards?
Kenrick Absolutely. I think the challenge is how do we replicate a long-term demonstrated strength in the TV environment in the online environment? The fundamental differences are that there’s just far greater competition in online than what there is in TV. The area that becomes quite challenging is if you have static display ads in an online environment, because there is almost an infinite supply of websites, and therefore that advertising—the pricing and the value of that—gets commoditised globally quite quickly. The area where we are putting the bulk of our focus is around video content online, and in that area we think that we’re offering a premium offering and a premium environment for advertisers. So the advertising that’s placed prior to midway through and at the end of our online or our Ondemand video streams is an area that offers great value for advertisers, and it’s something that we’re growing that revenue at quite an accelerated rate.

Lotu-Iiga OK, that’s good.

Curran Thank you for your presentation. It’s good to see you both here before the select committee for the first time. As you would imagine, I’ve got a number of questions, and I want to go first to a line of questioning that we discussed in last year’s review, which I understand you weren’t present at, but it was quite a pertinent issue at that time and it remains so today. And that is with regards to any discussions that TVNZ has had with the Government regarding the land, your land purchases, your land that exists, and which may be used for the SkyCity convention centre. At that time last year there had been material published in the New Zealand Herald on how some of that land could be used, but there had been no discussions entered into with the Government. I’d like to know are you in any discussions with the Government on the use of that land for the convention centre?

Kenrick Well, obviously I’ve only been involved since May of last year, but we’ve seen the speculation in the media, the same as everybody else. So we’ve acknowledged that that is a topic that’s live. We’ve yet to have any approaches from SkyCity about that land, and yet we wouldn’t be surprised if there was one at some stage in the near future.

Curran My question was are you in discussions with the Government on that issue?

Kenrick I haven’t been. I mean, Wayne, from a Chair perspective?

Walden Yes, well, look, what I can add to this is that following the publication of that article in the Herald that, in fact, from memory, had a diagram of the proposed development site for the convention centre that SkyCity were intending to develop, I did have a conversation with Minister Foss on the basis of—because, I mean, this was a surprise to us, because the indication on that plan was that they wanted a reasonably considerable amount of land, which was, you know, clearly currently in use, and really asked him whether or not he knew anything about this. He indicated at that meeting that he did not, and also indicated that “Look, one would assume that if it ever got to the stage where you were to be engaged with SkyCity, clearly any discussions would happen, no doubt, on a commercial basis.”
I understand that you’ve had a discussion with Mr Foss. Have you had discussions with any other Government Ministers since that time about this land?

No.

No. So there are no current discussions?

There are no current discussions.

In the report that you refer to, in the last financial review, I think it reports that Skycity have been discussing things with TVNZ. There were two portions of land. There was a part that wasn’t being actively used that they were interested in. I think that was in our last report of the previous select committee.

There was, but it was a live issue then and it’s a live issue now. So I understand that you haven’t. Have any other Television New Zealand officials, employees, been engaged in any discussions with the Government—any Government Ministers, or officials, on this—

I think that’s been answered.

Well, certainly, at this stage I’m not aware of any, and I think that’s the case, isn’t it, Kevin?

Yes.

Just for the record, in your discussions with Minister Foss, did he put forward that there may be any concessions, legislative or otherwise, for TVNZ if they entertain this possibility, or did you ask for any regulatory or legislative concessions or otherwise in the same way as we’ve seen with Skycity?

No, absolutely not. I mean, it was a very brief discussion, as I said earlier. It was a question of “What knowledge did you have of this as our Minister?”, to which he responded that he had no knowledge of that. And then, of course, it led on to “Clearly, this would be commercially driven transaction in the event that something might happen.”

To the chief executive, you didn’t give us an on-the-record answer to your previous inference, chairman, just clarifying that the chief executive’s position is that no employee, executive, or otherwise in TVNZ has had any discussion with any officials—

—or politicians.

—or politicians on the matter of Skycity’s potential purchase of your studio sites on Hobson Street or part thereof. Can you put that on the record, please, if that’s your position.

We employ somewhere in the region of a thousand people. I haven’t personally spoken to each one of them on the subject, but to my knowledge I’m not aware of any.
Bakshi My question is regarding the digital switch-over and your partnership with Sky Television on Igloo. What is the status right now and how do you look on that area?

Kenrick In terms of how do we view the digital switch-over?

Bakshi Yes, the digital switch-over and your partnership on Igloo.

Kenrick I mean, we view the digital switch-over as being a very positive thing for us and for other players in the market place. We think that it is being managed very well, and I think that the first regions that cut across—there was very high awareness. The vast bulk of people had been able to make the changes in order to be able to continue to access the TV signal. And it continues to look as though it’s on track and going very well.

The options for people around where they can access or how they go about accessing the signal post-DSO—we think that Sky TV has got very strong market penetration, we think that FreeView has grown and has got the bulk of those who are non-Sky, and Igloo is very much a new market entrant that would participate in that over the next period of time.

Bakshi Is there a minimum benchmark set that will be the minimum target for TVNZ to achieve in the coming year?

Kenrick I’m not sure I understand the question. In terms of—minimum target relating to what?

Bakshi To the sale of how many set top box you intend to sell in the first year.

Kenrick Around Igloo specifically?

Bakshi Yep, yep.

Kenrick There are multi-year plans around aspirations for Igloo over a sort of a 3-year time period, but they’re not specifically tagged to the digital switch-over.

Genter Thank you for your presentation. I note that in the annual report you mention that there’s “Continue transformation to a consumer and customer focussed organisation” and that the “demographic targets were closely examined to ensure they were best placed to maximise performance and revenue.” Does that mean that those New Zealanders who are in demographics that are less likely to be targeted by advertisers, such as older New Zealanders, those on lower incomes, are not going to have any content provided for them by TVNZ? Is it safe to say that that’s not a focus—delivering content for New Zealanders who aren’t in the socio-economic groups that are most highly targeted by advertisers?

Kenrick As I mentioned before, our vision is about engaging the hearts and minds of New Zealanders with the most watched content, and what we see is that the content that has appeal to different groups is not necessarily driven by their socio-economic status, rather than the content that they find compelling. So, from a commercial perspective, yes, we do need to ensure that there’s commercial viability in terms of appeal to advertisers, but the
crossover between that and a broader group of people seems to be quite high.

Genter So there’s no sense that there are some groups in New Zealand who might, for example, not have niche content provided for them, because they’re less revenue-generating?

Kenrick In terms of content, what we’re finding is our primary free-to-air channels—TV One, TV2—are very broad-reach, and typically in prime time we’re looking for content that will appeal to hundreds of thousands of people. In off-peak time zones, and also increasingly in the online OnDemand environment, we can support programming that might appeal to tens of thousands, and it’s just about getting the balance and the mix right.

Genter And, I mean, obviously, the groups who are less likely to attract advertising revenue are also less likely to be engaging with online mediums, because they’re older or from lower socio-economic groups. So is there any conflict there?

Kenrick I think the socio-economic side of that might be true, but I don’t think age is necessarily that much of a barrier in terms of online uptake. In fact, there’s plenty of evidence to suggest that older people are very active online. When you look at Sunday morning—

Genter They’re the most likely ones to consume online content? People over the age of 70 or—?

Kenrick Well, I mean, I’ll give you a sample of my parents, who are both over the age of 70 and who are actively involved online, and they’re not high socio-economic. You know, I used to work in the broadband environment, and there didn’t seem to be that much of a demarcation around age. But we also have the time period on Sunday mornings, which is commercial-free, or advertising-free, and there is quite a lot of content there that wouldn’t otherwise feature during prime-time schedules.

Cosgrove Just to go back a step, just, firstly, to ask you for some information. Could you provide us with the estimated cost of relocation and rebuild of your facilities at Hobson Street, in the event that they were utilised by another party or sold. Secondly, could you please tell us on what date that conversation took place with Minister Foss—it was with yourself, I take it, Mr Chairman—on what date, and, if you don’t have that date, I won’t waste your time. If you could provide it to us, please. Do you have the date?

Lotu-Iiga What’s the first question?

Young The first question—

Cosgrove Well, hang on, I’ve got an answer coming.

Young —is based on a very hypothetical scenario that you’re presenting.

Cosgrove No, no. The first question is my democratic right to ask a question and to seek information. Whether it’s hypothetical or not is of no relative interest. My first question was could you provide us with the estimated cost of
relocation and rebuild of your Hobson Street facilities in the event that you decided or were forced to move. The second question is could you provide us, please, with the date of when you had that conversation with Minister Foss. Do you have it with you, sir?

Walden I don’t have it with me, so I’d need to provide that—

Cosgrove I appreciate that. Thank you.

Walden —in writing to you. In terms of the cost—

Kenrick I mean, maybe if I can pick up the cost side of things. Obviously, we’ve been aware that this is something that’s in play. We have had initial discussions with an architect about what options we might have in our building. At this stage we don’t have any indication about what the costs associated with that would be.

Cosgrove Well, could you, given you’ve had—which is very interesting—you’ve had discussions with an architect, given that Minister Foss doesn’t know anything about this; well, that’s no guarantee that the Government’s not doing something about it. My request still stands. You can ring up your architect and ask what would be the cost of relocation and/or rebuild if you were forced or you chose to move.

Young Right, supp, please, on that too. Kanwal.

Cosgrove David.

Young Supp, Kanwal.

Bakshi Have you got any indication, as Mr Cosgrove has just mentioned, that somebody’s forcing you to move out of that place?

Kenrick No, not at all.

Walden Well, no I don’t think that’s the case at all. But, look, any diligent board, really, when one hears the, you know, tittle-tattle, if you’d like to call it that, in the market, one sees and reads the newspaper article, any diligent board would certainly commission, you know, some work on it.

Bakshi How—

Cosgrove Point of order, please. I just want a ruling from you, Mr Chairman. You, on a side bar, just said to me that we’re not continuing to go down this line of questioning.

Young Not repeating the same question.

Cosgrove No, you didn’t say that, and I just want to put on record we will not be gagged from pursuing this line of questioning.

Young You’re not being gagged.

Cosgrove It is legitimate. Just like I would not like to see your colleague gagged.

Young You’re not going to ask the same question three times.

Cosgrove Just like we wouldn’t gag your colleague, because your colleague’s question is germane as well.
Young

Young Sorry, no, excuse me. Order! I’d like Mr Walden to repeat his answer, thank you, because people didn’t hear it. Thank you.

Walden

Walden Yes, thank you, Chair. No, really, what I’ve said is that, look, I mean, given the rumour in the market, I mean, given the fact that, you know, there was an article published in the Herald—and, clearly, I mean, that was the reason why I raised it with Minister Foss. I mean, it would be, I think, sensible for the board to, in fact, ask the executive for their thoughts on this matter. I mean, should we, for instance, in the future perhaps look to enter into some form of commercial transaction. So, I mean, I would see this as being a diligent information-gathering exercise.

Cosgrove

Cosgrove Sorry, I didn’t hear. Did you say it is an item you’ve discussed with your board or it is something you would? Sorry, I didn’t hear.

Walden

Walden Well, the newspaper article, I mean, was certainly, you know, discussed around the board.

Cosgrove

Cosgrove Oh, thank you.

Walden

Walden Yeah, yeah, I mean—

Curran

Curran So it has been discussed at the board level, based on one newspaper article and a brief conversation with the Minister?

Walden

Walden Well, I mean, discussed in the matter of general business. I mean, a newspaper article appears in the—you know, appears that says: “Hey, look, you’ve got a couple of your pieces of your land involved in some proposal.” I mean, that is something that I think requires a board discussion.

Curran

Curran Have you undertaken—have you engaged an architect to do work on this issue?

Walden

Walden Well, I’m aware of a quantity surveyor, I think—is that right, Kevin?

Cosgrove

Cosgrove A quantity surveyor?

Walden

Walden To look at costs.

Kenrick

Kenrick We’ve had preliminary conversations with an architect about the building that we own and how we use that and what our options for that building might be in the future. We have not gone beyond that. We don’t have—if you wanted costings, you would typically go to a quantity surveyor. We don’t have costings at this point in time. But, you know, consistent with Wayne’s comments, if you believe that this is something that will come to a point of decision making, then you need to prepare yourself and be informed and ready for that.

Curran

Curran That’s right. Absolutely, and we completely agree with that, but it would seem to me that there would need to be, given that this is quite a substantial part of your organisation, there would need to be a risk analysis done of the impact on your organisation, given that I don’t know how many people are employed on that particular site. Have you undertaken any work in that area?
Kenrick: Not yet. I mean, there’s been speculation, there’ve been comments. There is no formal project of work, but there is some fact-gathering that would enable us to form a view, should we need to move to that phase.

Mitchell: I just wanted to come back to the point that you were making, Mr Chair, that if there is speculation in the national media about the future of the premises that you are currently using and doing your business in, wouldn’t it be prudent, actually, for the board to have a discussion around that? And wouldn’t it also be prudent for the CEO and the executive, as part of their annual review, and even looking at costing as to a review of actually where the business is located, and future plans? So wouldn’t that just be normal practice?

Walden: I think, well, I absolutely agree with that. I mean, as I said earlier, it makes sense, you know, if one is a diligent board to actually undertake that, call it, fact-gathering—you know, understanding also that what we have in the existing building is a pretty underutilised sort of building configuration. Those of you that may have visited the site will be well aware of the huge space cavity that runs down through the centre of it. You know, so it’s issues like that that I guess we would want to be looked at, really, in any fact-gathering exercise.

Young: Would you be—just as a supp—in terms of the increasing dominance of video and digital media, looking even at your facilities and thinking there could be some adaptation that’s necessary for that future growth?

Cosgrove: Pokie machines, maybe, in the lobby.

Kenrick: Yeah, I mean, I think the building that we’ve got is 25 years old. You know, we conduct repairs and maintenance on it. It seems timely to look at what are our options in terms of the future of that building, so that we are in a position to engage, should we get approaches from any external party.

Young: Right, so possibly it’s an opportunity for some advancement in terms of utilisation of space.

Cosgrove: How coincidental!

Curran: Can I just ask—can I just reiterate that we would like to know more information about the cost of relocation of the Hobson Street development, and how much has been invested to date, and what risk analysis the board is doing this area. It would seem to us that this is actually a significant issue for Television New Zealand going forward, in the context of your strategic review, and that it’s unthinkable that you aren’t taking all of these issues into account when you’re thinking about the next few years, given the speculation for over a year on this issue.

Young: Quick supp to Sam Lotu-liga.

Cosgrove: Well, hang on, do we have an answer? Did we get an answer?

Cunliffe: That was a request for information.

Kenrick: Yes.
Lotu-Iiga: There’s a yes. OK. And, through you, Mr Chair, just a reassurance that the work that you’re doing is part of commercial, viable work that you would do when such a proposition exists, but that it’s still subject to a huge amount of speculation, and that what you’re doing is part of what a normal commercial operation would do in the circumstances. Would that be fair to say?

Walden: Well, I think that summarises it very well.

Cosgrove: So can I just, sort of, get this straight, because I’m a simple human being—

Lotu-Iiga: We know that.

Cosgrove: Yeah, that’s true. I’m self-deprecating too.

Lotu-Iiga: It’s not about you, mate; it’s about these guys.

Cosgrove: The question is this: given this, the following mosaic, that the Government’s stated intention to push ahead with a Skycity deal in some form, given the need for adjacent space for a convention centre, given that you happen to have a conversation with Minister Foss—and him not knowing, to be blunt, doesn’t mean that the Government’s not pursuing it—you guys decide, so you get a QS in, just about the same time, and have a look at the building because it’s 25 years old. Now, I could say to you there’s a lot of other buildings in Auckland that are a hell of a lot older than TVNZ, which looks in very good shape to me. But this is all sort of coincidence, happenstance, and, you know, forgive the pun, roll the dice. This is just coincidence.

Young: What’s the question?

Cosgrove: Or could I hypothesise that you might be doing your job rather well, in seeing certain risks and factors playing out, and doing some forward planning, which I’d expect you to do?

Kenrick: My understanding is we have said yes to that. So I’m not sure what the question is.

Cosgrove: So you are doing forward planning based on the potential risk of a potential requirement for your premises and your geographical footprint to be utilised in the Skycity deal? You are doing forward planning?

Kenrick: At a preliminary level, and if it becomes more substantive, then we would do more work. You know, at the moment, from a—

Cosgrove: So it’s not just a 25-year-old building and a bit of space in the middle; it’s actually some forward planning—

Lotu-Iiga: They’ve said yes.

Young: So, my supplementary to that, which is going back to my comment before, is that, just with the growing transition of your strategic plan, are there components there where you need to be considering anyway the utilisation of your space and how you’re going to use that? Is that part of the strategic plan going forward?
2011/12 FINANCIAL REVIEW OF TELEVISION NEW ZEALAND LIMITED

Kenrick  Well, probably our most significant property initiative right now is the rebuilding of our demolished property that we had in Christchurch. That has been hugely impactful in terms of the operations of the business. We’ve managed to find a way through that. We are in the process of, you know, preparing to move into a new building within the next few months. From our property initiatives, that would be taking up 90 percent of our focus.

Curran  Are you in discussion with Skycity itself on these matters?

Kenrick  No.

Young  Clare, through the Chair, please.

Lotu-Iiga  Through the chair.

Cunliffe  Through the chair, as a supplementary, in relation to my earlier question, why, if you are doing this forward planning and prudent risk management—and no problem with that—why would some of your team not have checked with officials what they know about future options? Why would there not have been some discussions? Or perhaps there are some that you aren’t explicitly aware of.

Kenrick  I think Wayne answered the question earlier on that, you know, it was appropriate for a conversation between the Chair and Minister, and, until such time as there’s anything more substantive, we didn’t feel that there was a huge amount of value in further conversations.

Cunliffe  So you are repeating that there has been, despite the fact that you are actively engaged in prudent risk management around the footprint, you’re repeating that to your knowledge there has been no conversations between any TVNZ executive and any—

Lotu-Iiga  They’ve answered that question four times. I don’t know how much—

Young  This is what I said before, when—

Lotu-Iiga  Can we move on?

Young  No, I want to make a point, David, because Clayton made an objection, and it’s to do with repeating of questions, all right? That is taking up time, and we want to give everybody a fair shake in this—

Cosgrove  Well, with respect, could you show me the Standing Order that precludes a member from asking—

Young  No, I’m ruling, all right? OK, we’re going now—

Cosgrove  Point of order. Could you show me the Standing Order that precludes a member of Parliament from asking various shades of the same question if they are not satisfied that they have received—and I’m not saying this of the people at the end of the table—an appropriate answer or they want to clarify that answer. Point me to the Standing Order. There is none.

Young  Well, no—

Cosgrove  And you cannot gag members of Parliament.

Young  I’m not gagging a member of Parliament, at all, all right?
<table>
<thead>
<tr>
<th>Name</th>
<th>Statement</th>
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<tbody>
<tr>
<td>Cunliffe</td>
<td>Speaking to the point of order, Mr Chairman. New information had arisen in the course of the conversation that made the follow-up prudent.</td>
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<td>Cosgrove</td>
<td>It’s sensitive for you fellows, but, you know.</td>
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<td>Mitchell</td>
<td>Speaking to the point of order, I think that the Chair and the CEO now have been asked at least four times, and they’ve clearly stated that because of speculation through the media they took preliminary steps to see what the impact may be on them.</td>
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<td>Cosgrove</td>
<td>What’s the point of order?</td>
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<td>Mitchell</td>
<td>That’s all it was. I was speaking to your point of order. I was speaking to your point of order.</td>
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<td>Young</td>
<td>Right, a new question from Kanwaljit.</td>
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<td>Bakshi</td>
<td>Changing, a little bit, the topic, I would like to know what is your commitment towards Māori and Pacific Island programmes? And, plus, with the changing of the demographics of New Zealand, are there any plans to put Asian programmes on TVNZ?</td>
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<td>Kenrick</td>
<td>Firstly, if I focus on your question about Māori and Pacific Island programming, we have recently made a new appointment to the general manager of that division, being Shane Taurima. Shane is a hugely experienced producer, presenter, and has worked within TVNZ for some 12 years. He has a very good personal understanding and insight of the needs of the Māori and Pacific Island community, and we’re looking to build on where we’ve had some specific Māori programming to look for opportunities to leverage some of that content into some of our more mainstream offerings. So the value of reflecting Māori perspectives in our mainstream news, as opposed to purely in our Māori programming, would be a good example of the sorts of things we’re looking to explore. In terms of other content, we constantly monitor ratings performance against a broad cross-section of audiences, and, you know, as society changes and the make-up of society changes, then we need to be cognisant of what people consider to be compelling content and to remain in step with that.</td>
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<td>Lotu-Iiga</td>
<td>Thank you. I suppose we’ve asked this over a number of years, in terms of Tagata Pasifika, Marae, Te Karere, but you’ve got a commitment to ongoing programming of that type of content. Would that be fair to say?</td>
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<td>Kenrick</td>
<td>Sure. I mean, on two levels. We have a legislative requirement to reflect Māori perspectives, but arguably of greater importance is that we want to provide the most compelling content for New Zealanders, and I think that the Māori and Pasifika impact on New Zealand society is one of the very special things that makes New Zealand different from the rest of the world. And so content that reflects that is a key part of what our ongoing strategy would be.</td>
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<td>Curran</td>
<td>I have got a number of questions. First of all, with regards to Igloo, which launched in December—around 5 or 6 months after it was planned to be</td>
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launched—can you tell me how many customers there are currently on Igloo, and how many have been targeted for the first 12 months.

Kenrick We are a minority shareholder in a joint venture with—

Curran 49 percent.

Kenrick —Sky TV, and Sky has disclosure obligations as a public listed entity, and so we tend to follow their lead in terms of disclosing what would be seen as commercially sensitive information. My understanding is that they are releasing information about their business performance to the Stock Exchange in the next few days. My approach would be to follow their lead in that as opposed to pre-empting that.

Curran All right. Are you confident that Igloo is meeting its targeted programme with regards to, you know, up to date, and are you confident that Igloo is on track?

Kenrick Well, less than 100 days post launch, I would say that launching it, standing it up, and getting it to operate would be milestone No. 1, and we expect to grow the market penetration of Igloo over multiple years, so, yes, it is on track.

Curran Are you feeling confident about it? Are you feeling confident about Igloo and its direction?

Kenrick Yes.

Curran OK. Thank you. Can you tell me, as part of the Sky-TVNZ joint venture agreement, is TVNZ itself prevented from developing linear scheduled pay services? And are there any other restrictions on the type of pay services that you can enter into on your own or with joint partner ventures other than Sky?

Kenrick Rodney Parker, our CFO, would have a lot more expertise in that, and maybe if I could invite Rodney to answer that question.

Curran Well, the question is—

Young Could you repeat the question, Clare.

Curran I am happy to hear his answer, but it’s a pretty critical question: are you constrained by your relationship with Sky through Igloo from entering into other pay services and other joint venture arrangements?

Kenrick Not to my knowledge. It is a non-exclusive agreement, but if you wanted to talk about the specifics of that agreement—

Curran So that’s a no.

Kenrick —then Rodney would have more detail than I can provide.

Young Look, if you want to bring Rodney up to the table, that’s more than acceptable.

Parker The only exclusion is that we—TVNZ—may not launch linear pay DTT services with any other party, because that would be in direct competition.

Curran That’s quite a significant—
Parker No, it’s very minor. So that’s the only restriction. There are no other restrictions on TVNZ entering into any other pay services whether on its own or with any other party.

Curran OK. Can I ask with regards to current affairs, there’s been a lot of comment about TVNZ’s new venture Seven Sharp in the current affairs space, which is a critical time period for you. Can you give me a definition of what you consider to be current affairs?

Kenrick There has been a lot of commentary about Seven Sharp, which has typically come from less than 12 commentators, and they tend to reinforce a more traditional perspective of what current affairs has been, as opposed to a reflection of what it might be. So we think current affairs is, quite simply, affairs that are current, and it is about things that are newsworthy, that are conversations of the day that are taking place in society.

Curran Can I ask the Chair, do you consider and is it the case that the CEO is also the editor-in-chief of TVNZ?

Walden Well, the chief executive is the editor-in-chief of TVNZ.

Curran And, if so, is the editor-in-chief ultimately responsible for content on TVNZ?

Walden I would imagine so, absolutely.

Curran OK. Thank you. I suppose what my question goes to is that in the last month—bit over a month—we’ve seen the resignation of the head of news and current affairs on the eve of Seven Sharp’s launch, which is your premier current affairs show, and we’ve also seen the resignation of the Igloo chief executive just weeks after the launch of Igloo, which would seem to me to be—and not just to me but to other people—the flagship for a new direction for TVNZ. Doesn’t this send a disturbing set of signals about TVNZ’s direction, both in terms of new developments and also in terms of content? And I suppose it doesn’t look good, so I’d be interested to know what you’ve got to say about that, given the importance that you’ve placed on the strategic review and the direction that TVNZ is heading in.

Walden Well, I’m going to get Kevin to talk in a little more, perhaps, detail on that, but, look, certainly in the discussions I’ve had with Kevin, there are many reasons for a number of those resignations. People come, people go, people seek career opportunities, and then there are personal circumstances involved and so on. But, Kevin, you might just want to elaborate.

Curran Well, I suppose, with respect, Mr Chair, I’m asking you as the Chair of the board of TVNZ, given the direction that TVNZ has taken in the last couple of years. There’s been a lot of controversy around TVNZ moving away from its public sector broadcasting responsibilities into a true commercial environment. Now here we are, before the select committee, you’ve got the head of news and current affairs resigning weeks before the new flagship current affairs programme, surrounded by advertising, has been announced, and the resignation—

Walden And good reasons for that—personal reasons.
Curran  Well, I’m not contesting that; I’m saying that observing TVNZ right now, you’d be thinking “What the hell?”.

Walden  And that may be the case, but, you know, it is a large organisation. You know, we employ 900-odd people. We are going to have people come in and out of the organisation on a regular basis. That certainly would be concerning, but, I mean, it will happen for various reasons.

Curran  Well, then my question is what are you going to do about it, given that these are two critically important parts of your organisation in terms of its new direction and new look?

Walden  We will replace them with equal, if not better, people.

Young  Just a supplementary to this line of questions that Clare’s raising—

Cosgrove  Sorry, had you finished your answer, sir?

Walden  Yes.

Young  —just regarding the commercialisation aspect of it. In terms of programmes that are funded by New Zealand On Air, in terms of the delivery of those through TVNZ, because the concern that she’s mentioned, of course, is that we’re probably not getting the same level of the public broadcasting.

Kenrick  The model that we have is New Zealand On Air effectively provides funding for public service programming, and so we’re less reliant on a public service broadcaster versus having funding available on a contestable basis to multiple market participants around what would, I guess, loosely be described as public service content. We support that model. We think a contestable environment is the best one. Obviously, we don’t like it when our submissions get turned down, but we think it’s the right model and we think that it’s working well.

Curran  Turning to the FreeView platform versus the subscriber platform, research published today in the *Guardian*—UK—showed that 75 percent of viewing time on pay TV is spent watching services that are, in fact, available at no cost to the viewer, and I’ve got the article here. As part of TVNZ’s continuing analysis of your commercial performance, do you know how much time viewers on your competitor for eyeballs, which is Sky, spend watching programmes that are available on FreeView?

Kenrick  I don’t have the exact number to hand, but I do appreciate that the same behaviour patterns that you talk about from the UK are evidenced in New Zealand, and that the free-to-air channels do take up a large percentage of the viewership of people who have Sky.

Curran  Right, and I accept that you wouldn’t have that figure off the top of your head, but I would ask— I mean, it is possible to work out, I think, from the Sky annual report, that figure, and it has been told to me that that figure could be around 65 percent. And I wonder if you would be able to come back to the select committee with a figure. But I suppose my question goes to the post digital switch-over period. Do you think that it’s necessary for TVNZ’s commercial performance to continue to advertise FreeView’s existence as an alternative to paying for Sky?
Well, I think the decision about the level of advertising or marketing for FreeView would be taken by the FreeView board and management, of which we are, obviously, a participant. I think there is a period of time in the lead-up to the digital switch-on where people would be making the choice in terms of which platform they use, and what we’re seeing at this stage is of those who haven’t already elected to go to Sky that the vast majority of them are choosing FreeView. And we would expect that to play out through the balance of this year when the digital switch-on will actually occur.

So getting a little bit more specific here, will you continue to support FreeView’s marketing effort to the public as a platform for all free-to-air television, which obviously includes Māori Television, MediaWorks, and other broadcasters? Because that would seem to be quite an important question post digital switch-over and your commitment to FreeView as a partner in that.

I mean, as a significant participant in FreeView, it’s in our best interests to see it succeed. We believe that the marketing would be more front-end loaded prior to the digital switch-on, because that’s when most people are making the purchase decision. Beyond that we would work with the other FreeView participants to determine what’s an appropriate level of marketing thereafter, and ensuring that it provides an acceptable return on investment.

It’s a supp to an earlier question that Clare made. It was about Seven Sharp and just the fact that it’s pretty obvious that you sort of would like to go down the road of changing the way current affairs is delivered to Kiwis, which I think is a very good idea, personally. But I was just wondering if you can maybe share your vision for that and sort of what direction you’re heading.

Yeah, I think one of the things that we’ve observed is there was a period of time where most people got most of their news on TV at 6 o’clock, and now there are so many more opportunities and places where you can access the news, and as a result of them I think that consumers are looking for short, sharp sound bites. They’re looking for a punchy delivery. And what we found was an hour of news at 6 p.m., followed by a further half an hour of, essentially, a very similar format, was not holding the audience’s attention, and therefore it was timely for us to say “Is there another way to make that more compelling?” So given that our moves are entirely driven around consumer behaviour, we think that it’s absolutely in the right territory. We are completely committed to it for the long haul. There’s been plenty of speculation from so-called experts about whether it’s right, wrong, or otherwise. You’re only as good as your last performance. Last night we had double the ratings of Campbell Live, but I don’t expect to read that in the Herald any time soon.

If I could interpret what you’re saying, it sounds like you’re saying that because of the commercial focus that TVNZ has, the focus is really going to be on increasing revenue from advertising. And if that means there’s a dumpling down of news content, then that’s the sacrifice that you’re making.
Kenrick: I don’t see the trade-off in the same way that you’ve articulated it.

Genter: Sharp sound bites.

Kenrick: I think if we provide the content the viewers want to see, we will have an audience that would be attractive and appealing to advertisers. If we don’t provide the content the viewers want, we won’t have that reach and therefore we won’t have that opportunity to engage with advertisers. So I do think it starts with the viewer first, and then that creates the subsequent opportunity with advertisers.

Genter: So there’s no conflict between delivering robust, high-quality news information and delivering what consumers want? You think those two things are— You don’t think that there’s a tension between those two? You think that you should be delivering consumers—measured in terms of advertising revenue—the information that they want at news hour, as opposed to the actual news.

Kenrick: I don’t think the viewer is concerned about the advertising; I think the viewer is focused on whether the content is compelling, whether it’s interesting, whether it’s informing, whether it’s entertaining. And if we do that job brilliantly well, we will create the opportunity where we’ve got an audience that would be appealing to advertisers. So I don’t see this as being a trade-off between the two.

Lotu-Iiga: Her question—I didn’t hear that in your answer, about “the advertising versus”. But the question I do have for you, and what you actually said was that you found this. I just want to know—you’ve got this evidence of this moves to quick sound bites, rather than the sort of more expanded format that the seven o’clock show used to have. So it’s based on some evidence, some research, some study, overseas experience—is that—?

Cosgrove: Sam would like a shot at the show.

Kenrick: Sure, and, Sam, it is observable shifts in consumer behaviour, and judgment applied to that. At the same time, we know that there is a significant audience for your more traditional, in-depth, hard-hitting current affairs, and we lead the market with that with Sunday. We also have Q+A, we have 20/20, we have Fair Go, and this is actually part of the portfolio of programmes that meets the broad needs of New Zealanders.

Lotu-Iiga: OK. You’re satisfied that you’ve got that met, but you want to go short and sharp?

Curran: It’s entertainment; it’s not news.

Lotu-Iiga: Excuse me. No, I’m asking him, not you. So you’re happy with the short and sharp focus of seven o’clock programming?

Young: It’s like the Commerce Committee: short and sharp.

Kenrick: Yeah, absolutely.

Cosgrove: Good audition, Sam.
2011/12 FINANCIAL REVIEW OF TELEVISION NEW ZEALAND LIMITED

Curran Returning to my question around free to air, if Sky subscribers spend, say, 65 percent of their time watching what they could watch for nothing on FreeView, how does TVNZ extract commercial value by providing its free-to-air services to Sky at no cost? Isn’t that more of a benefit to Sky than to TVNZ?

Kenrick TVNZ’s point of difference in the market place, as it relates to advertisers, is that we have unparalleled reach. Part of that reach is distribution via FreeView, part of that is via the Sky platform, part of that will be via Igloo, part of that will be via Ondemand. And from our perspective we want to expand and maximise the opportunities to view of our content, which then gives us a proposition that we can sell to advertisers.

Curran That’s right. So if that benefit is shared, and since TVNZ has got commercial profit obligations back to the Crown, how does it share that benefit with Sky?

Kenrick If, for example, TV2 is made available through the Sky platform, it still carries our advertising.

Curran On the Sky platform?

Kenrick Yes. So we don’t recut the content and remove all the ads to place it on the Sky platform.

Curran So can you tell me, just finally, in the letter of expectation from the Minister to TVNZ recently, was there a figure of expectation of percentage return of dividend back to the Crown?

Kenrick I don’t recall the exact content of the letter, but, I mean, broadly, there is an expectation of a return of 9 percent.

Curran Is that return of 9 percent that was in the letter of expectation last year, that has been continued over for this year?

Kenrick I believe so.

Walden Nine percent or more, I think were the words.

Curran Pardon?

Walden Nine percent or more, I think.

Curran Nine percent or more?

Walden Yeah, just from memory of the letter. Yes.

Curran OK. Could you provide that information?

Walden Sure.

Curran Could you provide that letter of expectation to the committee, please.

Kenrick And for what it’s worth in commercial terms, that doesn’t appear to be an onerous expectation of rate of return for a shareholder.

Yang My question is quite short, or straightforward. Now, first I’ll come straight on securing 92 percent of advertising growth in the past financial year. Can
you please let us know the component of the growth, particularly how much online advertising, because this is related to your future strategy.

Kenrick The share of growth you refer to relates to the previous financial year. What I’d like to do is invite Rodney to speak on that, because I wasn’t a participant at that time, and he would actually understand that in more detail.

Parker Sorry, could you repeat the question?

Yang Yeah. Basically, you have secured 92 percent of advertising growth. I was curious about the components of growth. In which area—particularly the online area, for example, or TV, or other areas?

Parker So the growth that was referred to in the annual report last year that was all a share of television advertising growth, so that was information that we share amongst the industry, and so we can assess what our percentage share of the growth of the industry is, which was captured by TVNZ. In terms of our digital revenue growth, the digital revenue growth is off a very low base, but it’s increasing in double-digit percentage increases on a year-on-year basis. But, again, as I state, it’s off a very low base.

Yang So the 92 percent of growth, advertising growth, is mainly TV, just TV, not online, anything like that that’s different?

Barker Correct.

Yang OK. The second question is about content leading. You are aiming at being a content leader. Now, a challenge, of course, is the increasing cost of overseas content. Do you have any particular plans? I’m sure you have a planned strategy dealing with the challenge.

Kenrick Yeah. I mean, we have recently, in this financial year, renegotiated and extended a content supply agreement with Disney, and the rate of growth and cost of that has been demonstrably better than the rate of cost increase some of the other contracts we’ve renegotiated. But I think the critical thing for us is how do we organise things to free up as much as we can to invest in content? So the leaner and more efficient we can be in terms of the back office, the overheads, the infrastructure of the business, the more resource that we can free up to invest in content. And that’s an ongoing focus for us.

Yang Is the increase quite substantial, or do you feel it’s still gradual?

Kenrick There has been a step increase, particularly in this financial year, and, you know, for us, we are balancing that out in terms of growing our share of the advertising pie, delivering growth out of our digital business, and tightly managing our overhead costs.

Yang Thanks.

Young Thanks very much. We’ve finished our time with you. Thank you very much for appearing today, and all the very best.

Cosgrove Sorry, an administrative issue. Is the clerk clear on what we’ve asked—to provide these guys with a list of what we’ve asked?
Young: Yep. And you'll get correspondence from the clerk in terms of those questions. Thank you, Mr Walden. Thank you, Mr Kenrick. All the best for the future. Thanks to your team. Cheers.

**Conclusion of evidence**
## Contents

<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation</td>
<td>2</td>
</tr>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Student Achievement Component funding</td>
<td>2</td>
</tr>
<tr>
<td>Alternative education pathways</td>
<td>2</td>
</tr>
<tr>
<td>Adult literacy</td>
<td>3</td>
</tr>
<tr>
<td>Promoting new career pathways</td>
<td>3</td>
</tr>
<tr>
<td>Canterbury University</td>
<td>3</td>
</tr>
<tr>
<td>Performance-Based Research Fund</td>
<td>4</td>
</tr>
<tr>
<td>Completion rates in tertiary sector</td>
<td>4</td>
</tr>
<tr>
<td>Appendix</td>
<td>5</td>
</tr>
</tbody>
</table>
**Tertiary Education Commission**

**Recommendation**

The Education and Science Committee has conducted the financial review of the 2011/12 performance and current operations of the Tertiary Education Commission and recommends that the House take note of its report.

**Introduction**

The Tertiary Education Commission was established on 1 January 2003 under section 159C of the Education Act 1989 as a Crown entity, with the principal role of giving effect to the Government’s Tertiary Education Strategy. It does this by allocating funds to tertiary education organisations, monitoring their performance, and providing advice to the Government on the tertiary education sector. The commission's total revenue for 2011/12 was $3.161 billion, and it recorded a surplus of $37.279 million.

**Student Achievement Component funding**

We are aware that the Government pays Student Achievement Component (SAC) funding to tertiary education providers as a contribution to the direct cost of teaching, learning, and other costs driven by the number of students enrolled. The SAC funding is intended to help learners achieve foundation learning, which is deemed to be NCEA Level 1 or 2. We were told that the apparent decrease in the amount of SAC funding for institutions in some regions in the year under review was due to the allocation of $38 million of the funding being put into a contestable pool, and changes in the way the funding is targeted at learners without Level 1 and 2 qualifications. We heard how the move to a contestable funding pool may have contributed to an increase in places being funded in private training establishments.

We heard for example that in 2012, 25 percent of Level 1 and 2 learners in institutes of technology and polytechnics receiving SAC funding already had a Level 2 or higher qualification, and that SAC funding would be reallocated in such circumstances. We heard that five regions have received an increase in foundation places, while seven regions have received a decrease. Across the country, places have increased by around 120 places. We also heard all regions may access additional funding in other areas, such as Youth Guarantee, engineering funding, and priority trades funding. The commission told us that it will continue to work with the providers in the affected regions to help improve the standards of teaching in the regions, so that they can then qualify for increased funding.

**Alternative education pathways**

**Youth Guarantee**

The commission fell short of its target participation rate on Youth Guarantee. It explained that not all providers are delivering the places that they are funded for, where they don’t, the commission will attempt to recover the funding received in the previous year, for reallocation. The commission explained that the Youth Guarantee scheme is still being bedded in, and we heard that it is increasing the number of places available five-fold by
2014, to 10,000 places. The commission also noted a shift in preference towards trades places and a focus on delivering the types of learning that students are requesting.

**Adult and Community Education**

We also wanted to learn more about the Adult and Community Education (ACE) sector, which provides community-based education, foundation skills, and pathways to other learning opportunities. The commission recently conducted a review of the sector, which found that ACE was meeting the targets for which it was designed; it is being delivered to the right learners, particularly second-chance learners, and is targeted at foundation learning. We heard that only 21 schools in the country are funded to deliver ACE, but this represents a very small portion of delivery. ACE is also available through institutes of technology and polytechnics, wānanga, private training establishments, rural education activities programmes, and community organisations.

**Adult literacy**

We are aware that the commission administers a workplace literacy fund to improve adult literacy, but that it fell significantly short of its achievement targets for completion of the programme in the year under review. We asked what the commission was proposing to do to improve its results in this area. The commission explained that workplace literacy skills are delivered in three separate streams: one is an employee fund administered by English Language Partners and by Literacy Aotearoa, in response to individual applications. We heard that this stream, to which about $3 million is allocated, is working “extremely well.” Another stream is employer-led; companies teach adult literacy at work on contract to the commission. The commission said this stream is working “reasonably well”, and it is working with the contracted companies to increase their effectiveness. The third stream funds tertiary education organisations to work with employees. We heard that the performance of providers in this stream is “mixed”. The commission will reallocate the funding to the better-performing providers. We sought information on the involvement of unions in adult literacy programmes. We heard that a small amount of funding previously allocated for literacy initiatives that involved unions has recently ceased. We are aware of the importance of literacy for workplace productivity, and hope that these efforts will prove effective.

**Promoting new career pathways**

We asked what the commission had done to promote subjects, such as engineering, that are important to the economy and under-represented in student achievement. We heard that during the year under review, the Government committed an additional $8.7 million to engineering study, which funded 706 new places at tertiary providers. The tertiary system responded well to this increased funding; the commission said that universities and polytechnics expect that the additional spaces will be oversubscribed this year. The commission suggested that science is another potential candidate for additional funding, and we agree that this deserves consideration.

**Canterbury University**

In the aftermath of the Christchurch earthquakes, the University of Canterbury was required to make a business case for the redevelopment of its science and engineering facilities to the Minister for Tertiary Education, detailing its role in the rebuilt Christchurch. We heard that the commission is heavily involved in the development of this business case, hiring additional staff specifically to work on it. The commission told us it is confident that
the complex business case will be finished on time and of sufficient quality, and be submitted to Cabinet for consideration by October 2013. We look forward to seeing the outcome of this work.

**Performance-Based Research Fund**

We are aware that the commission administers the Performance-Based Research Fund, which is designed to encourage and reward excellent research in the tertiary education sector. There are three criteria by which tertiary institutions are evaluated and the allocation of the fund decided: research potential, which has a weighting of 60 percent; externally sourced income for research, weighted at 15 percent; and the number of eligible postgraduate research-based degrees awarded.

We were interested in whether the commission is evaluating the quality of the fund, and if it was, how it is measured. The commission has reviewed the latest round of funding in an effort to better refine allocations in the next round. We were told the success of the fund is not measured simply on the number of research reports published, but on whether the published research had an identifiable outcome.

We heard that any under-spending at the end of the year is reallocated toward priority projects, such as providing additional engineering places, and that the commission prefers to be in a position to reallocate funding at the end of the year, rather than end the year in deficit.

**Completion rates in tertiary sector**

The commission noted huge improvements in the tertiary education sector since 2009. The qualification completion rate has increased from 62 percent in 2009 to 71 percent in 2011, and course completion rates have increased from 77 percent to 82 percent over the same period. We noted the use of course completion rates as part of the funding mechanism. The commission also highlighted a major reorganisation of the industry training organisation sector, where credit achievement rates subsequently increased from 50 percent to 71 percent, and programme completion rates from 41 percent to 69 percent. We welcome these improvements, and hope they will continue.
Appendix

Approach to this financial review

We met on 17 April and 8 May 2013 to consider the financial review of the Tertiary Education Commission. We heard evidence from the Tertiary Education Commission and received advice from the Office of the Auditor-General.

Committee members

Dr Cam Calder (Chairperson)
Carol Beaumont
Catherine Delahunty
Hon Jo Goodhew
Chris Hipkins
Colin King
Tim Macindoe
Tracey Martin
Simon O’Connor
Dr Megan Woods

Evidence and advice received


Organisation briefing paper, prepared by committee staff, dated 16 April 2013.

Tertiary Education Commission, response to written questions 1 to 115.

Tertiary Education Commission, response to written questions 116 to 124.
2011/12 financial review of
Transpower New Zealand Limited

Report of the Commerce Committee

Contents
Recommendation 2
Introduction 2
North Island grid upgrade 2
Tiwai Point aluminium smelter 2
New technology 3
Dividends and debt 3
Relationships with stakeholders 3
Appendix A 5
Appendix B 6
Transpower New Zealand Limited

Recommendation

The Commerce Committee has conducted the financial review of the 2011/12 performance and current operations of Transpower New Zealand Limited and recommends that the House take note of its report.

Introduction

Transpower New Zealand Limited is a state enterprise which builds, maintains, and operates New Zealand’s high-voltage electricity transmission network—the national grid. Its chief executive is Patrick Strange, and Mark Verbiest is chairperson of the board.

Transpower is primarily responsible for transporting bulk electricity from generation sites to population centres and some industrial users, and connecting with lines companies which deliver retail power.

In 2011/12 Transpower generated total revenue of $794.2 million, an increase from $737.2 million in 2010/11. Its after-tax profit of $84.8 million exceeded the previous year’s $78.5 million.

North Island grid upgrade

Transpower has exceeded the projected costs for the North Island grid upgrade, and we asked it to explain this. The Commerce Commission approve a maximum cost for such projects. Some land had to be bought to secure access for this urgent project. Transpower has not yet made the necessary application to the Commerce Commission for an increase. We heard that, although it might seem unusual to spend in anticipation of approval, the urgency of the project, and the nearness of completion meant that the responsible thing to do was finish it. Shareholders were kept fully informed of progress and issues that arose.

Transpower expect the revised cost of the upgrade project to be agreed towards the end of 2013, and clarified that the revised maximum will be the amount that they can recover from customers. If Transpower spends less, so does the customer. Over all, it said that the money spent on projects evens out, with some over and some under their approved budgets.

Tiwai Point aluminium smelter

We asked how much had been spent contingency planning for the closing of the Tiwai Point aluminium smelter. Transpower said that it had always planned for its closure, and, equally, its remaining open or even expanding, so this was not a question that could be answered. The reality of transmission planning is that it is scarcely ever accurate, so it is sensible to consider all eventualities. Transpower has the resource to close the smelter, and has approval from the Commerce Commission, contingent on resource planning.

Some of us remain concerned at the ongoing and protracted contract negotiations between Tiwai Point and Meridian and view this as an ongoing risk.
New technology

We heard that technology in the electricity transmission industry is changing relatively quickly. The industry has to be conservative in adopting new technology, as the consequences of any failure are far-reaching.

We learned that Transpower installed New Zealand’s first transmission-connected static synchronous compensator at the top of the South Island about two years ago and consider it to be successful. This voltage support device protects the quality of power when it travels long distances.

Transpower is also considering spending time and money on demand management, with the support of the Commerce Commission. It is trialling a system to control demand when it rises to the point of reducing the capacity of the lines—for example, on hot Auckland afternoons. Such increases can be predicted by 10 am, and until recently the only solution was to increase local generation. Transpower is developing a software platform for asking customers to reduce their load temporarily for a financial reward.

Transpower’s alternatives are to invest more in transmission, which is expensive, or to run a thermal plant in Auckland for three or four hours (plus a warm-up time) to cover each spike in demand. Transpower does not have to do so for more than a few hours each year.

High voltage direct current inter-island pole 3 project

We heard that Transpower’s high voltage direct current inter-island pole 3 project has suffered some delays with engineering coordination problems encountered by the supplier, Siemens’ in Germany. The delays occurred early in the project, which is now running a year behind its original timetable. The project has stayed on track since the problems occurred, and Siemens has been very cooperative even though remedying them will be expensive.

Transpower considers that the quality and longevity of the completed equipment will not be compromised, and considers this more important than meeting the original deadline.

Dividends and debt

We asked Transpower about its board’s view on paying dividends while its capital programme is funded by debt, and what it foresees for the next few years. We heard that 2012 was the first time that dividends were paid in five years.

Transpower said it operates on a commercial basis, and since the Crown has capital invested it should get a return. It believes it has a conservative balance sheet that can absorb debt, which is how it has been funding its upgrades.

We asked why it was taking on debt, and whether it had considered domestic rather than overseas debt markets. Transpower said that it looks for the best rate for the most suitable term, and is now in the market for a domestic bond issue because it meets these criteria. It uses diverse funding sources to provide stability. All overseas funds are converted to New Zealand dollars, so there is no exchange rate risk. Labour members remain mystified as to why Transpower is taking on debt; they believe we did not get an answer to our question.

Relationships with stakeholders

We wanted to know if Transpower allocated a fixed amount of money each year for community projects, noting that in the last financial year it gave $930,000 nationwide.
Transpower said it thinks that it is important to give back, given the widespread effect and large impact its activities can have on communities and landowners. The company’s CommunityCare programme has a degree of independence; communities can apply for project funding to its panel of assessors. Its typical expenditure is slightly more than $1 million a year.
Appendix A

Approach to this financial review

We met on 7 and 20 March 2013 to consider the financial review of Transpower. We heard evidence from Transpower and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Peseta Sam Lotu-Iiga
Mojo Mathers
Mark Mitchell
Dr Jian Yang

Gareth Hughes replaced Mojo Mathers for this item of business.

Evidence and advice received

Transpower New Zealand Limited, Responses to written questions, received 28 January and 18 March 2013

— Presentation to the Commerce Committee

Office of the Auditor-General, Briefing on Transpower New Zealand Limited

Organisation briefing paper, prepared by committee staff.
Corrected transcript of hearing of evidence 7 March 2013

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Dr David Clark
Hon Clayton Cosgrove
Clare Curran
Gareth Hughes
Peseta Sam Lotu-Iiga
Mark Mitchell
Dr Jian Yang

Witnesses
Patrick Strange, Board Chair
Mark Verbiest, Chairman

Young Welcome, Mr Verbiest. Would you like to introduce your—of course, we know Mr Strange—your team?

Verbiest Yes, I’m accompanied today by our CEO, Dr Patrick Strange, our CFO—chief financial officer—Howard Cattermole.

Young Thank you very much. Now, if you could just do an initial presentation. We’d like it if you would keep that within, say, 5 to 7 minutes. That would be appreciated. Then we’ll have, obviously, some questions to ask you gentlemen. Thank you.

Verbiest Yes, that’s fine. Thank you. Members of the committee, I’d just draw your attention to the first slide: our full-year financial results to the end of June last year. You will see there an increase in the revenue, which is largely being driven by an increase in our asset base as new investments, particularly our major upgrade projects, have come to be commissioned, in particular the North Island upgrade late last year and the first part of the HVDC link, which is due for completion April-May this year.

You’ll see there a significant amount of dividends at the bottom. We’ve signalled in our report and to the committee before that that level of dividend includes a special dividend that we paid after a capital funding review was done, looking at our gearing in the company, and we were able to start returning some further funds to the Crown.

I wasn’t proposing to say anything more about that slide, because just last week we announced our interim results for the 6 months ended 31 December 2012. Again, reasonably straightforward in the sense that our
total revenue again has gone up. Again this reflects the investment that’s going into the grid, off the back of which we get, of course, a regulated return, as set by the Commerce Commission.

Our operating revenue tends to look flat to slightly higher. In fact, the underlying operating expenditure has slightly decreased. What is included in that amount is nearly $4 million in what’s known as instantaneous reserve, which is payments that we used to have to make through the market, and we had no control over that. That has been recognised by the regulator, and in time, going forward, we will be able to on-charge those costs to customers. The slightly lower dividend comparative to the previous year reflects the nature of the special dividends that have been paid to the Crown in relation to the review.

In the interests of time, I just note that we’ve got a couple of slides on performance as against our key KPIs under the SOI—our statement of intent—and we’re meeting all of those is the nub of that.

Project status—I mentioned earlier on that we commissioned the North Island upgrade in October of last year. The HVDC link looks to be on track for commissioning in April-May this year, and the North Auckland to Northland upgrade, again mid to Q3 this calendar year, is what we’re looking at. Once these particular projects are complete, we will continue to have a number of projects under way but not of this magnitude. So you will see on the next slide quite a drop-off in our capital expenditure as projected.

We’d just caution that the reference to the 2013-14 draft plan—the board hasn’t actually seen that yet. So this is the first time I’ve seen it, but, interestingly, as a result of our forecasting I think we’re getting a much firmer idea that CAPEX is falling to a more regular number, at between $350 and $300 million per annum, which will include in future both some upgrade work but also essential work that’s done on maintaining the existing grid. So effectively that is saying we’re seeing the end of the catch-up mode that we’ve been in for a while.

We have been investing somewhat in new technologies, and certainly questions around this I’m sure Patrick would be very happy to take. We have been looking at initiatives to actually avoid the need to invest in further grid upgrades as long as possible, without being cavalier about it. Certainly, those who are mentioned on the page have—early signs are that they have the potential to actually improve capacity of the system significantly. In that sense, the work that technology suppliers have been doing in the last few years in this space has been very valuable. So we are looking to spend money to take advantage of that for future benefit.

The next slide is one that we’ve shown the committee before. It’s our attempt at translating what is happening to the transmission charge contribution to an average residential customer. The obvious caution there is that depending on where people live and the individual circumstances of their own supplier, increases can be either north or south of this at any given time. So this is an average across the board.
Look, in the interests of time I think I’m happy to stop there and we’ll take questions.

Young Sure, all right. Thanks very much indeed for your presentation.

Clark Thank you for the presentation. I’ve got a couple of questions around the North Island grid upgrade. I understand that you’ve exceeded the allowed cost for the upgrade and wondering if you could tell us a little more about how the process for that plays out—conversations with shareholding Ministers. If you could just flesh that out a wee bit to start off then I’m keen to engage in a discussion on that.

Verbiest Sure. I’ll get Patrick to fill in some more detail, but basically we get a maximum approved cost for a project like this that is approved by the Commerce Commission. In this particular case, this project was urgent and so it proceeded. A lot of the planning was done in the absence of being able to get access to the land, and in many cases, in fact, as you will have seen from prior years’ accounts, we actually had to purchase land in order to get this line up and running.

The process is that we have to go back and apply to the Commerce Commission for an increase in that maximum approved amount. We haven’t done that yet, because we’ve got some matters to finalise with the contractors before we do, such that we’re clear on what the absolute end figure looks like.

Clark Isn’t that a little bit unusual to spend before you ask permission—in excess?

Verbiest No, we—well, when you’re in the middle of a project and you’re well under way, I mean, the most important thing is to actually finish it. The upgrade was required for the resilience and redundancy to keep the system reliable and secure. So the most responsible thing for us to do is to actually proceed and finish it. We’ve kept the shareholder fully informed, such that they’ve been aware that we’ve been facing this issue.

Clark When do you expect to agree the new maximum amount with “Com Com”?

Strange It will be later this year, just to amplify—the regime was actually approved by the Electricity Commission, that one. They give us a maximum number and we recover. Though if they give us, say, $90 million and we spend $63 million then the customer’s charged $63 million. We’re just not allowed to recover more than $90 million until they come back and say: “Yes, it was prudent expenditure.” The regime we’ve been through, and we’ve just got a draft decision on Ōtāhuhu, I think, where we spent $106 million against an approval of about $99 million, and the Commerce Commission’s draft approval is to approve it all.

The reality is that when you—back in 2006 they were trying to work out what a project of this size and complexity costs. Some will be over and some will be under. Of the three big projects, NAaN has an approval, if I take the substations out just separate, of about $415 million, and we are projecting to spend about $35 million to $330 million. The DC has got an approval of $673 million and the current projections are for a little over
$600 million. So there are swings and roundabouts. It’s a pretty typical regulatory regime around the world.

Lotu-Iiga Just a quick supp. So, I mean, you’re saying that this is consistent with what goes on around the world. What if you don’t get approval? I mean, I’m just saying, what are the sanctions that may be available? I understand how costs change over time, you know, with forecasts and the actual costs of projects.

Strange If we don’t get approval, then effectively the roundabout way is a charge to the shareholder. The profit goes down.

Lotu-Iiga OK. But you’ve got pre-approval—

Strange So we’ve got a lot of incentive to make sure we go under that number. At the moment we don’t give any increased return; if we only spend $600 million, it means all the benefits go to the customer. For RCP2, the new regulatory setting, I think (inaudible), there will be actually an incentive on that. So we keep a little if we underspend; we bear the pain if we overspend.

Lotu-Iiga Got it.

Hughes Thanks very much. Thanks for the presentation. I guess my question is how much has been spent planning, or contingency planning, for if the smelter does close?

Strange We actually have always, you know, when we do “what ifs”, look at things like pulp and paper mills closing and we’ve always considered one of the alternatives is for some reason Tīwai closes or stays there for another 40 years. So I couldn’t really isolate what particular (inaudible), because we just always do plan on that.

So if you look at the grid—the GUP requests for, say, the HVDC link—you’ll see a case in there, one of the cases is that Tīwai is no longer there. It doesn’t mean to say we believe it will be there or won’t be there, it’s just all these things are possible. So if I could give you an answer I would; I can’t.

Hughes Do you think that sort of run-of-the-mill planning is robust enough, given the chances of it having increased, and more likely than it had been in the past?

Strange It’s not run-of-the-mill planning; we absolutely take it into account. The reality of transmission planning is you’re always going to be wrong. We can’t predict the future. We’ve always got it wrong in the past. So you actually look out at the edges and say: “If this extreme occurred, how would you react to it? If this extreme occurred, how would you react to it?” So we have always considered Tīwai expanding, which has been looked at many times, and Tīwai not being there. So I wouldn’t say it’s run-of-the-mill planning at all.

Hughes Do you have the resources to respond if it did close tomorrow or next year? Or would you need to go to the Government for additional funds?

Strange No, we never go to the Government, anyway. We have the resource of—first of all, if Tīwai for any reason disappeared in, say, 1 year, 3 years, we’d need to reinforce a few lines between Clutha and Waitaki. Normally we
would go for that to the Commerce Commission for approval. Actually, we already have approval for a project through there, which we have on hold. The approval was based on a lot of renewable generation—wind and things happening in the lower South Island. It’s not happening at the moment. It’s not looking like happening for a while. So we’ve got that project quite well planned, but on hold. So we wouldn’t even have to go to the Commerce Commission. It’d take about 3 years to complete the project. As far as the funds, we would fund it out of our usual funding. No need to go to the Government.

Bakshi

Mark, you mentioned about the future investment in technology. Patrick, can you elaborate on that? What’s happening in the future on the technology front?

Strange

Yeah, well, things are changing reasonably quickly. We have to be a reasonably conservative industry. It’s all very well, you know—the chair is also chair of Telecom. I tell him, well, we can push technology there and all our phones go off for half an hour, and we sort of get a bit of bad press and move on. That’s what it’s like, isn’t it, Mark? When we turn the national power system off for half an hour it’s a bit more—but there are a lot of things going on—for instance, voltage support devices. When you move power a long way, say, from the South Island to the North Island, particularly over alternating current lines, the power sort of gets out of condition. The current and the voltage get out of step and you have reactive power problems. I’m not even an electrical engineer, so I won’t get into that. That’s always been a big problem for us and limits what we can do. There’s new technology—STATCOMs, *(inaudible)*—which are giving us sort of electronic ways of dealing with that. Some of it’s built into the HVDC link.

So that sort of thing is coming along all the time and we have been, where it is applicable to New Zealand, really almost industry leaders on it. We put the first transmission-connected STATCOM in in the top of the South Island a couple of years ago, and it’s been pretty successful—a few teething bugs. So where we need to push the envelope because of the nature of our system, we will.

The most interesting one, we think, going forward is demand side, where demand can participate. So, you know, your fridge can go off when we need a bit less power. That’s going to come over the next 20 years. It’s not straightforward. But we’re spending with the support of the Commerce Commission several million dollars on some pretty major trials—they’re more than trials, really—on demand side participation in Auckland. And, basically, what it says in Auckland sometimes we get very hot summer afternoons and very humid, as some of you will know. And the power system gets stretched: a, the load goes up, and, b, the capacity of all our lines and underground lines etc. is reduced. We can see that coming about 10 o’clock in the morning, but before that we haven’t had much we can do about it, apart from bringing on more local generation.
So what we’re looking on the demand side is paying people to reduce demand for 3 or 4 hours in the afternoon, and we’re building a multimillion-dollar software platform, which will allow our customers to directly contract with us. So it might be supermarkets, it might be steel mills all the way down to reasonably small customers. So we pay them for just the odd time, it might be only two times a year we can dial them up, or it'll be an electronic link, and say: “Can you please reduce load for 3 hours.”, and they’ll get paid a bit more there.

That’s quite exciting but it’s not as straightforward as you think. We’re pretty keen to see it demonstrated and see it happen. And that’ll (inaudible) this year.

Hughes What’s the best possible outcome? How many megawatts do you think you could save?

Strange In the trial we are aiming to have 100 megawatts, so it’s quite chunky. And the options are either to invest more in transmission, which is expensive, all for 5 hours a year, or to run a thermal plant in Auckland, an (inaudible) thermal plant for 3 or 4 hours, which has a warm-up time.

It’s not easy but, you know, the Commerce Commission’s been great. They’re already putting some pretty serious money there.

Young So you’re referring to, say, a gas fire warm-up plant, sorry, a peak plant in Auckland. What sort of time would it take to speed up?

Strange Well, the very Auckland—I don’t know what the fastest acting one is. One of Mighty River’s open cycle—without Doug here to answer it for you. Technically, it’s probably a couple of hours, but that’s warm-up (inaudible).

Witness There are fast-start thermals now, but they’re in Taranaki. They start up in a few minutes, but they’re very expensive to run.

Strange What we don’t want to have to do is have someone build another one, which is a big cost, all for 10 hours of the year when we (inaudible) demand side.

Mitchell Just in relation to your HVDC Pole 3 project—one of your major projects—there’s been some delays around Siemens. I was just wondering, No. 1, what impact has that had on the project, and how are you managing your way through that?

Strange Yeah, we’re almost a year later than we first projected. That happened in the early days, because of Siemens’ problems with engineering coordination in Germany. In reality, I think we were all too aggressive in saying we could finish it last year. But the problem is two things. It’s a brownfield site, so it’s not the usual “put it in and when you’ve finished testing call up Transpower and hand it over”. You’re right in the middle of the power system. And to test it we also require flows north and south, so we have to, say, have a test where we’re running 300 megawatts south for half an hour or for 5 hours. That’s not very easy to achieve when all the water from the South Island (inaudible) water in the North Island.
So that was identified about a year ago. We’ve stayed on track since then—well through testing now. And while Siemens, I’m sure it is costing them financially, we are very happy that they’ve put the effort into it that was needed, they’ve thrown resources at it. I’m sure it’s not pretty on their financials, but we’ll get a very good Pole 3 out of it, a bit later than we hoped, but it’s a 40-year asset. So we’re more concerned about having a good asset going forward than, you know, compromising it.

Mitchell
So Siemens stepped up to the plate and sort of remained a good partner on this?

Strange
Yeah, the beauty about contracting with someone like Siemens or ADB—you know, the premier—is their name is very important to them. It’ll be frightening numbers that they will have lost on this, but it’s small in their scheme of things. So they have, with some encouragement, come to the party.

Hughes
I was just wondering did you ever model or look at the alternative of greater use of small-scale distributed generation instead of the expensive grid upgrade?

Strange
Yes, that gets looked at. And actually our projections for quite a while have been for reasonably flat—low growth. But the reality, if I can just concentrate on—I won’t look at the DC, I mean that’s a bit of a no-brainer; it’s a replacement of an existing asset—the line through the Waikato. That was all looked at, but the reality is Auckland is going to about double in size in the next 30 years. All our renewable generation, the very efficient stuff is south of Taupō.

We also have, everybody forgets, about 1,500 megawatts of gas-fired generation sort of Huntly north, which is getting older and may be retired. And I think the one line that New Zealand will be very thankful for over the years, even if we can get a lot of small-scale generation, is that line. When it’s running (inaudible) it saves in losses just because it’s a more efficient line than existing ones, and about 40 to 50 megawatts less losses, less (inaudible).

Again we look at demand side, and we’d love to see more photovoltaics and everything when technology allows it.

Hughes
Have you ever modelled the maximum and/or the ideal amount of PV in our system?

Strange
I think you’d have to ask the distribution companies that. It’s more of an impact on them, because it really turns them upside down. But I know Vector’s doing a lot on that. Question them—as you’re talking to them one day.

Clark
In the past there’s been some criticism of you paying dividends when you’ve got a huge capital programme that’s funded largely by debt. What is the board’s current view on that, and what do you foresee for the coming few years?
Verbiest Well, we’ve actually been funding the upgrades through debt, and as I mentioned earlier on if you compare us to our peers we’ve still got a more conservative balance sheet that can take more debt funding. The Crown has got capital invested in Transpower and it’s operating on a commercial basis. The Crown should get a return off the back of its capital, which is regulated, by the way.

Also, I’d point out that for a couple of years—I think last year was the first year we started paying dividends again. We went through a period where we didn’t. How long was that?

Strange About 5 years.

Verbiest Yeah.

Lotu-Iiga Just on that subject—I’ll first say thanks for your presentation. The numbers look strong. I just want to talk about the debt, because obviously you’ve got—I think when we first reviewed you about 4 years ago, you’d come in, there was quite a high level of underinvestment in some of the capital expenditure. You’ve now addressed some of those issues and I think we see it tapers off now in terms of the CAPEX levels going forward.

You mentioned debt—which (inaudible) David’s question on the dividend issue—but you forecast debt to be $3.8 billion. That’s going forward, right? So there’s going to be quite a bit of debt issuance in the next few years. But when you look at the debt that you’ve gone through in terms of your capital programme, you’ve got long-term bonds through a US private placement of $466 million, Canadian private placement $307 million, and then you’ve got these domestic bonds totalling $200 million.

It comes with a little bit of risk, doesn’t it, in terms of this particular round of the interest rates and the exchange rates? And you’ve had to rewrite some of the debt down. First of all, is the reason you’re going overseas just the appetite for that type of debt and is it the pricing? Secondly, could you look more at domestic markets? If you are, or if you have to increase your debt overseas, what are you doing to sort of mitigate those risks? Because they can be substantial at times. Sorry, there’s three questions here, but if you could just break it down.

Verbiest OK, well, in the first instance, in terms of when we look at our debt profile, and to the extent that we need to raise further debt, the team does a trawl around in terms of what the available debt funding is and what the pricing is, taking into account the cost of swaps, currency, interest, etc. So to a degree we are looking for the cheapest cost of funds for the best length of term that we can get. As it happens, we’re actually now in the market, or just about to be, for another domestic bond issue of—

Witness Between 150 and 200.

Verbiest Because that is showing up as best pricing and it’s also for a long term. So we’re looking at our maturity, our profile. By the same token we do have an eye for the fact that it’s important we have a funding mix, because we have such a large debt portfolio. It’s very important that we have a spread so that if any one of those avenues were cut off, we’ve got some options in terms
of where we can look. I think you’ll find that the US PP's and some of the overseas stuff were done in different times, when the pricing offshore was better.

Strange They all swapped back into New Zealand dollars; we don’t have any foreign exchange risk. We look at pricing after the swaps into New Zealand dollars, so it’s all—

Verbiest And that’s reflected in our accounts. You’ll see we do a fair value assessment as if we were actually going to sell those swaps, which we won’t do until maturity normally.

Lotu-Iiga Until maturity, right. OK. That’s good.

Yang My question is related to Transpower’s relations with stakeholders like communities and conservation groups. I noticed that in the last financial years you allocated about $930,000 to 61 community-based projects nationwide. Do you have a set amount of money each year for this particular purpose? Or is it flexible depending on applications or demand?

Strange No, it’s—and it is important. I mean, we affect a lot of communities. I think we’re in all council regimes except one in New Zealand now; I think the exception’s Kaikōura, am I right? And we interact with about 25,000 landowners. And when we go and build something in a community we definitely have an impact. So we have the Community Care programme, where we run slightly independent from us—we have an independent panel of assessors and people can apply for funds, say painting the hall, to put a little bit of offset back into the community.

The typical expenditure is about $1 million a year, a bit more. It’s partly fixed. We’ll always do some of it, but it’s linked to the projects we’re doing. So we take a little bit out of each project and say that’s put aside to put something back into often rural or sometimes urban communities if we’re working in (inaudible).

So it’s not a huge amount of money. It does vary with the work we’re doing, but it’s hugely successful and earning some sort of goodwill from the communities, which we do have an impact on.

Witness We do have a budgeted amount.

Young Well, I think that we have asked all the questions. Thank you very much, gentlemen. All the best for your year ahead.

conclusion of evidence
2011/12 financial review of the Waikato District Health Board

Report of the Health Committee

Contents

Recommendation 2
Introduction 2
Financial and service performance 2
Finance, procurement, and supply chain 2
Hospital redevelopments 2
Emergency department 3
General practitioners’ fees 3
Māori health 3
Rural population 4
Project Energize 4
Appendix 5
Recommendation

The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Waikato District Health Board, and recommends that the House take note of its report.

Introduction

The Waikato District Health Board (DHB) covers a wide geographical area. Its population of over 368,000 is growing proportionately older, and a large proportion of it lives in high-deprivation areas. Almost 42 percent of the population live in rural areas, 60 percent living outside of Hamilton, and 22 percent identify as Māori.

The DHB provides inpatient and outpatient services across the area through the Waikato secondary and tertiary teaching hospital in Hamilton, a secondary hospital in Thames, and rural hospitals in Tokoroa, Te Kuiti, and Taumarunui.

Financial and service performance

In 2011/12, the DHB had a total income of $1,145.351 million, and its total expenditure was $1,135.911 million. After losses in associates (over which the DHB has influence, but no control over the financial and operating policies) a surplus of $9.409 million was recorded.

Finance, procurement, and supply chain

We understand that Waikato DHB will be one of the first to move to the single finance, procurement, and supply chain system being introduced for all 20 DHBs. In preparation the DHB has been taking measures to improve the supply chain, such as increasing the use of purchase orders, daily ordering to reduce wastage, and upgrading the Oracle system. We are pleased with the DHB's efforts in this area.

The DHB acknowledged that such extensive change will carry risks, but they have confidence in the new system, which is already well established in New Zealand, and there are plans in place to prevent disruption to patient services resulting from the changes.

Hospital redevelopments

The DHB is over halfway through upgrading Waikato and Thames hospitals, at a total cost of about $500 million over 15 years. The redevelopment programme involves several new building projects, refurbishment of facilities, and new infrastructure and information technology equipment. We understand that the DHB intends to fund the redevelopment from operating surpluses and long-term borrowings.

The project is slightly behind schedule but on budget with laboratory refurbishments, a new regional renal centre, a new Thames birthing unit, and the emergency department already completed. The DHB recognises that costs due to interest, capital charges, and depreciation as a result of the redevelopment will mount over the next few years, but it assured us that with surpluses over several years they are well placed to handle these pressures, with a surplus forecast for 2012/13 of $27 million.
Emergency department
The DHB said it was finding it difficult to meet the six-hour waiting time target for emergency departments; and it had an 11 percent increase in admissions during the past year, the highest in New Zealand. We were assured that the DHB has plans for reducing its admissions, which involve moving treatment into the community, and increasing investment in emergency services and technology resources.

One particular initiative of interest, Primary Options for Acute Care, aims to help general practitioners to arrive at a diagnosis promptly to reduce emergency department presentations. We heard that the initiative has enjoyed success overseas. The DHB stressed that it is committed to investing in services and reforming processes to find the best possible outcomes for patients within current funding limitations.

General practitioners’ fees
We were told that some general practitioners’ fees have doubled in the region over the past four years, and asked whether there was a correlation with the recent increase in emergency department admissions. The DHB disputed this interpretation, saying many variables are involved in the increase in admissions, and patient surveys indicate that few admissions are due to the cost of visiting a general practitioner.

We asked about the DHB’s monitoring of general practitioners’ fees in the region, and heard that general practices notify the Primary Health Organisation (PHO) of a proposed fee increase, and the PHO submits it to the DHB for consideration. The proposed increase is then measured against the Annual Statement of Reasonable General Practitioner Fee Increases, which is issued annually by an independent body. The report sets a reasonable fee increase level using national pricing indices such as the labour cost index, producers’ and capital goods pricing indexes, and the annual increase in DHB funding. If the proposed increase does not exceed the Annual Statement’s recommendation, it is automatically accepted by the DHB.

We were also told that Healthshare, the shared services agency for the region, runs an independent Fees Review Committee which assesses such proposals. The committee considers evidence submitted by the general practice, the sustainability of the service, and the fees of neighbouring practices, among other factors. We are satisfied with the comprehensive approach of the DHB to monitoring general practitioner fees, and we will follow this matter with interest.

Māori health
We congratulate the DHB on improving its immunisation rates for Māori: increasing from 64.5 percent being fully vaccinated at two years of age in March 2008 to 89.4 percent in December 2012. We note that the DHB has lower rates than other DHBs for total population immunisation, which sat at 87.5 percent in December 2012, and the lowest success rate of all DHBs in helping smokers to quit. We were told that the DHB has a Māori health plan, which sets out key health indicators and disparities on the basis of a health needs analysis. The DHB said that its top priorities are increasing immunisation and breast screening rates, and working towards being smokefree. We expect to see improvement in these areas.

The DHB provides pēpi-pods, general-purpose storage boxes that convert into baby-sized beds with fitted mattresses and bedding, to local babies at risk of sudden infant death. The
pēpi-pods enable babies to sleep safely on a bed or couch or in a makeshift setting, and come with a safety briefing.

**Rural population**

We asked what the DHB was doing to improve access to services and facilities for its ageing population in the eastern part of the Coromandel Peninsula, who currently need to travel to Hamilton for surgery and oncology services. The DHB said the rural areas in the region present a challenge because of scarce resources. Thames hospital provides 24-hour acute and secondary care, but its small size makes this difficult. We heard that the DHB is utilising nurse practitioners and nurse specialists in the area, and has contributed funds and is working with transport providers to find solutions to the transportation issues. We welcome its efforts in this area.

**Project Energize**

Project Energize is a school initiative to improve children’s physical activity, nutrition, and health behaviours, and reduce the risk factors associated with many chronic conditions. The programme involves a team of “energizers” supporting schools in their area. The energizers provide practical assistance to schools and teachers, and a dietician and community paediatrician provide clinical support.

The programme aims to reduce inequalities, giving schools in lower socio-economic areas and kura kaupapa Māori schools proportionally more time. We asked about the evidence base for the programme, and heard that there were challenges interpreting the results accurately given the many confounding factors. We have heard positive feedback from the local community, and we are pleased that the DHB is committed to continuing funding for the programme. We wish to congratulate the DHB on its initiative in tackling one of the biggest challenges to the health of New Zealanders and the future sustainability of our health sector.
Appendix

Approach to this financial review
We met on 13 February, 27 February, and 20 March 2013 to consider the financial review of the Waikato District Health Board. We heard evidence from the Waikato District Health Board and received advice from the Office of the Auditor-General.

Committee members
Dr Paul Hutchison (Chairperson)
Shane Ardern
Dr Jackie Blue
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Scott Simpson
Barbara Stewart
Louisa Wall
Dr Jian Yang

Evidence and advice received
Waikato District Health Board, responses to questions, received 11 February 2013.
Waikato District Health Board, responses to additional questions, received 25 February 2013.
Office of the Auditor-General, Briefing on Waikato District Health Board, dated 13 February 2013.
Organisation briefing paper, prepared by committee staff, dated 22 November 2012.
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Wairarapa District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Waitemata District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the West Coast District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
The Health Committee has conducted the financial review of the 2011/12 performance and current operations of the Whanganui District Health Board and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson