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NEW ZEALAND

2011–2014

VOL. 10

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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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 112 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 report on the 2012/13 financial review of the Southern District Health Board had not been presented to the House.

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.20C) in February 2014.
The Justice and Electoral Committee has conducted the financial reviews of the 2012/13 performance and current operations of the Abortion Supervisory Committee, and of the Electoral Commission, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Scott Simpson
Chairperson
# 2012/13 financial review of the Accident Compensation Corporation

Report of the Transport and Industrial Relations Committee

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The Transport and Industrial Relations Committee has conducted the financial review of the 2012/13 performance and current operations of the Accident Compensation Corporation and recommends that the House take note of its report.

Introduction
The Accident Compensation Corporation (ACC) is a Crown entity set up under the Accident Compensation Act 2001 to deliver New Zealand’s accident insurance scheme, to provide no-fault personal injury cover for everyone in New Zealand.

Financial and service performance
ACC’s income is generated from levies on employers, the self-employed, earners, petrol, motor vehicle licensing fees, investment income and Parliamentary appropriation. In 2012/13 the corporation collected net levy revenue of $4.7 billion (compared with $4.9 billion the previous year) and generated net investment income of $2 billion (an increase from $1.7 billion in 2011/12).

ACC had a net surplus after tax of $4.9 billion, and this decreased its unfunded liability, which had been $7.2 billion in 2012/13, to $2.3 billion in the year under review.

We congratulate ACC on its achievement of a 9.89 percent return on funds invested. We were interested to hear about its expansion of investment into areas beyond the traditional equity and interest portfolios, such as property investment and private equity.

Privacy
In 2012, the Office of the Privacy Commissioner and the ACC Board commissioned an independent inquiry to investigate a substantial and material privacy breach by ACC, and to deliver a comprehensive review of its privacy policies and procedures. The resulting report, in August 2012, made 44 recommendations, all of which were adopted by ACC. Twenty-two recommendations have not yet been actioned; the corporation says that they are to be implemented through its change programme.

We note that ACC intends to achieve its goal of eliminating privacy breaches by the end of the 2017/18 financial year. In the 2012/13 year there were 737 breaches. The rolling three-month average of privacy breaches was 27 per month at the end of November 2013, down from 68 per month at June 2012. We appreciate the effort ACC has made in responding to privacy issues, and we encourage it to continue implementing the recommendations.

Levies
ACC is required to be fully self-funding by 2019 in three of its accounts: Motor Vehicle, Work, and Earners’. The Work and Earners’ accounts have reached this goal and are at approximately 126 percent; the accepted range in the insurance industry for full funding is 110–140 percent.
We heard that ACC aims to keep levies smooth and stable, and that it recommends levy changes only in response to a well-established pattern. We were told that levy payers have not been overcharged, because the surplus this year reflects contributory events that were outside the control of ACC, such as the discount rate, and unexpectedly good rehabilitation results.

**Claims**

We were assured that ACC has no policy of accepting or rejecting a certain number or proportion of claims: each claim is assessed and accepted or turned down on its own merit. ACC also said it does not apply a stricter interpretation of the legislation now than it did in earlier years.

In the 2012/13 year the number of case decisions being reviewed fell substantially, as did the number of matters being referred to mediation. ACC said it is examining its handling of claims that are turned down and decisions being reviewed, with a view to making better decisions and handling cases more smoothly. It is keen to find out, for example, why many elective surgery claims are resulting in requests for decisions to be reviewed. We will be interested to see the results of this review.

**Claimants not earning at the time of the accident**

We note that in a recent high-profile High Court case, the presiding judge described outcomes under the ACC Act relating to payment of compensation to earners who were non-earners at the time of their injury as “unquestionably anomalous”; and we asked ACC to explain to us this policy and its implementation. We were told that a 2006 judgment found that, in order to receive weekly compensation, a claimant had to be earning at the time of the injury. ACC had changed its operational policy in March 2009 to bring it into line with this decision (which was subsequently re-affirmed by a decision of the High Court in a similar case).

We accept ACC’s assurance that the policy was changed to bring it into line with the rulings of the court, and not to make savings. We understand also that the criteria for eligibility for compensation payments are kept under regular review, and such reviews provide opportunity for adjustments to both policy and legislation.

**Injury prevention**

Injury prevention is a core function of ACC. However, over the past few years ACC’s investment in injury prevention has been reduced and is continuing to fall. We are pleased to learn that ACC has now doubled the amount it spends on preventing injuries in the home and the community. We expect ACC to achieve long-term financial returns from this investment, particularly in the areas of sexual violence, domestic violence, and falls in the home.

ACC’s chief executive is leading a cross-government injury prevention action plan. It involves the ministries of Justice, Transport, Women’s Affairs, Social Development, and Health, and the New Zealand Police. The group is focusing on four areas: falls by the elderly, vulnerable children, and family and sexual violence. ACC can help the plan succeed by providing data.

We acknowledge the success of some of ACC’s injury prevention programmes, such as RugbySmart, under which there have been no serious spinal injuries in the last two years, and a summer safety campaign (implemented with the assistance of the Police).
Sensitive claims

We were told that ACC is changing its delivery of services for sensitive claims clients. It is consolidating a number of support, assessment, and treatment services into a single contracted service. This will allow ACC to work with service providers as well as clients. ACC expects the integrated delivery of services to begin by the end of 2014.

We were pleased to hear that rape prevention education will be provided to more schools. ACC is confident it will achieve long-term financial returns from this investment.

Protest

We are aware that a client has been protesting outside ACC for several weeks about the way he has been treated by ACC. We were assured that ACC is committed to finding a resolution to the client’s grievances as soon as possible.
Appendix A

Approach to financial review
We met on 5 December 2013 and 30 January 2014 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
Carol Beaumont
Dr Cam Calder
Darien Fenton
Andrew Little
Simon O’Connor
Denise Roche
Mike Sabin

Evidence and advice received
Accident Compensation Corporation, responses to written questions, received 18 November 2013 and 22 January 2014.

Accident Compensation Corporation, presentation to committee, received 5 December 2013.

Office of the Auditor-General, Briefing on Accident Compensation Corporation, dated 5 December 2013.

Organisation briefing paper, prepared by committee staff, dated 12 November 2013.
Corrected transcript of hearing of evidence 5 December 2013

Members
David Bennett (Chairperson)
Chris Auchinvole
Carol Beaumont
Dr Cam Calder
Darien Fenton
Iain Lees-Galloway
Simon O’Connor
Denise Roche
Mike Sabin

Witnesses
Paula Rebstock, Chair
Scott Pickering, Chief Executive
Mark Dossor, Chief Financial Officer
Sidney Miller, General Manager, Claims Management
Mike Playle, Policy Manager

Bennett Welcome, Paula. If you want to give us a brief introduction, then we’ll open it up for questions again.

Rebstock Thank you very much, Chairman, and thank you to the committee for having the opportunity to talk to you about our performance. I’m sure that you’ll have questions, and we’re really pleased to answer them. Hopefully we can.

Public interest in ACC, in terms of the 2012-13 year, has really focused on the financial result, but I would like to start today by talking a little bit about the services we provided to New Zealanders and what really sits behind those results. Last year we accepted 1.7 million claims, of which 97 percent of all claims lodged were accepted; more than 85,000 clients, including 4,300 with serious injuries, received rehabilitation services; and in total we paid out over $2.2 billion. The corporation have made good progress, but we acknowledge that we still have a ways to go.

Just turn to slide 2, please. This year’s ACC’s injury prevention strategy is being refreshed and the budget significantly increased, but, of course, that comes only on the back of sound business cases. We will be trialling interventions in less-proven areas while continuing programmes that are performing well. Future campaigns will be aimed at the social drivers that contribute most to injuries, such as alcohol use, and at low-frequency, high-impact areas. ACC is coordinating an inter-agency governance framework
to encourage collaboration, because we believe better results will come from that integration.

I ask you to turn to slide 3. The ACC board has made the prevention of sexual violence a priority and has committed new funding to work in this area. It’s a critical time for the sexual violence sector, with a cross-government review under way as well as a select committee inquiry. ACC believes it has the capacity to lead cross-government initiatives on sexual violence prevention. It’s important that there’s an integrated approach across the prevention spectrum. We need to work in this space before violence occurs. We need to minimise harm and further revictimisation and ensure that victims’ longer-term recovery is supported. ACC will deliver a new end-to-end service for the management of sensitive claims in 2014, which takes on board the feedback and research that was gathered following Dr Disley’s review in 2010. We will ensure our improvements align with the outcomes of the sector review and the select committee inquiry.

If you turn to slide 4, please. ACC has already established very strong ties with WorkSafe New Zealand, and you will probably be aware that their chairman will be joining the ACC board. An operational partnership agreement has been signed, a joint governance group established, and work programmes will be aligned, particularly in the areas of agriculture, forestry, and the Canterbury rebuild. We see ACC and WorkSafe New Zealand as complementary agencies. ACC provides safety and injury management advice and offers levy discounts linked to safety performance while WorkSafe New Zealand is responsible for developing laws, they have the enforcement function, and they also are working at gaining employer buy-in. We will work together on education in injury prevention initiatives.

If you turn to slide 5, please. Last year 93.9 percent of ACC’s clients returned to independence within 9 months of being injured. Our target was 93.2 percent. The net number of long-term clients—people receiving weekly compensation for a year or more—dropped by 209 to 10,398. Our aim this year is not to exceed that total. The scheme in some sense has reached maturity, and so our goal now is to hold that. We will continue to rehabilitate and reduce numbers but we also expect the numbers to continue to come in at about the same rate.

Some long-term clients face increasingly complex challenges. ACC needs to adapt in order to meet their rehabilitation needs. They also need to provide more comprehensive vocational rehabilitation for people who have been on the scheme for several years. We are looking at how we can best help clients who are unlikely to ever return to full-time employment but may be able to work part-time. We also want to collect more information on the employment outcomes of all people who leave the scheme, to track whether we’re helping them to achieve better results over time.

Turn to slide 6, please. ACC reported a surplus of $4.9 billion in 2012-13. However, there is still a $2.3 billion deficit between our assets and the calculated future cost of all current accepted claims, which currently stands at $27.2 billion. We’re just at slide 6 in the hand-out.
It’s important to recognise the human reality of our future liabilities. For example, we have 1,600 serious injury clients who will each require over $5 million in support from ACC over their lifetime. These are people with significant lifetime impairments. When you add in weekly compensation and medical treatment, that figure rises to $6.25 million each. The total undiscounted cost of those claims is estimated at $35 billion, or 42 percent of ACC’s total undiscounted liability. ACC’s financial position is now in its best-ever shape. The earners account and the worker account are now fully funded. The motor vehicle account is nearly there, and, on average, worker account levies are at a historic low.

We turn to slide 7, please. ACC is New Zealand’s largest investor, with investments of $25.7 billion under management. Overall, half our assets are invested here in New Zealand. ACC’s investment team had another outstanding year: a 9.89 percent return on investments earned $2 billion, and that saw us out perform our market benchmarks for the 18th consecutive year. We hold 3.5 percent of total capitalisation of the New Zealand stock market, and investment of close to $2.5 billion. With shareholdings in 129 listed companies, we have the largest fixed-interest portfolio in the country at around $10 billion. We are significant holders of New Zealand bonds and property assets. ACC’s overall investment return last year was probably lower than that of some other funds because we typically allocate more investments to long-duration bonds in order to match the long-lived nature of our liabilities.

We turn to slide 8, please. Rebuilding public trust and confidence is very much at the forefront of ACC’s work programme, and it needs to be, as last year we did not meet our target of 49 percent. I’m pleased to say that trust and confidence measures are moving in the right direction, with the first quarter result for 2013-14 at 52 percent—the first time we’ve been above 50 percent in 18 months. I think it’s safe to say that while we’re pleased that we’ve arrested the fall and are moving in the right direction, the board remains unsatisfied with that result and management are working very hard to improve that.

Slide 9, please. Our customer satisfaction result for last year was below target, although a notable lift in the last quarter was maintained in the first quarter this year. Next year we will roll out a service model we’ve been trialling, which generated higher customer satisfaction and reduced time between claims being lodged and ACC making contact with claimants. Our medical assessments project is focused on clients having a choice of assessor and on making the process more transparent. We want to improve the overall quality of assessments and better monitor the distribution of our referrals to individual assessors. We are exploring the use of external medical panels covering various specialities to advise on claims and help monitor ACC decisions. We believe expert independent consensus opinion will enhance the quality assurance of clinical advice in ACC, and that in turn will increase client satisfaction.

We’ve also introduced several initiatives to improve internal procedures around decision reviews, including extending the administrative timeframe.
We expect to see fewer cases going through the formal review process as a result, and in the year under review we certainly saw strong initial signs of that.

We turn to slide 10, please. This slide shows the breach numbers against the volume of transactions on quarterly basis. This is privacy breach that I’m referring to. The breach numbers have dropped significantly. We recorded our lowest number of breaches in the month of November at 19. Obviously, we still have a distance to go, but we are on track to meeting the commitments that we have made.

We continue to work through the root causes of breaches and make system and process changes using the principle of privacy by design. Fifteen of the 44 recommendations in last year’s privacy report have been completed. A further 22 are being actioned and should be completed by the end of this year, and the remaining seven are part of our long-term change programme. All recommendations will be independently reviewed to ensure we have met our commitments.

Slide 11, please. Staff engagement dipped during what was a testing year in 2012-13, but ACC still exceeded its target, which was well ahead of the national average. A highly engaged workforce is central to delivering quality services, and we know we have to work to maintain the goodwill of our staff. Initiatives under way include a more equitable pay system that better recognises and rewards performance. We are establishing a central education hub and academy to offer greater opportunities for staff to learn and grow. The ACC academy will offer quality programmes and qualifications tailored to ACC’s needs, and initial courses will start in the first semester of 2014.

Slide 12, please. ACC has begun designing a new operating model to address systematic issues that have led to poor customer experiences. The project has three components. It covers customers, business, and technology, and will define how ACC wants to be organised and function in the future. Customers, levy payers, providers, and staff are being consulted and involved as part of the process and their views will help inform the design, which is due to be presented to the board in April 2014.

Chairman, those were just some of the highlights I wanted to mention before—

Bennett Thank you, chair. I appreciate that and just wanted to further convey to your staff thanks from everybody in the room. I’m sure all members of Parliament understand how tricky some of the situations are that you have to deal with, so if you could pass that on to your staff and say they do a great job, and thank you.

Rebstock Thank you, Chairman.

Lees-Galloway Let me start off by congratulating you on your investment efforts. I think everybody is in awe of ACC’s investment portfolio and the success you’ve had there, so congratulations on that. I also want to say that we appreciate
the effort that ACC is putting in to responding to the privacy issues. I know you yourselves say you’ve still got some work to go there, but I can see improvement, and that’s great. I do want to ask you some questions, though, about a few other areas. The question about levies—obviously we’ve recently had an announcement about levy reductions foreshadowed for next year. The work account and the earners account are both fully funded. They are actually over 126 percent funded. So at what point in time did they reach full funding? How long have they been beyond fully funded?

Rebstock Well, there is a question about whether they are fully funded at that point. The reason I—

Lees-Galloway That’s what the Office of the Auditor-General told us.

Rebstock Well, they are—I mean in a pure mathematical sense, you could say they’re fully funded at 100 percent, but obviously there is a risk distribution around that. So if you look at the standards expected of most insurance companies here and overseas—

Lees-Galloway Is ACC an insurance company?

Rebstock We are an insurance scheme, yes. And we are a company—an incorporation. So the question—and I think it’s a question that is one that is open to a lot of debate and consideration, but the current policy at ACC is that full funding would be in a range somewhere above 100 percent, because if you target 100 percent, then there is a high probability in any one year you could fall well below.

Lees-Galloway So what’s the accepted range, then?

Rebstock The accepted range right now—I’ll just ask Mark.

Dossor The current funding policy has us at a band of between 110 percent and 140 percent, so that’s the current funding policy that’s been approved by the board for each account.

Rebstock So, you know, we believe we are fully funded. We do not believe the scheme is overfunded at this stage. But I do absolutely accept your comment that there—you know, what we have right now is a very wide range. We know the Government’s thinking about the forward funding, long-term funding policy for ACC. A critical issue in that is should there be some margin above 100 percent and, if so, what should it be? So does it need to be in the range that you would see of a traditional insurance company, or, because of its position and the fact that it’s a Government-owned institution, could the risk margin be lower? I think there’s a conversation to be had about that.

Lees-Galloway Did you advise the Government that levies could have been reduced earlier than what has been proposed—for the worker and earners account, in particular?

Rebstock Well, we’ve given advice. This year the Government has accepted our advice on the worker and earners account, so we think that’s a really—
Lees-Galloway But you had previously advised that levy reductions were possible, and the Government rejected that advice?

Rebstock Well, for the board, in terms of what the board must have consideration to, one of the key issues for us is levy stability, right? So part of the policy is to maintain levy stability. So we look to smooth that over time, and we know from our levy payers that that’s one of the things they value most, right? They want to see levy stability because having levies jump up and down is not very easy to manage. So that’s why we have recommended even reductions before we reach full funding. It’s because we were smoothing and we could see that we were safely on a path, and the path was to reach full funding by 2019. So, obviously, we’re well ahead—two of the accounts.

Lees-Galloway Do you think levy payers benefit from the fact that you’re so far ahead of the target? I mean, the idea of the 2019 target was that it would ease the burden on levy payers getting to being fully funded. Is there a case, do you think, to be made that levy payers have been overcharged in order to reach the target so far ahead of what was originally envisaged?

Rebstock Well, you know, I don’t think they’ve been overcharged, because if you look at where we’ve performed well to get to the result that we’ve got there much quicker than anticipated, it’s across a wide range of things, each of which have contributed to that. So one of the things that has seen the liabilities reduce is the discount rate. Well, no one can control that or predict it. So you wouldn’t want to be trying to anticipate the $1 billion reduction in the liability that we got from that in the last year, and we will probably see the same thing this year.

The other thing was we did better on our case management and rehabilitation results than we anticipated, and we’ve continued to do that. So if you look at how our actuaries think about our liabilities, they want to see a long-established pattern before they give us, in a sense, credit that we can sustain that, and that thinking flows into the way we think about levies, right? So until we’re really confident that we’ve got a sustainable platform going forward, we’re not going to put the sustainability of the scheme at risk by moving too fast.

Lees-Galloway But you did advise the Government that you could have reduced levies before now, didn’t you?

Rebstock In our view, looking at the things the board looks at—yes, we did.

Lees-Galloway One of the other things that is possibly assisting with your financial position is that you’re accepting fewer claims. You accepted 64,000 fewer claims in 2012 than you did in 2008. Is that a deliberate strategy to reduce the number of claims that you accept?

Rebstock No, I think the percentage of claims that we accept of the total is relatively stable, but it’s actually, I think, increased, in my memory—

Lees-Galloway No, no, it’s fallen—it’s falling.

Rebstock —from 96 percent to 97—

? Yeah, from 2008, are you talking about?
Lees-Galloway It has fallen since 2008, hasn’t it?

Rebstock Yes.

Lees-Galloway It fell from 2008, but in the last 18 months it’s started to increase.

Rebstock So we’re seeing increases of 2 to 3 percent year on year at the moment.

Lees-Galloway So there’s certainly no strategy involved in that whatsoever. We assess the legitimacy or otherwise of any claim as it arises, and if a claim should be covered by ACC, then we cover it, and we clearly have the ability to do that. I mean, there’s no issue there right now with the scheme. We have ample ability to cover the claims that ACC is responsible for and we’re absolutely committed to do that.

Lees-Galloway There’s an element of interpretation though, isn’t there, about what the legislation says you are responsible for and how you interpret that legislation. Are you applying a stricter interpretation of the legislation than what you may have been a few years ago?

Rebstock No I don’t think that we are. No, I wouldn’t say that.

Lees-Galloway Do you keep any record of how many claims are turned down because of so-called pre-existing or degenerative conditions?

Rebstock We do look at and we are looking right now at the area of claims that are turned down but also ones that go to review, because we want to look at what the—sort of do a bit of root cause analysis so that we really understand it. Because if we can find common areas and we can do more analysis on it, we can do far more analysis of whether we’re getting it right, whether the way we deal with a customer in that context—even if we must say no because it’s not covered by the scheme—whether we’re handling that as well as we can, and we’re doing quite a bit of work on that.

If I look at the way that the reviews have gone over the period under review, we saw a reduction in the number of matters going to review—a significant reduction. We saw increase in the number of matters that were referred to mediation. We saw pretty good results, and we focused on that. But there’s still some areas we want to understand better, so I think the board needs greater satisfaction—that we understand why we continue to have a lot of elective surgery claims go to dispute. So this year we’re looking into that further.

Lees-Galloway I’ll be interested to see the results of that. Could I just ask you a couple of questions about the recent decision by Justice Kós regarding claimants who are earners who were non-earners at the time of the injury. Was there a decision to change policy in about 2009 regarding those claimants? Because there were some claimants that you were paying weekly compensation to, and then you contacted those claimants in 2009 saying that you discovered that you weren’t adhering to legislation. Was that an active decision to make that change?

Rebstock I wish I knew every case that we’ve had.
Lees-Galloway This is quite a broad one, so there might be someone in the room who knows about it.

Playle Yes, we did make a decision in about 2009, following a court case.

Lees-Galloway So, the court case was in 2006. Why did it take until 2009 to change the policy?

Playle Because we didn’t respond to the court case as quickly as we should have.

Bennett Do you want to repeat that?

Playle Well, because we should have responded earlier to the court case and we didn’t.

Lees-Galloway When you realised that you weren’t adhering to the legislation according to that 2006 court case, was any advice given to the Government regarding changing the law to bring the law in line with current policy?

Playle Yes

Lees-Galloway And the Government rejected that advice?

Playle We made a recommendation to the Minister at the time around the issues that we saw with the legislation, but there was no decision at that point to change the legislation.

Lees-Galloway So, just to clarify, the Minister, the Government, rejected any proposal to adjust the law so that those claimants could continue receiving compensation?

Playle I think the Government realised the issue with the legislation, and there’s currently both ACC and MBIE working on that particular issue in terms of the issue with the legislation around the non-earners’ date of injury. It’s just a case of, I guess, getting a legislative spot to be able to make that change.

Lees-Galloway It’s been 4 years since you changed the policy. But that’s not your problem

Bennett You’re asking there—so that was 2006, the decision—when did you take it to the Government?

Playle I can’t remember what date it was, but before we changed the policy we advised the Government in terms of what issues we saw with the legislation and the particular ruling. It’s a tricky one because just after the policy change the courts saw it a different way, and so the courts have taken a bit of an inconsistent approach to it.

Rebstock It might help, Chairman, if we provide some written material. We’re really happy to do that.

Lees-Galloway Just one last question on it: have you any idea what the cost saving was to ACC when you stopped paying compensation to those people?

Playle I can’t remember off-hand, but in the greater scheme of things it wasn’t a big saving.

Lees-Galloway So, if the Government had decided to change the law so that those claimants could get compensation, you don’t think it would have been a dramatic impact on ACC’s financial position?
Rebstock  I think we should come back, because I think it’s getting into some detail. We’re really happy to come back and answer those questions.

Lees-Galloway That would be great if you could come back to the committee with some detail.

Sabin Thanks very much for a very clear briefing, and I also acknowledge the performance and the work that’s been done here. There’s been slightly one-dimensional questioning—not unsurprising coming from the Opposition—around levies and the balance sheet and so forth. But quite clearly what you’ve shown, what you’ve demonstrated here, is that there are a number of contingent parts, a number of areas which go towards performance.

And I just want to acknowledge the fact that you’ve obviously done a lot of work in terms of checks and balances, in the main, to get that performance on track. One of the areas is injury prevention. Obviously, an injury prevented is obviously going to have a significant impact or effect on the business of ACC. Can you just talk me through what is going on in that injury prevention space, and where you see the gains to be made in terms of growing the capability in that area?

Rebstock  I might comment first and then hand over to Scott to follow up. I think the board last year looked at the investments we make in injury prevention, and looked at the spread of them across, and asked ourselves the simple questions, which was “Do our investments sort of reflect where the forward liability is across different areas?” And what we found when we did that was that we were probably significantly underinvested in prevention in the home and community space. As a result of that we’ve decided to increase our investment, which is why I mentioned that we’re focusing on things like sexual violence—big focus. Also we’ve been talking to police and other agencies about looking at domestic violence. We are also looking at the area of falls in the home because that creates a large amount of that liability.

This is a core function of ACC. It’s safe to say that over the years the investment in prevention has dropped and it’s dropped significantly. The board made a big commitment in the current year. We doubled the amount of funding that was available for injury prevention work. We doubled it. Obviously, under the Act we must show a return to that investment, so everything’s subject to business cases, but we intend to continue that. We’ve made it clear that if we’re successful in that space, we will look at further increases, because we really see in a mature scheme the need for prevention to play its part.

Beaumont Just on the point around injury prevention, and you just talked about doubling it and focusing on sexual and domestic violence—which is very welcome, but is it not true that injury prevention is at its lowest level ever, in terms of investment?

Rebstock  It was before we doubled it, yes.

Beaumont But you’ve had an ongoing trend of under-spending and below budget in that area?
Rebstock: There was an ongoing trend of it reducing, of budget reducing, so we’re absolutely going to address that.

Beaumont: So what plans have you got in place to ensure that you actually do invest that money, because there’s been a record of not doing so.

Rebstock: One of the things that I’d like Scott to speak to is—he’s chairing an injury prevention cross-department strategy. ACC can’t deal with these issues on its own, nor should it, so we’re looking to work with other agencies, so if it’s all right, I might just refer to him.

Pickering: Yes, from our perspective we are leading the cross-government injury prevention action plan, and that involves justice, transport, Ministry of Women’s Affairs, police, MSD, and health. Initially we’re focusing on four key areas on a cross-government basis, and those are falls for the elderly, vulnerable children, family violence, and sexual violence. What ACC brings to the table is, obviously, the level of expertise that we have in this area, but importantly a large amount of data, which we can really use to tailor effective programmes on a cross-government basis. I think that that’s very important, and I think that within ACC we’ve got a number of programmes in place, and we want to—as the chair has already said—continue to increase our investment in those areas.

I would point to some very successful programmes that we have had in place over the years. Our Rugby Smart programme with the New Zealand Rugby Union has thankfully led to zero serious spinal injuries in the last 2 years, and we’re looking to extend our relationship with them. Our recent announcement to work with police and other agencies on the summer safety campaign is important, and we also, as an organisation, worked very closely with the police and other agencies recently on the Roast Busters or Operation Clover, being able to work with Auckland help and other agencies to provide counselling services immediately and responsively. So we want to ensure that as an organisation we do respond to issues as they arise rapidly but also to put in place programmes which will have long-term benefits.

Beaumont: Could I just ask a couple more questions on the sexual violence area. First of all, just in terms of your current work with sensitive claims, I’m just wanting to know whether you have any information about customer satisfaction in that particular area, because I note that overall customer satisfaction has fallen and is below target, but do you know what it looks like in terms of the sensitive claim area?

Miller: No, I’m sorry we don’t have—

Beaumont: Can we find that out?

Miller: Certainly, yes.

Rebstock: We’ll come back.

Beaumont: That would be very helpful. Also, I’m wondering whether there’s been any further evaluation around the adequacy of the counselling provided in the sensitive claims area, because it’s been put to me that one of the issues is
you can seek additional counselling over and above what’s provided, but therapeutically, you know, if somebody’s in the middle of an intensive programme and then it has to pause while you wait to get approval—and I’m wondering if you’ve done any work on that, looked at that particular issue?

Rebstock  I think I could answer it, but I’d better let Sid. He’s the expert. We just had a briefing on this last week.

Miller  So as part of the Disley 14 recommendations we’ve looked at the whole way we deliver the service to sensitive claims. We’ll be putting in place a new service, which we’re currently working through, which will be in place before November next year. That brings together the whole, dealing with those clients in terms of their needs, the treatment, and the ongoing support as an integrated service rather than one-off areas. So one of the challenges there is working not only within ACC but with the providers as well so we can work together to actually give the best support to the clients on an ongoing basis.

Beaumont  Could we have information about what’s planned in that space? And, sorry, Mr Chair, just one last question in here. I mean, it is really good to see plans to do a lot of work in this area, and there’s certainly a lot of work required. Just in the prevention area, at the moment there is a huge gap. So in terms of education in schools, for example, in Auckland something like 20 schools rape prevention education can get into at the moment given their current funding. So we’re probably talking about reasonably significant amounts of resource. Is that what you have in mind?

Pickering  Yes that’s correct and we will be also working with the Ministry of Education in that respect. So it is absolutely on our radar and it’s something that initially we were looking at as a result of Operation Clover, but we do see this as a programme that we need to roll out across the board.

Beaumont  And this is all happening in conjunction with the inquiry the Social Services Committee are doing?

Pickering  Correct, but there are things that we can do now, and we are doing now.

Beaumont  Good. OK, thank you.

Rebstock  If I might just add—you know, we have an obligation to show a return on investments we make including, in prevention. I don’t think we’ll have trouble doing that, but we do have to be prepared to take a longer view than one year, which traditionally was done and, I think, limited what we invested in. So we need to be disciplined and rigorous about it, but we need to be prepared to take a longer-term view on what we invest in and the return, and how long it takes to see that. So we’re doing that.

Having said that, the board’s been really clear, and I think management were really pleased that we said to them: “While we have to be mindful of demonstrating and evaluating what we do, that shouldn’t stop us from responding quickly when situations arise.” And the corporation, probably of all the agencies, is in a better place to do that, if not for any reason because of our financial position that we are now in. You know, we pick up the
costs of these injuries. We see the cost to the individuals involved. It’s unacceptable going forward for the corporation not to take its share of responsibility for addressing things like sexual violence, domestic violence, violence against children, and we’re absolutely committed to doing it.

Beaumont That’s very pleasing to hear.

Auchinvole Good morning. Thank you for your presentation. One of the nice things about the annual event is that we see consistency, change, achievement. I’ve chosen the slide you gave on client satisfaction. I do have a particular reason for that because coming from the West Coast I notice they’ve achieved great things in Greymouth, for example—over 90 percent. That’s wonderful and they’re a keen group down there. But how much work do you do in trying to determine what it is that individual offices achieve and then spreading that? Is that one of the techniques you use?

Rebstock One of the strategies this year, when we’re looking at how to improve the service, is to look both at what we’re doing well and picking that up and using that across the country. Also looking at the things we’re not doing so well and finding solutions and spreading those. But, if you wouldn’t mind, Chair, I would like Scott maybe to have an opportunity to respond to that question.

Pickering Yes, I think that one of the things that we are doing is, firstly, we make sure that we do share best practices. There is a coordinated effort every week, where our branches are linked up and best practices are shared amongst the communities.

Auchinvole Every week?

Pickering Yes. So there’s a training programme every Wednesday morning for 2 hours. Our branches have a training programme and they share best practices. But importantly, as the chair said, we also talk about things that aren’t working so well. I think that that’s very important. But as the chair also mentioned, one of the things as an organisation that we need to do—and we’re acutely aware—is to improve and enhance our public trust and confidence. And, obviously, the by-product of that is our customer satisfaction. We’re presently undergoing a review, as the chair mentioned, about looking at the organisation through a process of re-engineering—looking at our customers, listening to our customers, what went right, and, again, what went wrong, talking with our providers and engaging with those providers as well, because I think that’s also been a disconnect, whereby many of our claims come through our providers, so we’re understanding the process there. This is all to do with really enhancing the customer experience of ACC. So from my perspective, I’m very committed to driving the organisation forward in a much more customer-focused way into the future.

Lees-Galloway Just a couple of quick questions about Mike Dixon-McIver. The decision to attempt to have him prosecuted for fraud, which was ultimately thrown out, does that reflect a more litigious approach from the corporation in recent years?
Rebstock  
This was quite a long time ago, but that prosecution, as I’m sure you know, followed another prosecution undertaken by another agency in a District Court finding. We referred the matter ourselves to the Crown Solicitor for review. Having said all of that, the case was ultimately thrown out. We were not found to have handled the case the way we would have like to have, or we should have. For that reason, the court ordered that a payment be made, and we made that payment. Nevertheless, having said all of that, the board, the management, and the staff of ACC are very concerned about Mr McIver’s health and well-being. We are engaged with him. I don’t want to discuss the particular case here, other than to say that we have offered arbitration, and we are very committed to finding a resolution to the matter.

Lees-Galloway Do you think he needs to take a more collaborative approach to that arbitration?

Rebstock  
You know, I don’t really want to comment on that. It doesn’t really help us go forward, right? So we want to work with him, and we need to be constructive about that. That’s what we intend to be and it’s very difficult, as I’m sure you know, individuals dealing with a large corporation—it wouldn’t help at all for me to make comments like you’re suggesting.

O'Connor  
It’s the question I asked last year too, around you investment portfolios. As you’d noted, they’ve done exceptionally well—almost 10 percent. Why is it that you think that you do continue to have such a success in this area?

Rebstock  
Well, I think, you know, it’s fundamentally based on a pretty structured and disciplined approach. So the corporation over many years has had a pretty stable team and probably a team that almost anyone in this country, or in Australia, would love to have come and work for them. But, they are committed to serving the public of New Zealand, which has worked in our favour. The really core story there is about the strategic asset allocation framework that we use. It provides that discipline. It provides the rigour within which our investment managers work. It has meant that we probably excel in the New Zealand equities markets. We excel in the fixed interest area. We are increasing our presence in other areas—property, and even in some cases private equity. You will have seen the PPP that we bid to join in—

Lees-Galloway  
It should be a good little earner, that one.

Rebstock  
Well, you know, we had a strategy session last week with the investment team and the investment committee. The corporation is really well placed right now, with $25 billion under investment. But we know that fund is going to grow to about $40 billion in not too long a time. We have to think about not just how we’re running the fund today, but given our place and size in the market, what do we do when we’re a $40 billion fund? So we did a little bit of thinking about that. To help the team really think about that—well, great, you’re doing really well now; we can’t find a diversified fund in the world that has out-performed ACC over a very long period. If you go back only 10 years, you can find the Yale fund and probably better, but no one else. But, you know, we have to think about how we’re positioned for the future. We will have to invest in new things. We will have to do some
things that in the past we didn’t need to even look at because there was plenty of opportunity in equities and fixed interest. So with the size and position and capability comes responsibility too. As the biggest player in the New Zealand market, we need to be able to sustain our performance. It gets harder as you get bigger, as you can well imagine. But we do have the advantage that our team doesn’t have to go out in the market. It operates as one team to one client. It gives it a really strong advantage, and we need to just continue to leverage that on behalf of our clients and levy payers.

Bennett

Thank you very much chair, and the team, for coming along. We’ve really appreciated the work you’re doing. Well done, and thank you very much.

conclusion of evidence
2012/13 financial review of AgResearch Limited

Report of the Education and Science Committee

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AgResearch Limited

Recommendation

The Education and Science Committee has conducted the financial review of the 2012/13 performance and current operations of AgResearch Limited and recommends that the House take note of its report.

Introduction

AgResearch’s purpose is to enhance the value, productivity, and profitability of New Zealand’s pastoral and related sectors. AgResearch is the largest Crown research institute by revenue. The total operating revenue for the group during the year under review was $160.068 million. Of this, 24 percent was core Crown funding, and 49 percent was from commercial revenue. It had operating expenditure of $153.839 million, and a surplus before tax of $7.643 million. Its adjusted return on equity was 5.8 percent, which is the second-highest for a Crown research institute. The Office of the Auditor-General assessed its management control environment and its financial information systems and controls for 2012/13 as very good.

Campus development

During the year under review, AgResearch released details of plans to invest $100 million in its campus facilities and resources, to be part-funded by the disposal of under-utilised assets. The business case for this development, called “Future Footprint”, proposed the creation of two large campuses, one at Grasslands in Palmerston North, and one at Lincoln in Canterbury, as part of larger agriculture innovation hubs with local sector partners. The Grasslands hub would focus on food, nutrition, and animal health; the Lincoln hub on farm systems, land use, and sheep, beef, and deer productivity. Most of the executive team and support staff would be located at the Lincoln hub.

AgResearch told us that having two large campuses with more co-located teams and staff would result in much more knowledge sharing and internal collaboration, resulting in the delivery of better science. The aim of such hubs is to allow clusters of researchers, particularly in multi-disciplinary teams, to solve the big challenges for New Zealand in an area where resources are currently thin. We heard that AgResearch has received support for the proposal from companies in the sector, including Dairy New Zealand, Deer Industry New Zealand, ANZCO, and Silver Fern Farms.

About 280 roles, including both science and support functions, are marked for relocation to Grasslands and Lincoln, starting in 2016/17. AgResearch assured us that there will be no science redundancies and no reduction in capacity as a result. We heard that the intended location of science teams was recommended to management by science team group leaders. The scientists recognise that increasingly integrating their specialised work into farm systems yields valuable results. Researchers also see practical benefits from co-location with their colleagues.

Some of us expressed concern that the relocation could produce duplication of services that currently exist at the Invermay campus, a loss of science collaborations with Otago University, and a loss of science capability.
Regional hubs

In addition to the proposed two main hubs, AgResearch’s existing facilities at Invermay, near Dunedin, and Ruakura, near Hamilton, would be downsized and continue to operate as smaller regional hubs, concentrating on region-specific environmental and farm system needs. AgResearch explained that the regional hubs will allow research to be conducted in different climates and topography. AgResearch is in the process of setting up a Waikato hub, where it may be joined by Dairy New Zealand, Lincoln University, NIWA, University of Waikato, Livestock Improvement Corporation, and Innovation Waikato. We were told that the creation of the Waikato hub has spurred other researchers to develop partnerships, and may encourage them to invest in more environmental and on-farm science.

AgResearch told us that opportunities for collaboration have also been discussed with the University of Otago. No evidence was provided during our hearing to allay the concern of some of us that capacity, including pure science and sustainable agriculture systems, might not continue to be built in the regions.

Transparency

AgResearch submitted a business model with multiple scenarios to its board for consideration. All scenarios were subject to the “better business case” procedures recommended by Treasury. The business case reported that building occupancy on three of four campuses is between 62 and 67 percent. Some of us felt that there is a lack of clarity about plans for development at the AgResearch campuses, however, because of the extent to which site maps were redacted.

The business case was not provided before our hearing with AgResearch, despite evaluations being requested. Some of us feel that if this information had been provided before the hearing, we would have been better able to scrutinise the business case.

Some of us felt that AgResearch’s responses to requests for information about the restructuring proposal were somewhat obtuse and lacked transparency. AgResearch assured us that this was not so, and that information was withheld out of natural concern for employees. AgResearch said it has released the appropriate information on the Future Footprint business model, while avoiding compromising commercial relationships or, particularly, affecting staff. We asked AgResearch to provide an unredacted version of the business case; it provided a substantially less heavily redacted version, where only commercially sensitive information that might disadvantage AgResearch was withheld.

Staffing

We are aware that AgResearch employed 25 fewer staff as at June 2013 than in the 2011/12 year, and that many scientists are nearing retirement. AgResearch told us that there is a good range of younger scientists coming through, but acknowledged that there is a shortage of scientists in mid-career. It ascribed this shortage to a national problem of low science study rates, and said more students need to be persuaded to see science as a viable career. AgResearch is itself helping to address the problem by supervising roughly 80 PhD and 15 or 16 Master’s students. The Future Footprint business case reports that 70 percent of AgResearch’s workforce talent is drawn from overseas. Some of us were surprised at how high this percentage was.

We are aware that a survey by AgResearch found that only 52.7 percent of its employees said they thought they have career opportunities there. AgResearch acknowledged that this was a concern, and said that they have introduced a “Tomorrow’s Leaders” programme in
an effort to address it. Frequent collaboration with other Crown research institutes has also opened up career opportunities. AgResearch said that a factor in the Future Footprint plan is the importance to younger scientists of multi-disciplinary teams and access to world-class facilities for progressing their careers. We heard that staff are excited about the opportunities that will be created by the new clusters.

Consultation

We are aware that disappointment with the plan has been expressed, particularly in the regions that will be losing staff. We asked for an update on consultation with staff, and any trends in their feedback on the move. We heard that staff consultation on the business plan was completed by the end of September 2013. Since then, AgResearch has begun discussing the plan with individual staff members. We heard that many staff have asked for time to consider their options, as the changes are some years away.

Some of us have heard from scientists that they would rather retire or emigrate than move to the new hubs, especially if their partners’ employment is affected. Some staff have already left the organisation rather than wait to discover whether they will be relocated. AgResearch recognises that some scientists will be unwilling to move, and it intends to draw up an individual plan for each scientist. AgResearch acknowledged that the biggest area of risk to the project is the retention of staff, and is applying international best practice methods of engaging with staff to ensure staff retention. It is seeking to ensure that it does not repeat the loss of staff that followed the closing of its Wallaceville site, when only seven of 25 scientists agreed to move to new facilities and the rest left the organisation.

Funding models

We explored the implications of a possible shift to a funding allocation model for Crown research institute’s based on the outcomes of successive National Science Challenges. We heard that certainty of core funding and flexibility in the use of this funding is important to AgResearch. AgResearch said that it already allocates some of its core funding to areas that the National Science Challenges have identified, such as high-value nutrition and land and water planning. AgResearch told us it would be concerned if funding for the National Science Challenges replaced core funding, but it is not currently concerned as the challenges are funded separately, in addition to core funding.

Funding genetic engineering

AgResearch has reported that at least 10 percent of livestock spending and 25 percent of forage and endophyte spending is devoted to genetic modification techniques. A member of the committee felt Forage Research will increase AgResearch’s genetic engineering commitment. The same member noted that the investment of at least 25 percent of the forage research and development budget into genetically engineered forage suggests a strong direction by AgResearch into genetically engineered forage. AgResearch did not identify any stakeholder or policy directive behind its drive into genetically engineered forage.

AgResearch is withholding photographs of the calves and cows raised on the Ruakura genetic engineering field trial site as it is concerned that some of them may be used to misinterpret the work, and could be used in a sensational way, although AgResearch asserts they do not depict scenes out of the ordinary on most farms. One member informed us he has seen information that suggests a high incidence of cattle deformities and pregnancy failures, and induction to lactation of 4-month-old kids.
AgResearch reported that as at 12 December 2013, it had no intellectual property arrangements with any private-sector companies for outcomes from its genetic engineering livestock programme. It reported that the emergence of commercial opportunities in this area is hard to predict because of the length of time it takes to develop products.
Appendix

Approach to this financial review

We met on 20 November 2013 and 12 and 19 February and 5 March 2014 to consider the financial review of AgResearch Limited. We heard evidence from AgResearch 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
Simon O’Connor
Grant Robertson
Dr Megan Woods

Evidence and advice received

AgResearch response to written questions 1 to 140, and 141 to 164, received 18 November and 20 December 2013.

Office of the Auditor-General, Briefing on AgResearch Limited, dated 20 November 2013.

Organisation briefing paper, prepared by committee staff, dated 18 November 2013.
2012/13 financial reviews of the Airways Corporation of New Zealand Limited, the Civil Aviation Authority of New Zealand, Maritime 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 2012/13 performance and current operations of the Airways Corporation of New Zealand Limited, the Civil Aviation Authority of New Zealand, Maritime 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
2012/13 financial review of Animal Control Products Limited, and AsureQuality Limited

Report of the Primary Production Committee

The Primary Production Committee has conducted the financial review of the 2012/13 performance and current operations of Animal Control Products Limited and AsureQuality 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
2012/13 financial review of the Museum of New Zealand Te Papa Tongarewa Board, the New Zealand Historic Places Trust (Pouhere Taonga), the Arts Council of New Zealand Toi Aotearoa, and the New Zealand Lotteries Commission

Report of the Government Administration Committee

The Government Administration Committee has conducted the financial review of the 2012/13 performance and current operations of the Museum of New Zealand Te Papa Tongarewa Board, the New Zealand Historic Places Trust (Pouhere Taonga), the Arts Council of New Zealand Toi Aotearoa, and the New Zealand Lotteries 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
The Health Committee has considered the financial review of the 2012/13 performance and current operations of the Auckland District Health Board, the Bay of Plenty District Health Board, the Canterbury District Health Board, the Capital and Coast District Health Board, the Counties Manukau District Health Board, and the Hutt Valley District Health Board. With Crown entities and district health boards we resolved to undertake formal hearings of evidence on a rotational basis. This year no hearings of evidence were held for the above district health boards.

The committee has no matters to bring to the attention of the House, and recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
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Broadcasting Commission

Recommendation
The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of the Broadcasting Commission, and recommends that the House take note of its report.

Introduction
The Broadcasting Commission was established under the Broadcasting Act 1989 as an independent broadcast funding agency. It funds local television, radio, music, and other media content. The commission operates under the name NZ On Air. Its main purpose is to ensure that “local content is innovative, visible, and valued by diverse New Zealand audiences”.

The commission is governed by a board of six members appointed by the Minister of Broadcasting. Jane Wrightson is chief executive of the commission; Miriam Dean has been chairperson of the board since February 2012.

In 2012/13 the commission received a total income of $131.402 million, and its total expenditure for the period was $131.751 million. This resulted in a net deficit of $349,000 (compared with a deficit of $3.341 million in 2011/12).

Conflicts of interest
We asked the chairperson about the commission’s conflicts of interest policy. Ms Dean said that the commission has a very strong policy preventing board members being involved in funding decisions where “real or perceived” conflicts exist; she also stated that she has a strong professional view, which was conveyed to the board upon her appointment as chairperson. The appointment and reappointment of board members is managed by the responsible Minister; Ms Dean declined to comment on the process. We were assured that Ms Dean would remind board members about the importance of the policy leading up to the 2014 general election.

Election programming
Some of us expressed concern about Stephen McElrea, who some of us consider to be a politically active board member, who objected to the screening of a funded documentary close to the 2011 election and has since been reappointed to the board. We were told that the commission makes decisions only about funding, and it is up to the broadcasters to determine when a particular programme is shown. Ms Dean said the commission refers broadcasters to the legislation, which constrains when political programmes can be broadcast before an election.

Funding
We asked why funding for national television decreased by $6 million from the previous year. Ms Wrightson said that the commission had received the same income for seven years, and maintained funding by seeking efficiencies and absorbing costs. However, if the amount in a particular fund such as that for digital media is increased, this is at the expense
of other services. The commission funds content specifically, but expects most funded programmes to be distributed on multiple platforms, such as television and online.

We heard that the commission only funds higher-cost television content that has the backing of a broadcaster; it does not consider it would be responsible to use public funds for programmes that might not be viewed. The commission believes that focussing funds on content that draws the largest audiences is a “good business discipline”.

**Digital media**

We asked about the commission’s strategy for digital media. We heard that television and radio still have the biggest audiences by far, but funding for digital media is expected to increase significantly over time. For funding smaller, low-cost projects, the commission already has a dedicated digital media fund. Its main focus is content for special-interest audiences, and smaller programmes.

**Commercial interests**

We understand that tensions can exist between content which commercial broadcasters want to screen and excellent but “edgy” content that might appeal to fewer viewers. The commission considers that their main role is to ensure that a variety of content, which the market will not provide on its own, is available for New Zealanders. The commission is confident it succeeds in funding a wide range of content each year, and said the online platform was a space where non-mainstream content could be viewed if it did not have the backing of a major broadcaster. Broadcasters do take risks, but the commission acknowledged that “riskier” content is often aired outside peak times.

**Collaboration**

We noted that the commission has moved to share premises with the New Zealand Film Commission, and is still co-located with the Broadcasting Standards Authority. The commission intends to collaborate with many agencies, and sharing premises with the film commission allowed opportunities for interchanging ideas, joint funding, and sharing back-office services.

The commission has launched a fund with Te Māngai Pāho, the Māori Broadcasting Commission, for five web series. It believes that the proposed restructuring of Te Māngai Pāho will not significantly affect its role.

**Music**

We asked how the commission supports New Zealand musicians and were told the commission’s music funding strategy has been focussed on diversity in popular music for the last two years. Funding decisions are made by a panel of six, with only one commission staff member taking part. The commission has contributed to theaudience.co.nz, a website where musicians can upload songs to test the audience for their music before seeking funding. The commission also has 2.5 full-time-equivalent staff who promote New Zealand music.

**Regional television**

We asked the commission for comment on reports that a number of regional television stations are having difficulty operating since the digital switchover; it currently funds one programme for each eligible regional station. The commission recognises that operating a regional station would be difficult in a country with a small population, and considers that
using online platforms would be more prudent, as television is the most expensive medium.

**Diversity**

The commission published strategies for Māori and Pacific content in December 2012. We were told that the commission provides representation for the Asian community via Access Radio, which broadcasts in over 40 languages. It also funds programmes that represent the diversity of the population, such as *NZ Story.*
Appendix A

Approach to this financial review

We met on 10 April and 8 May 2014 to consider the financial review of the Broadcasting Commission. We heard evidence from the Broadcasting Commission and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Evidence and advice received

Broadcasting Commission, Responses to written questions, received 28 March and 2 May 2014.

Office of the Auditor-General, Briefing on the Broadcasting Commission, dated 10 April 2014.

Organisation briefing paper, prepared by committee staff, dated 4 April 2014.
Corrected transcript of hearing of evidence 10 April 2014

Members
Jonathan Young (Chair)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafaoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Jian Yang

Witnesses
Miriam Dean, Chair
Jane Wrightson, Chief Executive Officer
Alan Shaw, Chief Financial Officer

Young Welcome to the Commerce Committee. It’s good to have you here. Ms Dean, if you’d like to just introduce your team, that’d be great. Thank you.

Dean Thank you, Mr Chairman. I’m pleased to be present with Jane Wrightson, our chief executive, and Alan Shaw, financial controller, so that we may discuss NZ On Air’s work for the past year.

Young Thank you very much. We’ll have a presentation from you for about 5 to 7 minutes, and then we’ll come to questions.

Dean About 5 minutes.

Young OK. Thank you.

Dean NZ On Air does consider that we have had a particularly successful year this past 2012-13, and I thought if I just very briefly highlight some of the high points—as we might put it.

Governance—as you will have noted from our annual report, we spent a good part of the last year reviewing our strategy. That was very much at a board level and led by the board, and that resulted in us developing a short strategic plan. Our vision is simple: diverse, relevant local content for New Zealand on air. Our intended outcomes we consider equally simple and clear, and that is that investment reflects changing audience behaviour, well-balanced mainstream and special-interest content, and that intended audiences are generally satisfied with our investments. It is a changing environment, and with the rapid changes in technology we’ve continued to go where the audience is, and whether that’s television, radio, online, or, in
this last year, we’ve certainly moved into the streaming services like Spotify and iHeartRadio. That changing environment was particularly reflected in our digital strategy this last year. We rolled out a refreshed digital strategy, and that focused both on experimenting with purely online content—and some of you may have seen that delightful little comedy Woodville about small-town New Zealand—but, equally, another aspect of our digital strategy is to now ensure that all our funded content is available on networks’ on demand sites for a period of time. So what it’s all about is ensuring that New Zealanders can watch local content whenever, wherever, and on whatever device they want.

Television—we funded some diverse television, ranging from Nothing Trivial, and we’re going to now wrap up a tele-feature on Nothing Trivial this year, due to popular demand when TVNZ did decide to not continue with further series, to the terrific World War I drama Field Punishment No. 1. Now, I know a number of you had been hoping to come to that last night. We showed it in your theatrette, and thank you for that. And all I can say, I think all of us thought it was the most incredibly powerful story about World War I, very much a local New Zealand story, and it’s a must see.

In the drama space, we thought Agent Anna was probably one of our most successful comedy launches in the last 10 years, and then we backed some excellent documentaries—First Crossings, to name but one.

In the music space, this was our second year of Making Tracks, and it’s put us squarely in the music diversity space. So 55 percent were for mainstream audiences, 45 percent for the alternative audiences, who are really looking for the rather different and diverse songs. We funded 143 tracks, and as at June last year we had a staggering 5.3 million spins on YouTube and Vimeo—way more now, of course.

Radio New Zealand—we continue proudly to support and fund Radio New Zealand, our No. 1 radio station. This last year we were really pleased to have added a new scheme with Radio New Zealand, and we partnered in a terrific new youth website. I don’t know if any members have had a chance to go online and look at it. And just last week it was announced as a best web finalist in the Canon Media Awards. So that’s terrific.

Captioning—we were very busy this year because we transitioned—my chief executive was very much involved in this—captioning and audio description out of the in-house Television New Zealand division to a stand-alone charitable trust called Able, and we think that’s a terrific development. We also are hopeful it may lead to operational savings and additional funding streams.

Māori and Pasifika strategies—we completed those this year, and we saw some great content delivered to these audiences. The Factory was the world’s first web Pacific musical, and that was a hit. And the second series of Songs from the Inside on Māori Television was nothing short of inspirational.

Collaboration continued to be a main theme this past year, as we discussed last year, and we’ve worked with a number of other agencies, whether it be
in the screen, music space, to look at ways of maximising opportunities and resources. Just one initiative was the joint documentary fund we launched with the New Zealand Film Commission last year.

Administration—we remained, as I committed to this committee last year, we would continue to be lean and mean, and our costs were less than 2.5 percent of our revenue, so I think that was a very good result.

Awards—it is icing on the cake when we get awards, and a number of our NZ On Air-funded artists received awards last year. And we were delighted overnight to learn that Mind the Gap, the documentary some of you may have seen, and the drama The Blue Rose won Gold and Bronze awards at the New York Festivals International Television & Film Awards overnight—so great success for local content. Real Pasifika, which is a Pasific cooking show, was a finalist, so well done to them too to achieve that status.

So, in closing, really, I suppose, our assurance to you as the select committee is that we are very conscious of our privileged role to champion local content in the sea of global. We are grateful for the support of all political parties as we certainly do our very best to try and ensure that New Zealanders can enjoy diverse, relevant local content, and we do believe that this past year we travelled a long way to succeeding in those objectives. So thank you, Mr Chair.

Young Thank you very much and good to hear that report and also the fact that you are facing all the transitional changes in technologies and responding to that very adequately. So congratulations on that. We’ll come to some questions now from members of the committee.

Genter Thank you very much for your presentation. I have some questions about the amount of funding for national television, public radio, and documentary. All those declined from last year to this year. I was just wondering if you could speak to some of the reasons for that. Were there fewer applications for funding or was there less money available to be allocated to national television and public radio?

Wrightson I’m not sure I understand the question.

Wrightson The level of funding that we had was constant. The amount of funding that went to our services was reasonably consistent with the previous year. So I wonder if you might be a bit more specific about where you’re referring.

Genter So I see that in financial year 2011-12 there was $86 million spent on national television. That was $80 million last year. Regional television declined slightly. Public radio declined very slightly. But given that the costs, I would imagine, of production are somewhat inflating, it would have been a real cut.

Wrightson That’s right. We’re absorbing costs as they fall. Our baseline has been frozen for some 7 years. We are looking for efficiencies very assiduously these days. So the fact that we’ve managed to maintain funding levels has
been really a result of looking carefully for efficiencies and making sure that every aspect of our funding is entirely defensible in a very constrained financial environment.

Genter

In the coming year are you anticipating further difficulties with frozen levels of funding?

Wrightson

I think every Government agency is under the same pressure as us.

Cosgrove

Hold on. Help is on the way.

Faafioi

Just a supplementary on that—the figures that Julie Anne was mentioning around television and radio, are there production reasons for that or is that because you're transitioning to other platforms that you want to focus more on, like digital? I'm just basically after an explanation as to why you've seen television go from $86 million to $80 million and regional television from $2.1 million to $1.8 million and so on.

Wrightson

Um, yes. When we undertake new initiatives we have to clearly do it from existing baselines so, as the chair said, we are looking at—we have always looked to go where the audiences are, so as we slowly increase the amount we make available to things like digital media funding, it comes from other services, no question.

Faafioi

Welcome, first of all. We are 5 months out from an election, and roughly this time out from the election we had an issue with a board member, and you talked about the work that the governing board had done in the last 12 months. There was a problem with one board member who questioned the timing of what he thought was election programming. Since then has the NZ On Air board or management come up with a policy to try and make sure that kind of thing doesn't happen again?

Dean

May I answer that? There's probably a couple of points. One, we have a new chair, and I am very strong on ensuring probity, avoiding conflicts of interests, and I think had quite a lengthy discussion with Mr Cosgrove on that at the last committee hearing.

Faafioi

He always is helpful.

Dean

Our conflicts policy—well, there is a couple of things. One, of course, we have since changed our model and a lot of the funding decisions are now delegated to staff, so less funding decisions actually come to the board. There is a strong conflicts policy, which prevents any board member from being involved in anything, whether it be a real or perceived conflict. Thirdly, in terms of timing of programming, that, of course, is for the broadcaster, and that is not a space where we will go. So I am confident there will not be a repeat of what happened a couple of years ago when I was not at the board table.

Faafioi

So can I just be clear as to what will not happen again? Are you clear that there won't be the issue—I mean, concern raised from NZ On Air—or are you confident that there won't be election-type programming funded by NZ On Air screened very close to an election?
Dean We will follow the legislation. The legislation provides for a period, or a window, when a particular programme cannot be shown, and that’s what we will ensure is followed. But we cannot otherwise interfere with when a broadcaster chooses to broadcast a particular programme. But Jane may well be able to speak to that.

Wrightson We don’t take the election year issue as a funding criteria at all. Talking of documentaries, for instance, we don’t even know what the documentary’s going to say at the time of funding.

Faafoi I guess, can I put the question in a different way—have you spoken to broadcasters who may look for funding and said to them “What are your intentions around when you may show this?” close to an election period?

Wrightson No.

Dean No, and we wouldn’t.

Cosgrove So how do you operationalise? You say you’re confident. Could you explain to us how you will operationalise the management of potential conflicts of interest so that—take a repeat performance of last time around. Mr McElrea objected to a certain programme, because broadcasters could formulate programmes on all sorts of social and political issues. So will Mr McElrea be—will his views be sort of corralled somewhere? How will it work operationally, in practical terms?

Wrightson Mr McElrea 2 or 3 years ago asked a question, and as I discussed with the committee last year, any board member can ask any question they like. It’s perfectly fine. We don’t expect anything in our current suite of content to be a particular problem. We don’t have any problem with the broadcasters exercising scheduling decisions. There is no operational issue here.

Cosgrove So if you got your board members together and had a bit of a brief to say “Look, we had a difficulty last year, perceived or otherwise. If you hold certain views like that, it’s probably best to park them at the door, especially those of you who have close, indelible political relationships.”

Dean Specifically no, but generally yes, because our conflicts policy is very clear that a member must raise any real or perceived conflict, so that that would exclude that member from participating. My own view is that it is appropriate that any member leave their politics at the door, whatever those politics might be, and that they do not influence outcomes. It is important—

Cosgrove Have you conveyed that view to the board?

Dean Well, it’s conveyed through the policy, yes.

Cosgrove But you’ve said you have a very strong professional view. You’re the chair. Why wouldn’t you convey that and make it explicit as an additional safeguard?

Dean I have conveyed it in (a) the written policy, and (b) certainly some time ago when I came to the board I made very clear my views around conflicts.
Cosgrove: Given we’re 5 months away from an election and it may be appropriate for you at the next board meeting to re-convey directly to your board that so they’re very crystal clear.

Dean: Absolutely. To some extent I did do it at the last board meeting but just in very general terms.

Cosgrove: Will you give us that commitment that at the next meeting you will do that?

Dean: Yes, absolutely happy to remind board members of their responsibilities. I do believe they are all aware of them.

Curran: Can I just turn to the reappointment process of Mr McElrea as a board member, which I understand happened in December 2013. Were his political affiliations considered during that appointment process?

Dean: The appointment process is a matter for the Minister. I cannot speak to that, Ms Curran.

Cosgrove: Were you consulted?

Dean: No.

Curran: To your knowledge, is he still John Key’s electorate chair?

Dean: I believe so, but I have to say it’s not something that’s of particular consequence for me. He was placed on the board, as I understand, because he has considerable broadcasting experience. He also has an accounting background, and he is a very good chair of our audit and risk committee.

Curran: The context of this—and this does go to conflict of interest—is that there is currently a quite significant process happening at Television New Zealand around the affiliation of staff members to political parties. It would seem that in the context of an election coming up, this would be an issue. This is actually not a staff member; this is a board member. The reappointment happened in December last year. It was a very controversial issue just before the previous election. One would think that the status of a board member having a close personal relationship with the Prime Minister, being the electorate chair past or present or current of the Prime Minister’s electorate committee, and being a member of a political party would be issues that would be considered in terms of reappointment. Do you agree?

Dean: That’s a matter for the Minister. The Minister makes the appointments.

Bakshi: Have you received any complaint that the board member has used any facility of your organisation to promote the party or anything?

Dean: No.

Bakshi: No? Thank you.

Faafoi: It’s more an operational question off the question we’ve just had, but, given the episode we had roughly 3 years ago, does this in any way influence the kind of programming decisions you make? Because I could understand one point of view is that you may not want to go down this road again, because one of your remits is to make sure that programming is funded to spark debate—which I think is a good thing before an election period—but I
could understand that some members around the board table might not want to do that anymore.

Wrightson No. Again, we look at a range of criteria when we’re considering funding applications, and that is about the professionalism and competence of the programme maker, whether the idea is a good one, the kind of support it gets from a broadcaster, any kind of co-investment stuff—those are the criteria, not what the programme is going to say.

Faafoi OK, then just another supplementary. In that light, without giving too much away around the content, have there been applications or are you aware of other productions that will spark that kind of debate that will be aired before the election?

Wrightson I don’t think so, not in the current suite of programmes that are finished or nearly finished—not sure. Again, some of the documentaries are funded but I don’t know what they’re going to say.

Cosgrove Can I just ask you to go back, because in Hansard the Minister was asked in February 2012: “The board chair tells me he”—he, at the time, obviously—“has full confidence in his members. I have full confidence in the chair, and therefore the board.”

The question is this. Surely the background of an individual—certainly an individual that attracted some controversy last year because of his connections to the Prime Minister—would interest you, because that goes to the heart of any issue that may arise, as we all do, in terms of a conflict of interest. And if a board member’s background isn’t known to you and they’re promoting certain views, surely it’s your job to say “Hang on, I don’t think this is the space you should be in. You need to withdraw from this.” if they haven’t used their professional—but the same thing happens round this committee table. Where we have conflicts, we have to declare those, and it’s out in the open and our questions are coloured by them. So when you say you’re not aware of the status of Mr McElrea, shouldn’t you be aware and shouldn’t you have asked him?

Dean Sorry, it is certainly my policy to ensure any board member does not take part in any decision if he or she has a real or perceived conflict.

Cosgrove And how do you define that?

Dean If I considered that Mr McElrea had a perceived conflict, even—not a real but a perceived conflict, even—as a result of his political role, then I can assure you I would be very clear that Mr McElrea should not participate in that decision. What I can say is in the last year we have had no matters where he has needed to conflict himself, apart from—I think it was a series about animal veterinary science and he had a relative who was involved in the programme. So I do recall that was the one specific instance where he was precluded.

Cosgrove So a broadcaster may seek funding for a highly politicised programme to be broadcast within the months or weeks leading up to an election. I assume then, on any particular political party, but let us just say the Government—
then I would assume that you would ensure that Mr McElrea took zero part in that decision. Would that be a correct assumption?

Dean If I considered, as a result of his political role, that that could amount to a real or perceived conflict, yes.

Cosgrove So in the same way as the broadcast last time—I think from memory—was about criticisms direct or indirect of the Government’s social policy and Mr McElrea did voice a view, you would expect that that wouldn’t happen again, because it turns to a definition of what may be, if you like, bluntly critical of the Government in a lead-up to an election.

Dean I wasn’t involved last time, and as I understood it, it was a rather slightly different issue because it was a question that was raised around the timing of a show not in relation to a funding decision. So I’m—

Young Well, this has been raised for three financial reviews in a row—this issue.

Dean I’m not across it.

Cosgrove And the reason it’s been raised—the chair’s right—is because we’re now back into an election year and we wouldn’t want to see undue influence besmirch the reputation of your organisation.

Dean Absolutely. And can I just add one point, though, that, as I said, I come back to the fact: we’re a board of six and no one member can actually determine the ultimate outcome of a funding decision, in any event.

Cosgrove But you only have one member with an intrinsic and close relationship to the Prime Minister. That in itself can provide pressure and influence.

Bakshi Before I start my own line of questioning, just going on from where my colleague left, is there any other incidences you can highlight where other board members had any conflict of interest, in your past experience?

Dean I think the only conflicts we’ve had in the past year, and I can only just do my best to bring to mind, is where a member has had a relative or a close colleague involved with, say, a production company. So yes. One very recent example? Donna Grant—we precluded her from a recent funding decision because one of her cousins was involved in the particular funding application that became before us.

Cosgrove But she declared that.

Dean Absolutely. And that’s the sort of—they’re fairly rare—but those are the sorts of conflicts that are normally registered.

Bakshi So it does happen that sometimes board members have got conflicts of interest and they declare it and they’re precluded from—

Wrightson And I might also add that the process operationally, how it works is that when the application comes in, the executives involved, who are fairly well aware of the various issues swirling around every single application will, firstly, identify a potential conflict. We will then preclude those papers going to the potentially conflicted member and ask the board to make a decision on the day. So there’s quite a number of steps and balances in the system to
make sure that conflicts of interest are addressed in a very conservative way in our organisation. I can tell you that.

Young Right. You have reported that to us in previous financial reviews. Thank you very much for reiterating that.

Bakshi My question is that you mentioned that you have funded about 150 new music tracks. My question is that the success of “Royals” on the international charts—and there are many youngsters, teenagers, who have got a lot of talent. So have you got any particular plans for the future to fund those teenagers to show their ability, first of all? And second thing, on the diversity front, are you looking at the changing scenario of New Zealand as Hindi has become the fourth most spoken language? So do you have any plans for the ethnic community to fund their musical talent?

Wrightson That’s a very good question. When we changed the music funding system some 2 years ago, we made a major strategic change from focusing exclusively on commercial radio, which, of course, has a reasonably narrow brief, to looking at diversity in popular music. They’re none the less looking for platforms and audiences, no question about that, but the range and diversity of funded music has changed exponentially since then. We can fund only around one in four applications that come to us. The decisions are made by an industry panel of six or seven, not us. One staff member has a vote; the other industry people, in essence, take the day. We’re not generally looking at non-English music at the moment, but we could. There’s nothing to stop it. It would depend whether the panel, firstly, thought it was good music and could find an audience.

Bakshi So what is the plan for your next year? How much funding are you looking for? How many tracks? Is there any particular allocation for that?

Wrightson The allocation will be roughly the same for the next year because we expect our income will be roughly the same.

Faafoi With the model changing of how we get music out there, what kind of partnerships are you working towards, because you can do it much more efficiently than just NZ On Air, I guess, to promote a new artist, as well?

Wrightson Sure. Well our music work takes two forms, as you know. One is the direct funding of music and the accompanying music videos. The other is music promotion, and our job is to, in essence, raise the profile of New Zealand music, in general, and funded New Zealand music, in particular. So I have two and a half people working exclusively in this space at the moment, one of whom will be working the digital line extremely assiduously. So the plans are to focus, again, where the ears are and to ensure that New Zealand music is adequately promoted in all the major platforms.

Yang Yeah, I have a few questions regarding the strategy. If you look at the strategy, you have a digital media strategy, Rautaki Reo Māori, and Pacific Strategy. Similarly, TVNZ also has a focus and programme for Māori and Pacific but not necessarily for any other ethnic groups, like Asians. I was just wondering whether you have any particular programme, which would support Asian communities in New Zealand?
We do this through two ways. We don’t have a specific television programme at the moment and we consulted with the Asia New Zealand Foundation around this to see whether we thought there was active community support for it, and the answer is at the moment not so much, because clearly the Asian New Zealand audience is extremely diverse within itself. So we look at this in two ways. One is particularly in the language work we focus around our work in Access Radio, in particular, which is broadcasting in at least 40 languages at the moment and is a very efficient and effective medium to convey language material. The other is trying in our mainstream work to ensure that the range and diversity of New Zealand citizens are overall represented. So programmes like NZ Story and Both Worlds, which screen in prime time, look at a range of different kinds of New Zealand communities. The NZ Story that focused on Meng Foon, Gisborne’s Māori-speaking Chinese mayor was absolutely astonishing and, again, brought a story to mainstream New Zealand that would have been lost had it been off-peak or on another platform. So we’re trying to, in our work, reflect New Zealand identity and culture, and that, of course, means the range of identities and cultures within this country.

Secondly, another question regarding the funding application—I’m aware of a young man, a Chinese man from the Chinese community here. He has, it seems to me, a very good animation project, very ambitious. However he has no funding. So I was thinking about NZ On Air. I’m not sure how to do that. A small company, started when he was young—a group of young people. What kind of—

—yeah—customers and criteria do you have, briefly, for a successful

If it’s a television programme, it does need a broadcaster pre-sale, and that’s because we don’t want funded content to sit on the shelf and not get broadcast. We do find that when broadcasters are presenting finished projects that they’re not involved with, they generally don’t want them. So that would be a very bad use of public funds.

It’s potentially possible that he could look at the digital media fund, if it’s small and modest. If it’s a very large budget animation project, it would be difficult, as it would be for any applicant.

Somebody also asked about new New Zealand musicians as well, and I should have mentioned, we specifically catered for them through a website called theaudience, which enables anybody to upload a song and try and find an audience. If they find sufficient numbers, they’ll get noticed and then they can start entering the funding stream. So it’s a path for the new people as well as for the more established.

My question is a bit boring after all the political intrigue that you’ve been having to deal with.

Come on, you can lift your game. We know you can do it.

I’m actually a bit curious. I want to acknowledge, Madam Chair, that you are running a very lean and mean machine.
Dean Thank you.

Mitchell As you reported to us last year, that was one of your aims. I notice that you are co-located with the New Zealand Film Commission and the BSA, and you are sharing some backroom services with them.

Dean Yes.

Mitchell Can you just talk a little bit more about that, and whether that’s part of your ongoing plan in terms of cross-management?

Dean Perhaps if I just speak generally and then Jane can speak a little bit more operationally. At a general level, a very clear message from the board to management to collaborate with as many agencies as we can with the Film Commission—yes, we think it’s excellent we are now locating in the same premise. There may be opportunities for savings, but it’s also just having people in the screen sector space—TV, film—able to, sort of, interchange on a daily basis. That provides a good mix for new ideas, new projects. I’m really excited as board chair. I, with Jane, have met with Patsy Reddy and the new chief executive of the New Zealand Film Commission, Dave Gibson, and we’ve already had an excellent session really brainstorming what we might be able to do together as New Zealand Film Commission and NZ On Air to essentially continue to promote local content. Where might we share resources? Where might we do some joint funding initiatives? It’s constantly something we’re thinking about, and I think co-location just helps that environment. But, Jane, you might like to add anything from your perspective.

Wrightson There’s not too much to add to that. We’ve co-located with the BSA since our inception in 1989, and only quite recently have we agreed to share backroom finance services, which has been very beneficial for the BSA in particular, as a very small organisation. The co-location with the Film Commission, as the chair has said, is more about ideas generation than anything else, because all three agencies are small and fairly efficient in their backroom operations. We do think we will share some professional staff at some point. We are particularly looking around the research and insights area at the moment, with the Film Commission. We may be able to report some work on that next year.

Dean And may I just add, it’s not just with the Film Commission. Just recently we’ve actually launched a fund with TMP, calling for proposals for five web-based Māori series—two in Te Reo. That, we think, is another good collaborative initiative where we’ve come together—the benefit of joint funds—and we’ll go out and, hopefully, get five great series for Māori online.

Faafoi You mentioned earlier that you chased the eyes and the ears, and we had TVNZ in here earlier this year. They also chased the commercial dollar. You mentioned Blue Rose before—congratulations for the award. There is a bit of a tension here, I guess, when you have to work with commercial broadcasters to get the content on, and then, I think in the case of Blue Rose, it was shunted to a much later time period where you get fewer eyes. I guess
the content was a little edgier. So is there a frustration in terms of you being able to fund what we might describe as edgier content because the commercial broadcasters simply won't take it on board? And if they do take a risk, you take the risk of getting into the situation that you got into with Blue Rose.

Wrightson Firstly, Blue Rose screened in prime time, where it was meant to go, so I'm not quite sure what you mean by that.

Faafoi OK—I can be more precise and say it shifted time slots.

Wrightson It might have. I actually don't recall that, but it certainly didn't screen off-peak. More importantly, I think in effect you're describing why we exist, and this has been the case since day one. You know, we are an intervention mechanism with a job to look after a range and diversity of material that the market itself can't or won't provide. So you can be assured that there are reasonably robust discussions that go on about range of content and the kind of work that we want to see going to air. The broadcasters have their own pressures; so do we. None the less, each year we have managed to agree on a fairly stellar range of content.

Faafoi Do you think you do lack in—where you can run some edgier content where it isn’t necessarily the commercial imperatives that a broadcaster saying yes or no to the content?

Wrightson I think that’s a fair comment, particularly in this very difficult environment for broadcasters, but that’s the blessing of online. I think that the future will be on the digital platforms for this kind of material, I suspect.

Faafoi OK, so the figures we’ve got are saying you’ve well and truly dipped your feet in the water in the digital space. How fast will you move there? Are you going to lead it or are you going to be a fast follower, depending on what broadcasters and other media do?

Wrightson We’re going to make haste slowly. Fast follower is generally what we do. We like the market to take the risk first, so we don’t find any advantage from a public funding perspective of being first, particularly in techie areas, where there are very many dead bodies. So, in effect, as I said before, we follow the audience. As the online eyeballs and ears increase, presumably so will our funding.

Dean But the reality is that all the research we’re still getting from the UK, the US, television is where there are the greatest number of eyeballs, and that’s where you get the biggest bang for your buck. So it’s all a case of ensuring we don’t move away from television, but at the same time we just incrementally develop online while we wait and watch and see what the world is going to look like in 5 years.

Wrightson It was partly why we refocused the digital strategy 2 years ago. It was pretty open slather back in 2007 when we devised it, and it’s fair to say we had our trainer wheels on in that space as much as anybody else. But by the time we reviewed it in 2011, we then looked at it in the context of the other content issues and opportunities we had, and increasingly we will focus digital media
expenditure in particular on special interest audiences, I think, because they’re the ones least well-served by mainstream media.

Young In terms of the different platforms that you’re managing in terms of your funding, you mentioned being a fast follower. How are you managing the tension when, perhaps, a legacy platform is contested for funding that a more digital or portable platform is looking for funding for? Is that contestability actually driving change?

Wrightson Again, we don’t fund platforms; we fund content. That’s one of the absolute beauties of our model. It wasn’t quite intended back in 1989 that it would be able to encompass the internet but it’s managed it very well.

Young Yeah, but do people, when they make their application, say we’re going to maybe go multiple platform—

Wrightson Sure.

Young They’re informing you?

Wrightson We expect multiple platforms for all our funded content. But at the moment the television, the broadcast, the radio platforms are still delivering the biggest audiences.

Curran Just a wee supp question on that—is it a concern to you that TVNZ’s Ondemand service is only available on one brand of internet TV, given that it’s a State broadcasting entity?

Wrightson That’s a business issue for TVNZ. I’m sure they would want it on other brands as well.

Curran But I heard you say earlier today that your content should be available on all platforms because it’s publicly funded content. So if it’s—

Wrightson It’s available on the internet. That’s the point. If it only has an app on a particular screen, that’s a business issue. The point is it’s available online.

Curran But if I buy a Sony internet TV, then I can’t get TVNZ Ondemand at the moment.

Wrightson No, but you can get it on another device.

Curran OK, so that’s not a concern to you is what you’re saying to me.

Wrightson It’s a business issue for Television New Zealand.

Curran OK. So that means, basically, when you’re making your funding decisions and you say “Where are they going to be available?”, do they give you that information and say—

Wrightson They say they will be screening it on TV1 or TV2, and they say it will be available for a period on TV as TVNZ Ondemand, which is available on multiple platforms. If it isn’t available on a specifically branded television set, it’s a business issue for Television New Zealand.

Curran So that basically could become an issue for a group in the community that are buying internet-enabled televisions that aren’t able to get publicly funded content.
Wrightson They will still have internet access in another way, would be my guess. If they're buying an internet television, they'll probably also have a tablet or a Surface.

Curran OK. Thank you.

Faafoi I’m going to try and make sense out of this issue. You said before you fund content and not platforms—

Wrightson In general.

Faafoi —in general, but I’m trying to think—there are two relatively recent examples of, I guess, artists in New Zealand where they have done very well on the international stage, where they weren’t necessarily backed to the full by whether it be TVNZ or New Zealand On Air, not necessarily by decision but by their own choice, and they are the Flight of the Conchords and Lorde. So, I guess, do you want an outlet where it would be much easier for you to say, as New Zealand On Air, “We’re going to back you because, regardless of the ears and eyes watching, you’re a little bit edgier and we’re going to take a punt on you guys.”?

Because I just don’t think we’ve got that environment at the moment, with the commercial broadcasters saying “We don’t like it because it’s too edgy. We’re not going to air it.”, whereas you as decision makers for the funding might say “We think these are guys who’ve got talent.” but you can’t get anyone to broadcast it.

Wrightson I think there’s always a multitude of potentially good applications that can’t get through the funding door. I don’t think there’s been any change in that environment. As I said before, if there is interest in a particular artist or group, then the opportunities the internet affords—there’s much more of a positive aspect to their world than it would have been, say, 5 years ago. Television does take risks, but, frankly, every piece of content is risky. Edginess tends to be off-peak—it’s there. If you look at the Jono and Ben show, you’re not telling me that’s safe. So there are still opportunities.

Yang Back to your strategy—the digital media strategy—could you elaborate on new initiatives which are being funded through this digital media strategy?

Wrightson The digital strategy has three parts. We have specific funding available for digital media per se, and, as I described before, they’re largely focusing that towards content for special interest audiences these days or, indeed, small and cheeky little applications that might prove to be useful a bit further down the stretch. That’s the place for innovation at the moment. We absolutely require things to be significant investments to be on screens and we are looking to enhance the rights around funded content as best we can.

Faafoi Sorry, a supplementary to that—could we lessen the expectations around eyes and ears there to help you, though, to make it a little bit easier for you to make a decision around an application where you think it might go on a platform where there might not necessarily be so many eyes and ears but you want to give it a go?
Wrightson You could. You could, but it’s also quite a good business discipline, again in an environment where public funding is fiercely contested. You would still have to draw the bridge up at a reasonably high level, and potential audience size compared to potential funding requires quite a good discipline. If it’s a small amount of money and it’s a really good idea and somebody out there wants to put it on their platform, then often we can make that happen—that’s true. But if that really good idea is a multimillion-dollar one, probably a non-broadcast platform is a bad idea.

Yang So, given that digital media is going to be more and more influential—so, basically, you think you are going to increase the fund?

Wrightson Exponentially, over time, yes. Again, slowly but surely we will.

Curran I've just got a quick question, and that is around your—and that’s changing tack, is that all right?

Young Yep.

Curran Around your collaboration relationship with the range of organisations for which you either manage funding or have other relationships with, in particular, Te Māngai Pāho—and so my question is have you had a role in being consulted with, having discussions about, the future structure of Te Māngai Pāho into this proposed new structure that is in the Māori Language Commission?

Dean No.

Wrightson No.

Curran So what is your relationship with Te Māngai Pāho?

Wrightson They’re a fellow funding agency. They have a different job to do with us, so we’re careful to work in different spaces and then when we cross ground, it’s generally around funding joint ventures for projects that suit both our goals. But we’re largely in the English language space; they’re largely in Te Reo space.

Curran Yes, and I understand that. So in terms of them changing the structure and perhaps not existing anymore and becoming something else, how then would that affect you?

Wrightson Relatively little effect, I suspect, presuming that an organisation over here is still looking after Te Reo in broadcasting matters, which is not our fundamental job.

Curran So, just to clarify, you haven’t been asked for or offered any views, had any discussion about, the future structure of—

Wrightson No.

Curran —the Māori Language Commission and any structures within that? Cool. Thank you.

Young In terms of the community out there who seeks funding, in the last particular—you know, the diverse community of broadcasters—the number has reduced back a little bit in terms of we’ve noted the volume of
applications has come back slightly in 2012-13. There have been fewer applications. Do you have any understanding, any reasons for that slight decline?

Wrightson I’m not sure where you’re getting that figure from. Can you refer the page? We’re not noticing any drop-off. It might be a fluctuation, but I’m not quite sure which figure you’re referring to.

Young Well, we have been informed that there were fewer applications for funding. Is that not correct?

Wrightson I don’t think so, but I’d need to check.

Young Right. We’ll check on that, too. Thanks.

Faafai We’ve got a little bit of time available. I just want to ask about regional TV, and not necessarily about your funding but the state of it, because I’ve spoken to a number who feel they’re up against the wall at the moment since the digital switchover. Have you had discussions with the body, or individuals out there who are running stations, about what state they’re in and how close some of them are to falling over? Because I personally think they’re quite important to the communities they operate in and it would be a shame that they weren’t able to exist because of the technology switchover that’s happened recently.

Wrightson My community broadcasting manager is in constant contact with them. We only fund one programme for each eligible station, and we focus that now on regional news and information as a market gap—a clear market gap. There’s no doubt about it that running a regional television business is very hard in a country of 4 million people, and this will always be the case.

Faafai Is it an issue that is coming across your table as a wider issue, as opposed to just individual stations, about how they may start falling over?

Wrightson Personally, I’m a bit torn with this because you do wonder why “Television is the most expensive medium.” is the right answer any more. It may be that online options are better. I’ve absolutely no idea, but it’s always been a hard road for them. Most of them manage extremely well on extremely slim resources. It’s difficult, yes.

Faafai OK. Thank you.

Young All right. Thank you very much.

Dean Thank you.

conclusion of evidence
2012/13 financial review of the Broadcast Standards Authority, the Electricity Corporation of New Zealand Limited, the Government Superannuation Fund Authority, the Guardians of New Zealand Superannuation, the New Zealand Productivity Commission, the New Zealand Tourism Board, Public Trust, the Real Estate Agents Authority, and the Standards Council

Report of the Commerce Committee

The Commerce Committee has conducted the financial reviews of the 2012/13 performance and current operations of the Broadcasting Standards Authority, the Electricity Corporation of New Zealand Limited, the Government Superannuation Fund Authority, the Guardians of New Zealand Superannuation, the New Zealand Productivity Commission, the New Zealand Tourism Board, Public Trust, the Real Estate Agents Authority, 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
2012/13 financial review of Callaghan Innovation

Report of the Education and Science Committee

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Callaghan Innovation

Recommendation

The Education and Science Committee has conducted the financial review of the 2012/13 performance and current operations of Callaghan Innovation and recommends that the House take note of its report.

Introduction

Callaghan Innovation is a new Crown agent, which was established in the year under review. Before 1 February 2013, many of the functions of Callaghan Innovation were conducted by Industrial Research Limited (IRL), which now exists as Callaghan Innovation Research Limited, a subsidiary of Callaghan Innovation. The purpose of Callaghan Innovation is to accelerate commercialisation of innovation by firms in New Zealand, particularly in the high-value manufacturing and services sector. During the five months ended 30 June 2013, Callaghan Innovation received $76.39 million in revenue, and made a profit after tax of $2.83 million. The Office of the Auditor-General assessed Callaghan Innovation's management control environment and its financial information systems and controls as very good.

Establishment

Callaghan Innovation spent much of the period under review establishing itself. This involved recruiting a chief executive, developing its organisation design, and deciding which components of IRL to retain and which belonged elsewhere in the research system. We heard that Callaghan Innovation had its initial business case and Statement of Intent approved for the five months to 30 June 2013. A three-year business case, which was with the Minister at the time of our hearing, was released in December 2013.

Callaghan Innovation has focused on three areas of work: delivery of specific services, motivating an innovation culture in New Zealand, and aligning the structure of the organisation to its mission. Callaghan Innovation seeks to build relationships with businesses and other research organisations in the manufacturing sector. It has negotiated memorandums of understanding with UniServices (the commercialisation arm of the University of Auckland), Lincoln University, the MacDiarmid Institute which is hosted by Victoria University, Scion, and KiwiNet. It hopes to eventually conclude memorandums of understanding with all the major universities and research institutes.

We heard that Callaghan Innovation is negotiating about the possible transfer of groups of researchers to the universities. At the time of our hearing, no final agreements had been signed with universities. Callaghan sees its role as harnessing the research expertise throughout New Zealand, and ensuring that businesses can access the expertise they need. It said Callaghan has no need to employ specialist researchers itself.

We were interested in the proportions of technical, science, management, and administrative staff employed by Callaghan Innovation, compared with IRL. We heard that at its establishment in February 2013, there were 385 permanent and 45 temporary employees. Of the permanent employees, 13 were administrative or management, 281 were operational, and 91 were support and corporate staff. In the next 10 months to 30
November 2013 staff numbers in all three areas declined, mainly from resignations and redundancies. Of the 365 permanent employees as at 30 November 2013, 8 were administrative or management, 271 were operational, and 86 were support and corporate staff, with an additional 43 temporary employees.

**Contestable funding**

In its statement of intent, Callaghan Innovation signalled that it would not be participating in the contestable funding process beyond the 2013 round as it is not appropriate for the organisation. IRL submitted 16 proposals to the 2013 Ministry of Business, Innovation and Employment investment round, and Callaghan Innovation described itself as the receivers of the outcome. It was successful with only one proposal, worth $1.8 million, leaving a funding shortfall of $4.3 million. Callaghan Innovation had identified the potential loss of $6.3 million in funding coming off contract at the end of the contestable funding round as its greatest financial risk. However, Callaghan told us that there was no shedding of capability as a result; some researchers were redirected from contestable funding projects into near-market product development work. Callaghan is refocusing its own research and development on product development and the near-market research needs of businesses.

**The FoodBowl**

One of Callaghan Innovation’s main operations is the FoodBowl, a facility where companies can produce commercial runs of new products for trial marketing and thus capitalise export opportunities. Auckland Tourism Events and Economic Development (ATEED) established the FoodBowl, but Callaghan Innovation took a two-thirds ownership stake in the organisation to seek efficiencies in areas such as maintenance and insurance contracts.

Under the agreed conditions of Callaghan Innovation’s participation with ATEED in the FoodBowl, its work was focused on client engagement, efficiency and effectiveness, relationships with other public-sector entities, options for expanding beyond the pilot plant, industry engagement, awareness, and addressing the capital constraints on enterprises that use the facilities.

The FoodBowl also offers equipment providers a place to showcase their equipment, something that an individual firm could not generally afford itself. Callaghan suggested that similar capability-building investment could be made in the pharmaceutical industry. We look forward to the results of such initiatives.

**Better by Lean**

We are aware that Callaghan Innovation has picked up the business improvement training programme Better by Lean, which was previously run by NZTE. It provides training to help businesses eliminate inefficient processes and activities, and thus improve their performance and customers’ satisfaction. We heard that 32 firms have already undertaken the training. “Lean clusters” have been formed in a number of regions, providing a forum for businesses to learn from each other, and share insights, and to ensure sustainability. Callaghan told us that it intends to run more training programmes in areas such as development capital, funding, and marketing, to help firms capitalise on their innovation.

**KiwiStar Optics**

KiwiStar Optics, a division of Callaghan Innovation, provides a system for designing and manufacturing optics and their mechanical housings, and the assembly and precision
alignment of optical systems. We heard that Callaghan Innovation has engaged a third-party investment management firm to seek potential buyers for the company. It expects a recommendation as to a suitable buyer by the end of 2013.
Appendix

Approach to this financial review

We met on 4 December 2013 and 12 February 2014 to consider the financial review of Callaghan Innovation. We heard evidence from Callaghan Innovation 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
Simon O’Connor
Grant Robertson
Dr Megan Woods

Evidence and advice received

Callaghan Innovation, responses to written questions, received 2 December and 20 December 2013.

Office of the Auditor-General, Briefing on Callaghan Innovation, dated 2 December 2013.

Organisation briefing paper, prepared by committee staff, dated 2 December 2013.
2012/13 financial review of the Canterbury Earthquake Recovery Authority, and of the non-departmental appropriations for Vote Canterbury Earthquake Recovery

Report of the Finance and Expenditure Committee

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Canterbury Earthquake Recovery Authority, and the non-departmental appropriations for Vote Canterbury Earthquake Recovery

Recommendation

The Finance and Expenditure Committee has conducted the financial review of the 2012/13 performance and current operations of the Canterbury Earthquake Recovery Authority, and of the non-departmental appropriations for Vote Canterbury Earthquake Recovery. It recommends that the House take note of its report.

Introduction

The Canterbury Earthquake Recovery Authority (CERA) was established in March 2011 as a government department to plan, lead, and coordinate the rebuilding and recovery effort after the earthquakes in Canterbury. CERA’s governing legislation, the Canterbury Earthquake Recovery Act 2011, has a lifespan of five years, to April 2016.

As well as receiving funding for its own operations, CERA monitors a very large amount of earthquake-related spending for which the Minister of Canterbury Earthquake Recovery is responsible. We have combined our financial review of CERA with that of such non-departmental appropriations.

We plan to carry out a separate financial review of the Earthquake Commission early in 2014.

Financial and service performance

CERA recorded a total income of $63.593 million in 2012/13, and expenditure of $44.505 million. The net surplus of $19.088 million was returned to the Crown. The main variance from budget was in fees for consultants and contractors, which were $15.5 million lower than expected, as recruitment was deferred until the cost-sharing agreement with the Christchurch City Council was finalised, which took longer than planned.

The Office of the Auditor-General assessed CERA’s management control environment and service performance information, systems, and controls as needing improvement—as it had the previous year. The grading for financial information systems and controls has improved to “good”.

We note that the Auditor-General’s grades and associated comments aim to highlight areas for improvement. They are not an assessment of CERA’s overall management performance, nor of its effectiveness in achieving its objectives.

Organisational challenges

We are grateful for the work CERA is doing, and aware of the pressure it operates under as the central agency for a massive multi-faceted recovery effort. It has had to build its organisation and systems from scratch since 2011, and to deal with extraordinary, evolving challenges as it moved from initial emergency response to recovery and rebuilding. It is perhaps understandable that its controls, systems, and information have not yet reached the
standards expected of public-sector entities. Nevertheless, we expect it to act on the Auditor-General’s recommendations.

We place particular importance on CERA’s governance capability, given its central role and the very sizeable amounts of non-departmental expenditure it is responsible for monitoring on such key work as the restoration of horizontal infrastructure and the central city anchor projects. We have some concern about whether it has the necessary expertise and arrangements to coordinate the next stage of the recovery to minimise risks and avoid bottlenecks, as rebuilding will inevitably place pressure on available resources.

**Staffing and recruitment**

Having started with 50 staff, CERA had 300 employees at the end of June 2013, on a mixture of secondments and long-term and short-term contracts. Its annual report highlighted the need for more capacity to manage key projects. We understand it has lost several staff since June, and has had problems recruiting and retaining staff, including key positions in risk management and assurance. We realise such difficulties may worsen as CERA approaches the end of its planned lifespan, and asked whether it believes it has the capability to manage the work ahead of it.

CERA acknowledged that it has many vacancies at present, but says it has been more successful than it expected in recruiting staff with project management skills for rebuilding the central city, with several appointments since the annual report was published. It is seeking a balance of specialist skills and knowledge of the local community.

**Legacy planning**

As the Canterbury Earthquake Recovery Act will expire in April 2016, we would expect CERA to cease to exist after this date, and consider it very important to plan for its legacy. For accountability, it will be important that the goals it is committing itself to now can be adopted and pursued by other organisations. We asked how a smooth and effective transition is being planned. The chief executive said it is early for such thinking, and the Government has not yet made any decisions about CERA’s legacy. He noted that the expiry of the Act will not necessarily mean that CERA itself will cease to exist. However, he agreed that planning will be needed, as work on reconstruction will clearly continue after 2016. He observed that some work could move to other agencies such as Environment Canterbury, the Christchurch City Council, and Ngāi Tahu.

CERA has agreed to provide us by next year’s financial review with a clear plan for arrangements beyond 2016 so we can examine this issue more closely.

**Central city rebuilding**

CERA’s annual report notes several significant achievements during the year toward the rebuilding of the city centre, including removal of the cordon that had restricted public access. The Christchurch Central Development Unit within CERA was set up in April 2012 to develop a central city recovery plan and blueprint, and coordinate rebuilding work. The plan includes 17 “anchor” projects for the central city, and the Government and Christchurch City Council agreed during the year on the funding each will contribute.

We see the anchor projects as an important catalyst for the city’s redevelopment, but also as high risk. Careful governance and monitoring of the overall programme will be vital to coordinate the demands on resources and avoid undue cost pressures, or the crowding-out of residential rebuilding activity. We understand that CERA has been working with the
Treasury to develop business cases for the projects, and were told they have been completed for those where work is commencing—the Avon River precinct and the bus interchange—and are under way for several others. We believe it would be beneficial to have a business case for the programme as a whole, not just for individual projects; we understand that the State Services Commission has also advocated this. We intend to follow up progress with business cases at our next review.

Some of us consider it important that planning should try to ensure that all New Zealanders benefit from the rebuilding effort, since all taxpayers are contributing to it. For example, jobs in the forestry industry would benefit if timber construction was favoured. CERA told us that the anchor projects have not yet reached the stage of considering construction materials, but it noted that private builders report more use of timber, as it fared better in the quakes.

CERA told us it has consulted the community closely over the Avon River precinct and the metro sports facility, and will be doing so for other projects, but is trying not to overload the public by seeking feedback on everything at once. Some of us remain concerned that the Government has committed $284 million for the convention centre precinct but has yet to develop a business case or seek the community’s views.

We note that construction costs in Canterbury are already increasing at about 10 percent a year, well above the national average. CERA said that cost pressures are unavoidable, and likely to increase, but it is trying to plan work to minimise bottlenecks as far as possible.

**Timing of anchor projects**

The first two projects to be developed will be the Avon River precinct and the bus interchange. Work has started on removing silt from the riverbed, which will help to counter the rise in water level caused by the earthquakes. Most of the work on the river precinct will be done in 2014, with completion expected in the second quarter of 2015. A family playground will be completed in late 2014. No funding has yet been appropriated for developing a riverside park, but we are hopeful it will be forthcoming in view of strong public support. We heard that the principal structures will be located on the south bank and near the convention centre, with less substantial work elsewhere to help return the river to a natural state.

The bus interchange is a high priority. Work is expected to start in early 2014 and finish in 2015. Work on the East Frame, a residential development inside the central city, is also expected to begin early in 2014. Expressions of interest are currently being sought from developers.

For the convention centre project, which could include hotel, restaurant, and shopping facilities, the Government has been exploring commercial partnership options; five consortia have expressed interest, and it plans to choose one by mid-2014, with the aim of having the complex open in the first quarter of 2017. A preliminary business case has been prepared, but final plans will need to be developed with the consortium partner.

Work on the planned justice and emergency services precinct will begin in early 2014, with construction over three years. Development of a health precinct is being led by the private sector, which is showing strong interest. Design concepts are now being sought for a sports facility, with completion expected in 2017. A stadium development will be a later project, probably opening in 2017.
Private sector investment

We note that the anchor projects were selected on the basis that they are likely to prompt related developments by private investors, and asked how much interest is being shown. CERA told us there has been no great capital flight from Christchurch; large businesses in the city before the earthquakes such as the Hotel Grand Chancellor remain committed to rebuilding.

Preservation versus replacement

Some of us are concerned that the blueprint for the central city has resulted in some buildings being demolished, apparently because their location did not suit the plan, when they could have been repaired. The central library seems to be an example, and some of us are also concerned that the replacement building will entail a significant element of betterment. CERA told us that structural damage is not always visible, and the library had sustained substantial damage. The chief executive acknowledged that in some cases repairable buildings had been demolished, but said efforts had been made to retain existing large buildings when designing the blueprint. He undertook to try to provide us with information about the relative costs of repairs and rebuilding; we were subsequently told that CERA does not hold such information.

Horizontal infrastructure

Work is well advanced on restoring roads and underground pipes for fresh water, stormwater and waste water (“horizontal infrastructure”). Completed repairs to 30 June 2013 included 59 per cent of the water supply, 43 per cent of storm water and 29 per cent of waste water drains, and 18 per cent of roads. The repairs are being managed by SCIRT,¹ an alliance of CERA, the Christchurch City Council, the New Zealand Transport Agency, and five private contracting companies. CERA told us that the work is being timed to fit in with the central city anchor projects and major private developments. It expects the repairs to be completed by the end of 2016.

This is one of the largest and most important parts of the recovery effort. The infrastructure is vital for basic health and social wellbeing, movement around the city, and its economic development. The total cost has been estimated at $3 billion, of which the Crown has agreed to fund $1.8 billion and the Christchurch City Council $1.14 billion. We note, however, that this estimate is still highly uncertain, as the extent of damage often cannot be known until repairs are begun. The audit report on the non-departmental financial statements includes an “emphasis of matter” paragraph to this effect, pointing out that the Crown’s liability for such costs could change.²

A performance audit report by the Auditor-General was published the day after our hearing with CERA, commenting on the effectiveness and efficiency of arrangements for the repair of horizontal infrastructure. We will report on it separately to the House. We expect CERA to consider the Auditor-General’s recommendations carefully, and to act on them.

Residential areas

We heard that the pace of progress on residential repairs and rebuilding has picked up, with the residential construction rate now 50–60 percent higher than it was before the quakes.

¹ The Stronger Christchurch Infrastructure Rebuild Team.
² CERA, Annual Report 2013, pages 15, 61, and 72.
CERA noted that this pace will need to increase by half again if insurers are to meet their aim of completing work by 2016, but its discussions with the insurance industry indicate they are confident of achieving this ambitious goal.

By the end of the financial year, 6,379 residential properties in the residential red zone had been settled, and 2,409 demolitions completed. As more people than expected chose to have the Crown purchase the land only, and settle with their insurers over the property, CERA undertook only 50 of the demolitions in 2012/13, with the rest undertaken by insurers. CERA said it hopes to see demolitions in Canterbury’s flat areas completed by April 2015.

We discussed the situation in the Port Hills area, and of Redcliffs School which faces another year on a temporary site while it awaits geotechnical data on the stability of the cliffs behind its original site. CERA agreed the delays have been far from ideal, and understands the stress and frustration felt by Port Hills residents over changes in land zoning as geotechnical information has been updated. It noted that the state of the roads in hill areas makes even demolition work impossible.

**Community wellbeing**

CERA works with several agencies to promote the wellbeing of the community in Canterbury. From the regular surveys it commissions, it believes people are generally coping well, but some still find life very difficult, so CERA is trying to concentrate on helping them. It funds 60 earthquake support officers in the community, and in the past year has set up a residential advisory service to help with insurance problems. A winter programme offered residents help with weathertightness problems, and in summer a series of “parties in parks” aims to lift morale. It noted that overseas observers and the Red Cross have commented favourably on the amount of community support it coordinates.

**Non-departmental appropriations**

The Minister of Canterbury Earthquake Recovery is responsible for a large amount of earthquake-related expenditure under several non-departmental appropriations, which CERA monitors on behalf of the Crown. Details are provided in its annual report. They include the cost to the Crown of acquiring red-zoned properties, purchases of land for anchor projects in central Christchurch, and contributions to local authorities’ costs for restoring horizontal infrastructure. The independent auditor has drawn attention to the considerable uncertainty about these non-departmental expenses, and hence about the Crown’s liability.

As in previous years, actual spending differed greatly from estimates. Several appropriations were significantly underspent in 2012/13, with actual expenditure totalling $533.8 million against appropriations of over $2.2 billion. (In 2011/12, appropriations were considerably exceeded.) The following were the main causes of the underspending:

- Under a cost-sharing agreement with the Christchurch City Council, the Crown’s exposure for water infrastructure repair and rebuilding costs was reduced. Expenditure for this purpose totalled only $239 million in 2012/13, from an appropriation of $985 million.
Appropriations of $202 million to acquire residential properties in Canterbury’s red zone, and $8 million for land remediation work, were not required in 2012/13; future requirements will depend on the resolution of the remaining zoning issues in the Port Hills.

Only $100.9 million of a $716-million appropriation to purchase land for the central city anchor projects was spent in 2012/13, as negotiations took longer than expected. We also note that unappropriated expenditure was incurred of about $10 million. While such sizeable variations against budgets, and unappropriated spending in particular, are always a cause for concern, we accept that the earthquakes have created unusual circumstances that make estimates particularly difficult.
Appendix

Approach to financial review

We met on 13 November 2013 and 29 January 2014 to consider the financial review of the Canterbury Earthquake Recovery Authority, and of the non-departmental appropriations for Vote Canterbury Earthquake Recovery. We heard evidence from the Canterbury Earthquake Recovery Authority and received advice from the Office of the Auditor-General.

Committee members

Paul Goldsmith (Chairperson)
Maggie Barry
David Bennett
Dr David Clark
John Hayes
Hon Shane Jones
Dr Russel Norman
Hon David Parker
Rt Hon Winston Peters
Jami-Lee Ross
Hon Kate Wilkinson

Evidence and advice received


Organisation briefing papers, prepared by committee staff, dated 11 November 2013.

Canterbury Earthquake Recovery Authority, responses to committee questions, dated 11 November and 18 December 2013.
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Careers New Zealand

Recommendation

The Education and Science Committee has conducted the financial review of the 2012/13 performance and current operations of Careers New Zealand and recommends that the House take note of its report.

Introduction

Careers New Zealand is a Crown agent established under the Education Act 1989. It changed its name from Career Services to Careers New Zealand in August 2011. Careers New Zealand’s objectives are to build the capability of others to provide careers advice, and to provide career support services, especially self-help and online services.

Careers New Zealand’s total revenue for 2012/13 was $15.46 million, a decrease of 1.3 percent from the previous financial year, reflecting lower revenue from non-Crown sources. It had a surplus after tax of $486,000.

Performance Improvement Framework

Careers New Zealand was subject to a Performance Improvement Framework review of its fitness for purpose and its ability to meet future needs. It was assessed as needing better engagement with staff and increased engagement with key stakeholders.

The review recognised the value of the Careers New Zealand website as a source of trustworthy information for career decision-making. Careers New Zealand said that budgetary constraints limit its marketing of the website; we agree that it should seek to increase the number of visitors to the website. Some of us are aware that students using the website have found it unhelpful in determining what subjects they should study, or what tertiary institutions they should attend.

We were surprised to learn that Careers New Zealand does not conduct rigorous evaluation of its IT services and products, and asked how the organisation decides where to direct funding when it cannot determine the success of its existing products. Careers New Zealand can count the number of visitors to its website, but acknowledges that more sophisticated evaluation tools and programmes are desirable.

Change to delivery model

Careers New Zealand has changed its delivery model, moving to more online services and less one-to-one mentoring. It told us it is still seeking the right balance between physical and digital interactions, and we were pleased to hear that face-to-face interaction will not cease completely.

Careers New Zealand is reviewing the qualifications available for career advisors, with a view to setting consistent qualification standards. We discussed the possibility of licensing careers advisors to work in communities rather than schools, ultimately on contract to Careers New Zealand. We will watch with interest any developments in this area.
Schools and community engagement
Careers New Zealand works with low-decile schools, and those with low achievement rates or high attrition rates, to run career development programmes for their students. It has developed Career Education Benchmarks, which are self-review tools for career education, seeking to ensure a consistent national approach to career education.

Careers New Zealand has also been trying to build awareness of its services in the community, for the benefit of young people outside the school system. The organisation is running a pilot programme on career options with Pacific Island community groups in Auckland. It is also developing resources to improve understanding of the labour market in the Canterbury region, and intends to roll this programme out nationwide if this proves successful.

Interaction with stakeholders
Careers New Zealand seeks to maintain a healthy working relationship with other government agencies and employers. It has also sought to improve its relationship with industry training organisations, iwi, and employers to help predict labour demand. We heard a suggestion that industry groups might contribute funding to Careers New Zealand in exchange for emphasis on career opportunities in their sector.

Engaging with the Ministry of Social Development
Although its priority is delivering careers advice to young people, Careers New Zealand also seeks to assist the unemployed, the underemployed, and people keen to change career. We heard about its complementary work with the Ministry of Social Development in this area. Careers New Zealand also works with the ministry to train front-line workers.
Appendix

Approach to this financial review
We met on 19 February and 19 March 2014 to consider the financial review of Careers New Zealand. We heard evidence from Careers New Zealand 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
Simon O’Connor
Grant Robertson
Dr Megan Woods

Evidence and advice received
Careers New Zealand, response to written questions 1 to 140, and 141 to 146, received 10 February and 3 March 2014.

Office of the Auditor-General, Briefing on Careers New Zealand, dated 17 February 2014.

Organisation briefing paper, prepared by committee staff, dated 17 February 2014.
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Children’s Commissioner

Recommendation

The Social Services Committee has conducted the financial review of the 2012/13 performance and current operations of the Children’s Commissioner, and recommends that the House take note of its report.

Introduction

The Children’s Commissioner is an independent Crown entity, supported by an office, and operates under the Children’s Commissioner Act 2003. The office promotes the interests, rights, and well-being of children and young people up to the age of 18, and promotes the United Nations Convention on the Rights of the Child.

The office seeks to improve outcomes for children and young people in four specific areas: health, poverty, education, and abuse and neglect. It is acknowledged that the causes of poor outcomes for children are complex, and that the office can only contribute to their improvement in collaboration with other agencies.

The office’s main functions include monitoring and assessing the services provided for children under the Children, Young Persons and their Families Act 1989. It also advocates for the interests, rights, and well-being of individual children, and provides policy advice to other agencies.

2012/13 performance

The office received a “very good” rating from the Office of the Auditor-General for its management control environment, and for its financial information systems and controls. It received a “good” rating for its service performance information and systems and controls. The Office of the Auditor-General acknowledged that this aspect of the office’s performance had improved, with deficiencies found in 2011/12 regarding performance trend information partially addressed. Improvements in this area are expected to continue in 2013/14, as more trend information becomes available.

In 2012/13 the office’s total revenue was $2.248 million and its total expenditure was $2.491 million, resulting in a loss of $245,000. This overspending was financed from the office’s reserves, and has been attributed to the office’s increased advocacy output, and specifically to work carried out on child poverty. The office is forecasting a further loss in 2013/14 and a further drawdown from reserves is likely to be necessary to fund this. The office is managing the risk to its service delivery by tracking its budget and resourcing levels, and monitoring all intended expenditure. It is also seeking a way of working with the Ministry of Social Development to ensure its service delivery is sustained despite financial pressures.

Addressing child poverty in New Zealand

In 2012/13 the office did a substantial amount of work on child poverty. An Expert Advisory Group on Solutions to Child Poverty was established by the Children’s Commissioner in 2012. Following extensive public consultation, including of children and young people, the advisory group released its report, Solutions to Child Poverty in New Zealand:
Evidence for Action, in December 2012. The report includes 78 recommendations and a list of initial priorities. We heard that when Budget 2013 was announced, 23 of the 78 recommendations had been partially or fully implemented. We were told that formulation of a plan to target and monitor progress in addressing child poverty is the next step that the commissioner believes should be prioritised.

We discussed the transformation of the related White Paper for Vulnerable Children into the Children’s Action Plan in 2012/13. The office told us that, although it has had an advocacy role regarding the plan, the plan primarily seeks to improve the care and protection of children at risk, and is “not an answer to child poverty.” The recommendations made in the Expert Advisory Group’s report constitute a more comprehensive approach to child poverty. The commissioner told us that these recommendations need translation into a child poverty action plan. We agree that involving those most affected by poverty will be important in developing and ensuring the effectiveness of the plan, as well as making individuals accountable for the plan and its intended outcomes.

In December 2013 the office, in partnership with the University of Otago and the JR McKenzie Trust, released its first annual monitor of child poverty. The Child Poverty Monitor is intended to raise public awareness, and to track progress on reducing negative outcomes for children living in poverty. Four measures of child poverty are reported in the monitor: income poverty, material hardship, severe poverty, and persistent poverty. The commissioner told us that any plan for action would require measures to be “formally” adopted. Some of us are concerned that the Government has yet to do so.

Some of us are concerned that the office may be under-resourced and unable to carry out its advocacy function effectively. Specifically, we were concerned to hear that the Child Poverty Monitor is being funded by a charitable trust, and that the office is expecting a further financial loss in 2013/14. We were told that the funding from the charitable trust is guaranteed for five years, and were pleased to hear that the office is optimistic that major steps to addressing poverty will have largely been implemented by then.

We heard that partnering with other organisations may help overcome resourcing constraints; funding from charitable trusts, in particular, is not contingent on changes in government. Working collectively also enables the sharing of skills and knowledge to achieve the best possible outcomes for children.

Child abuse and neglect

In 2012/13 the office engaged with leaders of various faiths on the issues of child abuse and neglect. We heard that 40 such leaders have signed a national statement, Faith Communities Against Violence, committing themselves to addressing family violence and to keeping children safe. Although the office will give the leaders formal training, we heard that it will be up to the individual faith organisations to develop their own good practice principles. We were pleased to hear that the office is confident the initiative will send a powerful message that family violence is not acceptable or justifiable in any faith, and thus help reduce family violence. We are interested in how the outcomes of the initiative will be measured and expect the office to provide more concrete information at its next financial review.
Monitoring of Child, Youth and Family services

The office has a statutory responsibility for monitoring and assessing the services provided by Child, Youth and Family. We understand that the recommended caseload for a social worker at Child, Youth and Family is from 12 to 18 cases, and that there are current instances of social workers managing up to 40 cases each. We asked for an update on the current review of caseloads in Child, Youth and Family. We were told that a number of factors influence the size of a social worker’s caseload. The office assured us that the standard of practice in Child, Youth and Family is generally high, and that it is confident the needs of children are being well served by the status quo. We were also told that the current review will lead to “substantial changes that will lead to better practice, better safety, and a better service for vulnerable children.”
Appendix

Approach to this financial review

We met on 19 February 2014 and 9 April 2014 to consider the financial review of the Children’s Commissioner. We heard evidence from the Office of the Children’s Commissioner and received advice from the Office of the Auditor-General.

Committee members

Melissa Lee (Chairperson)
Hon Phil Heatley
Jan Logie
Le’aufa’amulia Asenati Lole-Taylor
Hon Peseta Sam Lotu-Iiga
Sue Moroney
Alfred Ngaro
Dr Rajen Prasad
Mike Sabin
Hon Chris Tremain
Louisa Wall

Holly Walker replaced Jan Logie for this item of business.

Evidence and advice received


2012/13 financial review of the Commerce Commission

Report of the Commerce Committee

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Commerce Commission

Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 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 was established under section 8 of the Commerce Act 1986. The commission’s purpose is to make consumers better informed, markets more competitive, and regulation more targeted and effective. The commission acts as both a competition authority and a regulatory agency, funded through Vote Commerce and Vote Communications. Its responsible Minister is the Minister of Commerce.

The commission’s chief executive is Brent Alderton, and Dr Mark Berry is chairperson of the board.

In 2012/13 the commission received a total income of $40.221 million, with expenditure for the period of $34.077 million, leaving a net surplus of $6.144 million.

Investigation of alleged anti-competitive behaviour

We were interested in the commission’s investigation of the Countdown supermarket chain (whose parent company is Progressive Enterprises Limited) in response to allegations of anti-competitive behaviour. The committee notes that Dr Berry advised for the record that he is not on the panel for the investigation into Progressive Enterprises because of a potential conflict of interest arising from a previous case he acted in some years ago whilst in private practice. The commission told us that it is in the preliminary stages of the investigation and is gathering evidence. The investigation is limited to Countdown, as most of the complaints received thus far relate to the chain. We asked if complaints had been received about other supermarkets, and Mr Alderton confirmed that complaints had been received about the industry generally; however, on the basis of the commission’s criteria he does not believe it is appropriate to widen the investigation.

We heard that the commission is gathering evidence by reviewing documents and conducting interviews. It will be approaching the supermarkets’ suppliers for information, including companies that have not lodged a complaint. All complainants are guaranteed anonymity. The commission confirmed that all parties involved in the investigation were cooperating with it. However, if necessary, it could compel evidence under the Commerce Act 1986. Mr Alderton assured us the commission was sufficiently resourced to carry out the investigation.

We explored the nature and magnitude of the complaints received, and asked whether the commission will be working with the Police, the Serious Fraud Office, or sharing information with the Australian Competition and Consumer Commission; Mr Alderton said he could not comment on these matters whilst the investigation is in progress.
We heard the investigation is likely to take several months, after which the commission will issue a report on its findings as to whether any breaches of the Acts the commission enforces had taken place. We await the commission’s report with interest.

We received a letter after the hearing of evidence with the Commerce Commission from Progressive Enterprises Limited’s legal counsel requesting all information held in relation to the allegations that the commission is investigating. We released the letter and the corrected transcript of the hearing in our interim report on 9 April 2014. Labour members expressed concern about the content and tone of the letter. Labour members noted the issue of natural justice was raised in the content of the letter, and so moved a motion at the committee to invite Progressive Enterprises, if they so wished, to appear before the committee to deal with these matters. The committee did not agree to the motion. National members were not concerned by the tone of the letter and voted down the request by Labour members to invite Progressive Enterprises to appear before the committee. The committee as a whole released the information to ensure transparency around any information that was received by the committee about the matter.

Complaints process

We asked the commission to detail the process it follows once a complaint is received. Each complaint is assessed by investigators and managers to determine whether there has been a possible breach of the Fair Trading Act 1986, the Credit Contracts and Consumer Finance Act 2003, or the Commerce Act 1986. If a potential breach is found, an investigation would be opened. Mr Alderton said that the length of investigations varies depending on their complexity. All complainants are offered anonymity.

We were interested in the procedures for receiving evidence from parties involved in an investigation. The commission has wide powers to compel documents and evidence (including telephone and bank records) under section 98 of the Commerce Act 1986. If information is provided voluntarily the commission requests an affidavit or a sworn statement. However, if parties are compelled to appear and give evidence under section 98(c) of the Act, they are put under oath. Dr Berry said that gathering information for investigations was generally not problematic.

In order to ensure that the Commerce Commission’s investigation into Progressive Enterprises Limited is as thorough and in-depth as possible, we would hope that where parties have requested that they be compelled to appear before the commission, the commission would use its section 98 powers so as to give those parties protection. Further, we hope that the Commerce Commission would not shy away from using its section 98 powers to gain all relevant information and witness testimony in respect of this investigation.

Presence in communities

We understand that vulnerable communities are targeted by fringe or lower-tier lenders. We were told the commission made 81 visits to lower-tier lenders in the 2012/13 financial year. It has also appointed a credit advocacy adviser, to work at a grassroots level with budgeting and family advisory services, as well as lower-tier lenders such as “truck shops”. We heard that two investigations have resulted from this work so far.

We asked how the commission helps those for whom English is a second language understand their rights as consumers. In September 2013, work was completed with the Commission for Financial Literacy and Retirement Income and with Māori groups on
delivering information to communities in an accessible way. The commission considered these efforts successful and is planning more work of this kind. It is also planning to translate some of its fact sheets into other languages.

**Legislative change**

We asked what has been done to prepare communities for the enactment of the Consumer Law Reform Bill. The bill proposes amendments to several consumer-related Acts, some of which the commission is responsible for enforcing. We heard the commission has invested heavily in educational materials. It has published fact sheets, and has set up an information portal on its website. It is working with community groups and chambers of commerce to disseminate information about the changes.

**Legal proceedings**

We note the commission’s announcement of legal proceedings against a number of banks. The proceedings relate to insufficient disclosure during the sale of interest-rate swaps to rural customers; the commission believes three banks may have breached the Fair Trading Act 1986. Dr Berry said the commission had conducted an extensive investigation, but the extent of the resultant harm is yet to be established.

**Measures of competitiveness**

The commission is changing the way it uses the Herfindahl-Hirschman Index. The index measures competitiveness by comparing the market shares held by companies in a specific sector. However, the commission believes this measure can be applied more accurately when the market is divided into regions and customers are segmented.
Appendix A

Approach to this financial review

We met on 20 March and 10 April 2014 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
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Evidence and advice received

Commerce Commission, responses to written questions, received 12 March and 7 April 2014.


Organisation briefing paper, prepared by committee staff, dated 14 March 2014.
Young Dr Berry, welcome. Dr Gale and Mr Alderton—good to have you here at the Commerce Committee. We have an hour with you. Apologies for being a little bit late; we’ve had a pretty busy meeting this morning. If you could address us for up to 7 minutes, around about then, and then we will come to questions. Thank you, sir.

Berry Thank you very much. I’m the chairman of the Commerce Commission. Mark Berry is my name. With me are Dr Stephen Gale, Telecommunications Commissioner, and our chief executive, Brent Alderton. Look, I’ll start off and keep to those time limits.

During the last year, 2012-13, the commission obtained $39 million in penalties and $63 million in compensation for affected consumers. That has been a very good year, we think—if you measure our success in those terms. Over and above those kinds of awards, we have actually had significant achievements in other ways in terms of preventing further harm. For example, one of our Fair Trading Act cases relating to a company, Love Springs, resulted in people in vulnerable areas being misled. Expensive filtered water systems were being sold in the poorer areas to people who were told “this causes cancer” and other mischievous allegations. So we’ve shut down those kind of practices for that.

I’ll touch very briefly—as you will know from those figures, we have had significant litigation outcomes in the last year. I’ll mention, quickly, three. The first was in the merits review relating to input methodologies. These are the rules and processes relating to regulated entities such as the electricity
lines businesses, gas pipelines, and these are matters like asset valuation and the cost of capital or rate of return. So after 3 years of litigation, our rulings were endorsed by the High Court in virtually all respects. Out of 58 legal challenges, there were only two minor findings where the court made adjustments. That is a truly significant outcome, because what this decision means is that it protects the interests of consumers, because it effectively prevents the transfer of around $2 billion from consumers to regulated businesses.

The second case I’ll mention briefly is air cargo. I’ve talked about that other years. This has been a long-running cartel case relating to air cargo. We settled with the last of the 11 defendants—Air New Zealand—in the course of the last calendar year. The total penalty for those cases, involving 11 airlines, was $43 million in penalties as well as $3 million in costs.

The last litigation matter I’ll mention very briefly is Credit SaILS. Again, I mentioned this last year. We achieved a very favourable settlement with Forsyth Barr and Crédit Agricole to return to harmed consumers what they had lost with an investment product that was represented to be low to moderate risk. I am pleased to report that of the $60 million that we achieved in the settlement fund, all of that money has now been returned to investors, but for $17,000—we couldn’t find one person after extensive attempts.

Young

Sorry, how much was that amount? Sixty million?

Berry

Sixty million—six zero. So we have returned that to everybody except for one person for $17,000. Very quickly—two current cases that I’ll just mention briefly in passing. Late last year we announced that we would be issuing legal proceedings against three banks, ANZ, ASB, and Westpac, regarding the sales of interest-rate swaps to rural customers. Work continues on this area, and we expect to file proceedings by the end of the month. I should add we have been asked to keep the Primary Production Committee informed on this, and we will be writing to them in the near future.

Also last month, as you’ll know, we launched an investigation into allegations made against Countdown of anti-competitive behaviour. While the investigation has significant public interest, we will not make any further comment until the investigation is concluded, which is our standard investigation practice. While I am on the topic of the Countdown investigation, I would like to record that I am not actually on the panel dealing with this issue. I have a potential conflict arising from a previous case I acted in some years ago when I was in private practice. However, Mr Alderton is involved with the investigation, so he is in a position to answer any questions that you may have.

I will touch very quickly on the construction industry. That’s another significant area of activity. Last year we had a number of competition and consumer investigations in that sector. Most significantly, we had a cartel case involving the supply of timber for commercial construction in Auckland. The case involved price fixing between PlaceMakers and Carter...
Holt Harvey. We have taken proceedings against Carter Holt Harvey. Fletcher Building was actually the leniency applicant in that case. Yesterday the High Court held a penalty hearing into that case that you would have seen reported in the media this morning, and the decision in that case is reserved.

While on construction I’ll also mention that we have heard stories about anti-competitive behaviour concerning tying or bundling of materials by a larger merchant in Christchurch. I’ve been in close contact with Roger Sutton, the chief executive of CERA, about concerns that both Roger and I have heard regarding Fletcher Building’s position on the Christchurch market. I have offered to go to Christchurch to meet with participants in the building industry who have concerns, and that offer still stands. Roger Sutton advises me that despite his attempts to find persons wishing to report a complaint and to discuss it with me, he has yet to find anybody who is prepared to do that.

Cosgrove Excuse me—could I just ask why you went to CERA? Because the agency that has jurisdiction over that is EQC, not CERA. It’s nothing to do with CERA. It’s EQC.

Berry Look, they’re conversations Roger and I have had—he mentioned to me he had been hearing these concerns, and I said, look, can you tell me about them so we can do something. That simply is how it happened.

Cosgrove Can I invite you—you may want to check with EQC, because EQC are the agency—

Berry That’s right. We have had conversations with them as well.

Dyson Why would anyone complain to them?

Berry Sorry, complain to…?

Dyson CERA.

Berry Look, I mean, Roger is talking to a lot of people in Christchurch. He wouldn’t have been looking for that. We didn’t stop there. We actually sent staff down to Christchurch, and we’ve spoken to five residential building companies, Master Builders, and a significant procurer of construction services, and the outcome of those conversations is that none of those builders actually said they had those problems. There were other viable suppliers, namely Carters and ITM. So we had taken steps to follow up what we were hearing, and the evidence we gathered didn’t support those allegations. So, as I say, our door is open and I am more than happy to go down—

Cosgrove Did you provide anybody with anonymity?

Berry Yes. Those people we spoke to, we treat them as confidential complainants so that they were at liberty to talk freely to us.

Cosgrove So you’d entertain people coming forward as individuals or whatever to offer evidence and you’d accord them anonymity?
Berry As a matter of standard practice when we have a complainant coming to us, we have a position of confidentiality for that.

I’ll deal very quickly with our work in the fair trading and credit contracts arena. The commission was part of a combined agency investigation into pro forma invoicing. This was Operation Edit led by the Serious Fraud Office—we worked with them. Six suspects were arrested and charged under the Crimes Act. In the course of this year we have also, for the first time, prosecuted under the Crimes Act—again, in the pro forma invoicing sector. That trader was sentenced to 10 months home detention for false billing practices.

In terms of lower-tier lenders, we’ve made 81 lender visits to all persons we could identify, in areas such as South Auckland, Porirua, and so on. Following those 81 visits, we issued four warnings and 29 compliance advice letters. So that represented the level of offending that was potentially there, and we were able to talk to these people and have steps taken to see what remedial matters could be taken.

Young Thank you. Have you got anything further to say, sir? Because we can come to questions right now.

Berry OK, just very briefly—that covers our competition and consumer arena. In terms of our regulatory arena, I was just going to point out that we have made significant progress in getting the Part 4 regime in place. In dairy, we did the first statutory review of Fonterra’s milk price.

Just one last matter I’ll raise is that we have completed the three reports on Auckland, Wellington, and Christchurch airports on the effectiveness of information disclosure requirements. Again, that is well publicised. We found that Auckland’s pricing was essentially in line with our approach to regulation—Wellington and Christchurch, there were issues, and we’re pleased to see that Wellington is looking to re-consult on price and Christchurch is looking to redo its methodologies on a forward-looking basis.

Young Thank you very much, Dr Berry. Firstly, just before we come to Mr Cosgrove, congratulations on some of the achievements that you have fought for and won this last year and certainly the benefit going to consumers, so our congratulations as a committee for that.

Cosgrove Mr Berry, look, I preface these questions—I bear in mind what you’ve said about the grocery issue. You may or may not be able to answer these questions, and I accept that upfront. I’m going to ask you some process questions, which I would have thought your team could answer. I’m going to ask you some specific ones, but the answers are yours. Can you confirm that you have now received a number of complaints and/or evidence of retrospective payments, including complaints that include bullying and intimidation, in respect of the grocery issue?

Alderton We have certainly received a number of complaints.
Cosgrove Would that number be in excess of 30?

Alderton No.

Cosgrove OK. Can you confirm that after a complaint of a $2 million retrospective payment was made to the commission that that complaint, once it reached your desk—and I’m not accusing you guys of anything—effectively vanished because Progressive Enterprises went to the supplier and basically said it was a big mistake, they didn’t want $2 million, and it just vanished off the face of the earth? Could you confirm that?

Alderton No, I can’t confirm that.

Cosgrove You can’t. OK. Thank you. Can you confirm—will you be using section 98 of the Act, and will be invoking that to compel anybody, members of the industry, to provide evidence to you?

Alderton Section 98 is certainly an option to have that open to us, yes.

Cosgrove Is it your intention, if parties refuse to cooperate with you, that you will invoke that provision?

Alderton We could do that, yes.

Cosgrove You could do that. Have any parties or any individuals refused to assist you in your inquiries?

Alderton Not that I’m aware of.

Cosgrove Will your inquiries—do they go simply to the Progressive Enterprises/Countdown company, or is this inquiry going to look at retrospective payments and the allegations made across the grocery industry?

Alderton It’s in relation to Progressive Enterprises/Countdown.

Cosgrove Can I ask you why you haven’t thought to widen that to the industry? It’s a very small industry.

Alderton Certainly. The allegations that were made were in relation to Countdown and Progressive Enterprises. We will be talking to a number of parties across the industry though as part of that investigation. If we found information that warranted widening that, then we would make that decision at that time.

Cosgrove So can I ask you for your rationale as to yes, there have been a series of complaints in respect of Progressive, but we only have two or three players in this industry, why you wouldn’t proactively widen your investigation to look at the whole industry, given that there are similarities?

Alderton We haven’t received—the allegations were in relation to Progressive Enterprises and Countdown, and we’re following the normal sort of process we would in an investigation of this type.

Cosgrove So would it be fair to say you have received no complaints—the only complaints you have received are surrounding the activities of Progressive Enterprises/Countdown, not other players in the industry?
Alderton: By far the majority of the complaints that we have received, because we have asked for complaints about Progressive Enterprises and Countdown, are in relation to those companies.

Cosgrove: The vast majority. So is it fair to make the assumption that you have received complaints about other industry players?

Alderton: There are general industry complaints that have been received, yes.

Cosgrove: OK. So my question is gently if you have received—because you’ve said you act on complaints, so you have a series of complaints about Progressive Enterprises. You’re now saying you have a series of complaints that go industry wide. So my question is why would you not prudently widen your investigation to the entire industry? You now have complaints about everybody, it seems.

Alderton: No—just to be clear, I didn’t say that we have a series of complaints that go wider than the industry.

Cosgrove: No, no—wider than Progressive Enterprises/Countdown.

Alderton: Wider than Progressive Enterprises or Countdown.

Cosgrove: Sorry, could you clarify? I thought you said the majority of complaints—and I will not put words in your mouth—were about Progressive Enterprises/Countdown. That would seem that the minority of complaints are about another entity or some other aspect in the industry. Would that be correct?

Alderton: That is correct.

Cosgrove: So those complaints would be about other players in the industry?

Alderton: The complaints we’ve had are primarily about Countdown and Progressive Enterprises. Without going into the specifics of what’s said around those, we have to make a call as to whether it is appropriate to open an investigation or widen an investigation. It’s our assessment at the moment, based on the information we have and looking at what those complaints mean against the Act, that it is not appropriate at this time to widen the investigation.

Cosgrove: And that’s based on the number—

Alderton: It’s based on our enforcement criteria.

Cosgrove: Well, OK, I’m just trying to understand, because you’ve had a serious complaint from my colleague Mr Jones. You’re now saying you have other complaints, presumably providing evidence reinforcing the original complainant, Mr Jones, about Progressive Enterprises and Countdown. And then you have a series of other complaints about other players in the industry. What’s the threshold? One complaint, three complaints, two complaints? Because I would have thought, efficiency-wise, given it is a small industry, you would look at the lot, especially if you’ve had complaints about others?
That’s a decision we have to take all the time on these sorts of things. If there are matters that are simply isolated or don’t meet some of the other thresholds that we use in our enforcement criteria, then we don’t broaden the investigation or start an investigation, in fact.

Could I ask you—and, again, I might step over the bounds, you tell me. You’ve received complaints, presumably, about alleged retrospective payments?

I don’t think it’s appropriate that I answer that.

Can I ask you, for the record, have you received complaints about other matters, including bullying and intimidation?

I’m not prepared to answer that.

Thank you. Can I ask you—and this may be a technical question. Can you tell me, because there’s been some conjecture about this, what is the difference between a retrospective payment and forward payments based on retrospective data? Because I’m advised by the chief protagonist in this that this is the argument that is being made. But putting that aside, could you tell me what the difference of that would? Because it seems to me it is money for nothing either way.

That would involve me speculating. Simply, what we do is make an assessment of the behaviour against the Act.

OK. And just for the record, when I asked you about the $2 million retrospective payment complaint that disappeared, are you—forgive me, I think you said you couldn’t comment or you couldn’t confirm it. Can you confirm that there was a complaint of that order of magnitude?

No, I can’t confirm that.

So you’re not—you just simply can’t comment on it?

That’s correct.

And have you had, in terms of complaints, complaints from individuals as well as companies?

We’ve had complaints from a wide range of people. Clearly, when they phone they might be speaking on behalf of a company or they may be putting their own position. But most of the suppliers to supermarkets are companies.

Sure. And could you tell me what actions—and I presume this is a process question—are you undertaking to proactively go out and seek evidence and complainants?

We will be approaching suppliers to the supermarket, including those who haven’t complained to us.

Finally, are you in a position to give us an idea of the process and the time line on this investigation?

Sure. So at the moment we’re basically in the information-gathering stage. That will involve both looking at documentary evidence and interviews.
Until we’ve done that, it’s very difficult to be specific about how long this will take. But my expectation is that it could take several months to complete this investigation.

Cosgrove: And for the record, anybody seeking to provide you with information would be guaranteed anonymity?

Alderton: That is correct. Unless we’re required by the law to release that information, we will guarantee anonymity, yes.

Cosgrove: Is Progressive Enterprises/Countdown cooperating with you in all aspects of this inquiry?

Alderton: Yes.

Young: The Commerce Commission deals with, as we’ve just heard, complaints across the spectrum of all sorts of activities that happen here in New Zealand particularly. As this committee has been progressing the Credit Contracts and Financial Services Law Reform Bill, which is focusing particularly on loan sharks, my question to you is: what sort of presence do you have in those communities that are affected by issues around loan sharks?

Berry: As I have mentioned, we did 81 visits to lower tier lenders, and so we have endeavoured to talk to people affected in and around that part of the community. We have actually just appointed a dedicated credit advocacy adviser and that person has extensive grassroots community experience with budgeting and financial services, and so look, you know, we appreciate that we can do more in that zone and that’s our first step, to get somebody with very, very extensive experience of that kind, working more closely within those communities. We do a lot, and we can do more, and that is our goal.

Young: So what sorts of activities would that person be doing in those communities, in terms of working with the people?

Berry: Look, I mean, she has a wide network of contacts through budget advisory services and all those kinds of organisations, and so this is somebody who’s been in the sector for a long time and has a lot of grassroots connections that she will be able to work on. I can get our General Manager, Competition, to give you further elaboration on the person in question and how we see her functioning in the foreseeable future. Kate Morrison is our General Manager of Competition.

Young: Great. Thank you.

Morrison: Good morning. Just to elaborate on Dr Berry’s description of the new role. It’s designed specifically to enable us to better connect with the communities that we need to, in order to better administer and enforce the law. To date we’ve used agencies such as family advisory services, Family Budgeting Services, and worked actively with them. We’ve got two active investigations that have been referred to us from those types of groups. We do work directly with groups of providers or lenders, including, as referenced, the lower tier lender visits. We work with truck shops in the
communities. We’re doing direct work, but the role is envisaged over time to make us better connected with what’s happening on the ground, what harm is being done, better understand the lending practices in a fast way, in a more intelligent way, and better address them, either through our own mandate or through other agencies and with other agencies.

Young

That’s good. OK, in terms of the Consumer Law Reform Bill that’s soon to be enacted, what sort of work are you doing around that in the communities, in terms of education around the provisions that are in that bill?

Berry

Again, I will get Kate to speak to that, but we have had a very active programme putting together fact sheets so that as each of the new consumer law tranches of the provisions comes into effect, we have advice to the market place as to our interpretation and approach to that, but I can just get Kate to give you a feel for the fact sheets we’ve done and what’s in the pipeline.

Morrison

So the lead up to the consumer law reform for us has been one of heavy investment primarily in providing educative materials across the board. That’s to business stakeholders and community groups, for example. We’ve published a series of fact sheets about the first set of laws that have been implemented and we’re proposing to do the same in the next 3 to 4 months for those that will be implemented. The way that we promulgate those and make sure that the people who need to know about it do know about it is—obviously there are multiple points. We’re working through things like chambers of commerce. We’re working through places like community groups. We use our website as a portal and we’ve had, for at least the last 7 or 8 months, the ability to sign up. If you’re active in this area and you want to know about what the changes are and what the commission thinks the rules mean, and how we’re going to consider their enforcement, then you can sign up and become a recipient of information as we put it out.

Bakshi

That’s good to know—what you’re doing right now. But for a lot of vulnerable consumers, English is not the first language for them. It is a second language. What are you doing to help them to understand those laws and what rights they have?

Morrison

We’re very aware of that issue. Last year, during Money Week, which I think was September last year, we worked with the financial literacy commissioner and provided our materials directly to a number of a groups who might provide their materials to their communities in a different way. So, some Māori groups took our materials, and whilst they didn’t translate them into Te Reo, they did translate them in a way that they thought was more usable directly for their community. We think that’s a really great way of getting our message out. We intend to build on that. We do also have plans to translate some of our fact sheets. Last year we also did a smaller version of something called “Know your rights” around the credit law, and made that available again through citizens advice bureaus, and would hope that other active groups would work with their communities to make that more accessible.
Following on from the new role that we’ve created, the credit advocacy role, that is specifically to help not just the information we need from the community to help us enforce the law, but to help make sure that our messages are accessible to the communities that need them most.

Mitchell Just quickly on that. If it is translated, do you guys check the translation to make sure that nothing has been changed in the translation, which can happen sometimes?

Morrison It can do.

Mitchell Unintentionally.

Morrison As I say, for us that’s work—we haven’t done the direct translations yet. The experience that we had last year with the financial literacy community was learning for us, and it wasn’t translation but it was saying actually sometimes the way you guys talk isn’t the way our communities talk. Can we take this message? We looked at that, but I wouldn’t call it a right of authorship. I’d say that we wanted to enable those groups to talk directly to their community members, so they could better understand what the law was for.

Mitchell Just very quickly on your portal and your website, are you monitoring how many visits you sort of are getting to that? I mean, I’m interested to know whether people are actually going to the site and having a look.

Morrison I don’t have that information but I know we do monitor that kind of information, so it would be part of our performance matrix. There’s no point having these sites if we don’t know that they’re being used. Certainly my anecdotal feedback is that businesses particularly are signing up and receiving that information.

Mitchell Excellent. Thank you.

Lee Just a very quick supplementary question on the issue with ethnic communities—how much of a presence does the Commerce Commission have in their community, in terms of do they actually know about your existence, because often, as my colleague said, they speak in a different language and they may not know about your existence or the kind of work that you do, and the rights of their own people, because they have been often ripped off by their own community? So how much presence do you have, is one question. The other is, in terms of the complaints that you receive, there will be a vast array of complaints from different people having different issues, whether it’s actually price fixing or loan sharks, or whatever, how much complaint are you receiving from the ethnic communities, and does it actually say something about their understanding of the role that you play and the issues that they face?

Morrison When we investigate particular matters or potential breaches of the law, we obviously end up working in specific communities, and I would concur with your reflections around harms in those communities sometimes. As I’ve already said, that credit advocacy role is specifically designed to help us get better in this sphere, but we are, by no means, blind to it. In terms of the complaints, my own experience is that a lot of those complainants would
come through other more grassroots groups, and so our work has been in making sure that we’ve got really great connectivity with places like citizens advice bureaus or in particular family and budget advisory services, because I think that you might be right on one level, that we need to have several ways to hear about and learn about harm under the laws we enforce, and that’s what we’re working on.

Lee The reason I say that is because they are a certain percentage of the population, and if you’re not having a certain percentage of the population complaining from that sector, they’re not actually being represented. They’re actually possibly not getting the right information to deal with the issue. So it might be work that you might have to focus on.

Berry We do recognise the issue, and that’s what generated the creation of this new position. We’ve got high hopes of really starting to work harder in that territory.

Shearer Could I just go back to Progressive Enterprises one more time—

Cosgrove Might be two more times.

Shearer Two more times—could you just elaborate a little about how you’re going about this examination? Are you getting calls from people? Are you going out and meeting people?

Chair Well, he’s answered that question before, but anyway.

Shearer Pardon?

Chair He asked the question and he answered it, but repeat it, if you like.

Alderton Yes. So, we received complaints on this—

Chair Wasting time.

Alderton It’s a serious issue, and it’s his time, not yours. Sorry.

Alderton We are receiving complaints, assessing those, working with Progressive Enterprises to get information from them, and we will be approaching others, for example, other suppliers who haven’t complained to us.

Shearer So people are coming to you actively, in terms of emails or phone calls or coming to see you in person?

Alderton That’s correct.

Shearer And so you will then—say if there’s one fish supplier that has complained, you will be going out and meeting other fish suppliers or whatever and checking with them whether the same issues have been facing them as well?

Alderton Potentially, yes. That’s correct.

Shearer Have you started doing that yet, or is it…?

Alderton The investigation is at a very early stage. It is simply following the sort of process that we would normally follow in one of these investigations, and, as we get more information, that can lead to the position where we have to explore other avenues. So it’s certainly as we would normally do.
And the way that it normally happens—because I’m not familiar with how you normally do things—you would go back to Progressive Enterprises with a bundle of complaints, or you’d go back to them with individual ones, or how does it sort of work in terms of the to-ing and fro-ing?

Sorry, could you just clarify the question?

Well, you get a complaint from a supplier; do you go back to Progressive Enterprises and say—how—

Absolutely. We may well seek more information from Progressive Enterprises in relation to something that a particular supplier says to us, yes.

And so that would be an ongoing—that wouldn’t be just one meeting and another meeting in 2 or 3—

Yes, that is correct.

And you have the power to obtain documents?

Yes, we do.

And compel witnesses?

Yes, we do.

Are you looking at any activity of Progressive Enterprises, Countdown, or other players outside the New Zealand jurisdiction?

No.

Are you precluded in any way from looking at behaviour of companies acting in New Zealand in other jurisdictions to, for instance, see if they’re at it over there, as they may well be here?

We can only act within the jurisdiction that we have under the Commerce Act in New Zealand, so—

But that doesn’t stop you, within New Zealand, observing or gathering evidence that might come across the Ditch, presumably. So, as long as it’s within the 12-mile limit, you can look at it?

Yeah. Look, we do work closely with other agencies. So if we just talk generically on that issue, the ACCC is the organisation with jurisdiction in Australia to look at on matters, and we do engage in regular information sharing.

So are you, in respect of this case?

Because you’ve asked about supermarkets, I’d have to go back to Brent, sorry.

We talk with the ACCC. We talk with the ACCC all of the time. It’s a normal part of our business. We are not sharing evidence in this case at this time.

Are you talking with them in terms of—normally, you would talk to a kindred organisation and say “Look, are you guys having the same difficulties there?” especially given the ACCC has embarked on inquiries
anyway. That would be a logical thing to do, the same way the police might ring up their counterparts in Aussie and say “Is Joe up to no good over there as well?” to try and get, perhaps, a pattern of behaviour. Are you going to be interacting with the ACCC over this inquiry?

Alderton I’d be speculating. It would depend on what information we needed and what information we had.

Shearer Dr Berry, you mentioned a conflict of interest. Can I ask what that conflict of interest might be?

Berry I was in practice as a barrister before I joined the commission, and I acted for a number of suppliers 8 years ago in relation to similar kind of fact situations—not identical, but similar. I don’t think technically I’ve got a strict conflict, but out of an abundance of caution, given the profile of this, I have decided to step aside. Having said that, there is a panel of commissioners and staff overseeing it, and these kind of issues do happen from time to time where individual commissioners have conflict, so it’s as simple as that.

Cosgrove I would have thought if you’d acted for suppliers, you might be called as an expert witness, perhaps.

Shearer Can I ask your opinion on this, then!

Berry It’s so long ago I actually struggle to remember what it was about, to be honest.

Cosgrove No, I thank you for declaring that. You might want to offer your services for a large fee to Judith Collins.

Chair Right, ha ha. Yeah. Now, can I come to just a question around the telecommunications sector. I note that you plan to review your use of the Herfindahl-Hirschman Index, which actually measures competitiveness. Why are you doing that?

Gale Shall I answer that, Chair?

Chair Yeah. Thank you.

Gale For a while there in our regular monitoring of the mobile market, we’ve reported on this concentration measure, but in respect of the nationwide market shares. So for those not familiar, the HHI index is a measure that you make out of market shares. So for those not familiar, the HHI index is a measure that you make out of market shares. In this case we’ve been reporting it on the basis of subscriber numbers in the companies, and the way we’ve done it up to now is then what’s been published under the decision we’ve made about monitoring that market, we’ve published that on the base of nation market shares.

It’s been clear to us for a while that as a measure of concentration, it’s not fully reliable, because, for example, Vodafone has a very strong market share in Auckland and Telecom has a much stronger market share in other parts of the country. So averaging across different regions of the country gives you a slightly misleading view as to the level of concentration. So
when we break it up, we’ll find higher levels of concentration measured by that. And we’re going to do that by customer group and by region.

Chair OK. So what measure are you going to start using instead of that?

Gale Well, we use the same measure, but we just break up the market into regions and then to customer classes.

Chair Right. Yeah. OK, because it’s most able—and when it works in regions.

Gale Yeah. And the other thread to that is that we’ve revealed recently, but we’ll now more regularly report, that concentration measure by revenue as well as by—because you’ll be aware that the market shares by subscriber, some things have a share of the lower revenue customers than others.

Chair Right. OK. Thanks very much indeed for that answer.

Cosgrove Can I again return just briefly to our favourite subject. Would you have any objection, Dr Berry—would the commission have any objection to appearing before this committee once you’ve reported in your normal process in public to take this committee through your report findings once they are concluded and reported back?

Alderton This is in relation to Progressive Enterprises?

Cosgrove Indeed.

Alderton I’d be very happy to.

Chair Well, that would be a committee decision.

Cosgrove I know. I’m just being polite and asking; I have no other objective. Are you likely to—I know this is putting the cart before the horse, but you’ll be aware of remedies that exist in other jurisdictions, Australia and the UK, in terms of a grocery code of practice. Is it likely that you—if there is a finding that there’s a difficulty, would you be looking at those jurisdictions and others for remedies?

Alderton The code of practice is really a policy issue, from our perspective, and—

Cosgrove Indeed. But you’ll be recommending, if there is an issue, presumably, remedies?

Alderton It’s something that we could comment on, but we need to go through the investigation process.

Cosgrove But in your normal process, once you’ve conducted a recommendation, is it your normal practice to recommend remedies that a Government, legislatively or otherwise, could put in place?

Alderton It’s not common in relation to our investigations.

Cosgrove So, what, you’d just simply issue a finding of—

Alderton That’s correct.

Cosgrove —if you like, guilt or innocence, as it were. And how detailed is that finding normally?
Alderton: Very detailed in some cases. So, for example, if you have a look at the Credit Sails investigation close-out report, which is on our website, you’ll see that there is quite some detail there.

Cosgrove: And in terms of your findings, you will obviously look at legal breaches. Would you look at, if you will, non-legal breaches? So, for instance, intimidation is a legal issue, but behaviour that might fall within the law but is grossly unethical—bullying, intimidation, other things? Would you normally make comment on that sort of behaviour?

Alderton: Basically, what we do is—the investigation report is an assessment of the facts against the Acts that we enforce. So it would be framed around that.

Cosgrove: So comments about strict legal breaches only?

Alderton: Correct.

Cosgrove: In terms of jurisdiction, are you likely—in the same question as the ACCC—are you likely to seek advice from the office of the adjudicator of the grocery code of practice either in the UK or their equivalent in Australia? Are you likely to interact with the ACCC or your equivalent in the UK as well, given they’ve had significant issues?

Alderton: We would certainly, in the ordinary course of events, interact with those sorts of agencies.

Cosgrove: And so you may well, in respect of this inquiry?

Alderton: We may well do.

Cosgrove: OK. Do you feel you have enough resource to deal with this inquiry?

Alderton: Yes, we do.

Cosgrove: So there’s no other special requirements you’d need from the Crown?

Alderton: No.

Cosgrove: Can you give us an idea of what sort of resource you’re putting into this in terms of FTEs or…?

Alderton: We have seven investigators actively on the matter at the moment, with—

Cosgrove: Seven? How many investigators do you have, roughly?

Alderton: Investigators? About 180-odd staff in total. About half of those work in the regulatory area. We’ve probably got—Kate, could you—

Morrison: Approximately 50.

Alderton: About 50?

Morrison: Between 40 and 50 people.

Cosgrove: So you’ve got seven on it full-time.

Alderton: Correct, and then—no, not full-time. There’s seven actively on the case, and then there’s economics and legal resource around that. So it would be more or less that.
Cosgrove Have you liaised with the police or the Serious Fraud Squad, or if you haven’t are you likely to in respect of these inquiries?

Alderton I don’t think it’s appropriate that I answer that.

Mitchell I was just wondering if you could really just quickly run through the process from the time the complaint arrives with you, and the other thing that I was going to ask is, you know—obviously you’re able to offer confidentiality, which I think is really important, especially talking about the investigation that my colleagues are discussing, but, and I’m not telling you to suck eggs here, all I’m just interested in myself is, for example, if you had to go back and you had a line of questioning to a customer about a supplier but the line item may actually inadvertently identify the actual supplier that’s come to you with information, do you have sort of systems around that so that you could—

Alderton We deal with these sorts of issues all of the time and we would not compromise the information or the identity of the complainant in any way through the process. So we would be very careful about. We are very careful about it. We do have systems and processes that allow us to deal with that and that is what we do.

Cosgrove Sorry, just for the record, for those who will be following this, you can give a guarantee to parties who may wish to come forward and provide information that their anonymity will be secured?

Alderton That’s correct.

Cosgrove Thank you.

Mitchell Sorry, just coming back to the original question, can you just quickly take us through your process when you do actually receive a complaint.

Alderton So we—you mean in this specific example?

Mitchell Well, actually, no, just in your—it doesn’t even need to be this specific case.

Alderton So we receive a complaint, often into our contact centre, which is where we receive between 9,000 and 15,000 complaints a year. Those are then assessed by a group of managers and investigators in the competition branch as to whether there is likely to be a breach of the Act and an assessment against the other enforcement criteria that we have. If it basically looks like there is an issue here that requires investigation, we open an investigation and then we would seek information and make an assessment of that information against the Act that we are looking at it under.

Mitchell And depending on how complicated the case is, they can vary from what sort of a time frame, in terms of dealing with it?

Alderton There are some matters that are able to be dealt with in a day through to those that take several years, depending on the complexity of the matter, whether we need to bring in external economics or legal resource, but often, or sometimes, you can resolve an issue with a simple phone call, and we can do that as well.
Cosgrove: Have you or will you be putting parties under oath when you are—sorry, in the ordinary course of business for an inquiry such as this, would you put parties under oath when they provide evidence to you?

Berry: If we conduct a so-called 98(c) hearing where we compel somebody to come before us and to give evidence, that would be on oath.

Cosgrove: So if somebody were to come voluntarily and make serious allegations and the inquiry proceeding, if information is voluntarily provided, you wouldn’t put them under oath?

Berry: If it was voluntarily provided, we would potentially end up getting them to do an affidavit or a statement, or to present some kind of sworn statement to us, but we typically only would involve a section 98(c) hearing and have people under oath where they weren’t prepared to come forward and to discuss matters with us voluntarily.

Cosgrove: And is it the norm that you would put the accused—if you like—party, under oath?

Berry: In most cases parties under investigation do cooperate and do fully provide answers to us, and in most cases we will put out section 98 notices requesting documents. So we do ensure that documents are produced against that kind of discipline.

Cosgrove: I suppose my question really goes to: the party can provide information and cooperate, or the party may—say, voluntarily—have a different order of magnitude if they know they’re under oath, even though they’re providing that information voluntarily and cooperate. So do you distinguish between those two issues?

Berry: I think when a person under investigation gets a letter from us demanding all the documents under our 98 notices, you know, we have confidence that they will come forward and honour that. They do run a risk if they don’t properly comply and if there are subsequently proceedings, you know, there are discovery and other techniques and methods that do provide a check in terms of the documentary evidence. I think it’s fair to say that there is proper disclosure. I mean, the risks are so high for parties who don’t properly comply that we will discover the documents. Information gathering just really hasn’t been a problem in the bulk of our work.

Cosgrove: Do you give parties the option?

Berry: No. If we want the information, we demand it. Look, sometimes our information request might be too demanding and too wide, and we will typically then agree: OK, well, look, we might trim it back—instead of all of this over the 3 years, give it to us over the last year. And we might get information in tranches. We need to work cooperatively and make a reasonable request. But we will start out usually with fairly broad information requests and we do have wide powers. There’s a lot of cases where we can access the telephone records and bank accounts. We always do those under section 98 notices. So that the banks and telephone companies aren’t breaching confidence, they do provide that evidence under command.
Cosgrove: And this might sound strange, but if a party requested to be put under oath, would you agree to that?

Berry: Oh, if they wanted to, yeah, I don’t think we strike that, but—

Shearer: Can I just supp. off that? I mean, you mentioned bank accounts and telephone details etc. Can you just give me an indication—in your inquiries, is that normally the case and would you anticipate, for example in this case, that that might be needed?

Berry: It depends on the fact of the case. When we were looking at these pro forma invoicing scams, it was very helpful to get the bank accounts just to see who they’d been sending false invoices to and where the money was coming into. There was another case recently of a dating agency that was running a fairly bogus scheme of events, and we executed search warrants—

Cosgrove: Anybody we know?

Berry: I can’t say I know the identity of any of the customers, but we were able to get exactly what money was going into the bank account and where it was going. So when we started the investigation, having that kind of data at the beginning was pivotal to how we then framed and shaped the investigation.

Shearer: Did you anticipate in this particular case that that might be necessary, to look at bank accounts and phone records?

Alderton: It’d be purely speculating at this time. I don’t think—

Chair: Yeah. Can I ask a question now. You mention in your initial presentation, Dr Berry, about the interest rates swaps that I believe that you’re going to be starting proceedings on at some time in the future. Just some questions around that—presumably this is around about financing farms, etc. Can you tell us the quantum figure that you feel has been put on the farming sector regarding what you feel may be unfair?

Berry: Look, I don’t have an immediate answer. What we have given to the Primary Production Committee is the actual total number of the book of transactions. You know, we are still working our way through ascertaining what the actual harm is. We have the value of the loans that are covered by that, but, of course, that doesn’t equate to what may be the harm that is involved. So I don’t have those numbers immediately, but I can come back to you with those.

Young: So in terms of the harm factor, were there a number of farm foreclosures, or—what sort of data do you have behind that? Are you free to be able give us—

Berry: Anecdotally, there are stories of foreclosures of some farms, but look, at the end of the day that’s not actually the issue facing us. We would have to establish that the banks did not give proper disclosure in advice to farmers and that they were misled in terms of what they were walking into. So any compensation that would attach would be related to the harm, if it was demonstrated, in any given case, and then there is also the prospect of penalties if the matter goes to trial.
2012/13 Financial Review of the Commerce Commission

Chair Right. So what stage are you up to with this?

Berry We’ve conducted an extensive investigation and, as I mentioned, we have announced before Christmas that we have reached a view that there is a likely breach of the Fair Trading Act, in our view, and that it is our intention to file proceedings.

Cosgrove Could you tell me, again, returning to our other subject—can you confirm whether any parties have been threatened with reprisals, commercial reprisals, or otherwise—

Alderton No, I can’t confirm that.

Cosgrove —if they have approached the commission?

Alderton No, I can’t confirm that.

Cosgrove And can you confirm whether parties who have approached the commission have been threatened that if they continue to cooperate, there will be commercial or other reprisals?

Alderton No. As I say, what we’re trying to do here is make sure that, to the greatest extent possible, obviously, these complainants’ information is kept confidential and that there is no way to identify them so—

Cosgrove Well, presumably you would look at if there was a widespread—what I’m saying, I suppose, is you would presumably look at activity where parties had been warned off, because that would be circumventing justice, presumably.

Alderton Had been warned off?

Cosgrove Well, have been told “If you go near the Commerce Commission, don’t come Monday.”, or “… nothing will be on the shelf next year.”

Alderton I’m not aware of any matters.

Cosgrove But if that was occurring, that would be perverting the course of justice, presumably.

Alderton Basically, our assessment is against the Commerce Act. So what we’re doing is collecting the information and making the assessment of the behaviour against the Commerce Act or other Acts that we enforce.

Cosgrove Would you be asking parties if they are under duress or have been under duress or threatened with commercial duress, when you speak with them? Because I would have thought that would have been reasonably germane.

Alderton We’ll be collecting the information we need to make the assessment under the Act.

Chair Understanding that this is the financial review of the Commerce Commission and, probably, digging deep into some of these cases is not necessarily the purpose of this meeting. Do we have any further questions? Right. Well, thank you very much, gentlemen, for attending here today. We appreciate your time here.

Conclusion of evidence

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2012/13 financial review of Drug Free Sport New Zealand

Report of the Government Administration Committee

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Drug Free Sport New Zealand

**Recommendation**

The Government Administration Committee has conducted the financial review of the 2012/13 performance and current operations of Drug Free Sport New Zealand and recommends that the House take note of its report.

**Introduction**

Drug Free Sport New Zealand (DFSNZ) is an independent Crown entity established under the New Zealand Sports Drug Agency Act 1994 and continued by the Sports Anti-Doping Act 2006. The organisation works to maintain a culture in which New Zealand sportspeople reject doping. It is responsible for implementing and applying the World Anti-Doping Code in New Zealand. Its total income in 2012/13 was $2.56 million, and its total expenses were $2.262 million, resulting in a surplus of $297,802.

Drug Free Sport New Zealand received a rating of “good” from the Office of the Auditor-General for its financial information systems and controls, its service performance information and associated systems and controls, and its management control environment.

**Drug use in New Zealand sport**

A core function of DFSNZ is to monitor drug use in New Zealand sport. Drug use in sport is commonly referred to as doping. As a recent investigation by the Australian Crime Commission showed evidence of wide use of prohibited substances in Australian sports, we asked if there was evidence of similar practices in New Zealand. DFSNZ told us that the extent of doping in New Zealand was unknown, and had not been generally investigated. It is continuing to work on its relationships with the New Zealand Police and the New Zealand Customs Service, to improve its ability to monitor and investigate doping.

We asked whether increasing professionalisation and financial incentives in sports were pressuring athletes into doping to remain competitive. DFSNZ said there was no clear link between the two, and that historical evidence showed that many sports without financial incentives had a high incidence of doping.

**Reaching young people**

DFSNZ seeks to educate athletes and those involved in sport about doping and banned substances. It is developing strategies to engage with young people, to educate them on doping and banned substances and persuade them that they can win without resorting to drugs. DFSNZ admits that there are limits to how many young people they can reach, but they try to catch their attention as much as possible, and are starting to use social media for educative purposes. Recently, DFSNZ piloted an online education seminar on cannabis use, which showed positive results, especially when the coaches were involved and were committed to the programme. We support these initiatives.
World Anti-Doping Code

We were interested in the new World Anti-Doping Code and how the changes in the new code would highlight the involvement of all personnel involved in deliberate doping. DFSNZ told us that a new World Anti-Doping Code would come into effect in 2015, and that it had a stronger emphasis on punishments for everyone involved in deliberate doping.

Testing for cannabinoids

We heard that the use of cannabinoids by athletes causes between 60 and 70 percent of all positive tests for banned substances. DFSNZ told us that much of its time is taken up with work related to the use of cannabinoids, which are banned substances and must be tested for. However, there is little evidence that cannabinoids improve performance, and a solution could be to lift the threshold for cannabinoids testing to proof that the athlete was under the influence of the drug on the day of the sporting event. This would give DFSNZ more time to focus on preventing doping and educating athletes.

We appreciate the candour of Graeme Steel, Chief Executive Officer of Drug Free Sport New Zealand, and note our appreciation for his work to keep New Zealand at the forefront of international efforts to stop dope cheats in sport.
2012/13 FINANCIAL REVIEW OF DRUG FREE SPORT NEW ZEALAND

Appendix

Approach to financial review
We met on 9 April and 14 May 2014 to consider the financial review of Drug Free Sport New Zealand. We heard evidence from Drug Free Sport New Zealand and received advice from the Office of the Auditor-General.

Committee members
Hon Ruth Dyson (Chairperson)
Chris Auchinvole
Kanwaljit Singh Bakshi
Hon Trevor Mallard
Eric Roy
Mojo Mathers

Evidence and advice received
Organisation briefing paper, prepared by committee staff, dated 9 April 2014.
Drug Free Sport New Zealand, Responses to written questions, dated 9 April and 2 May 2014.
2012/13 financial review of the Earthquake Commission

Report of the Finance and Expenditure Committee

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2012/13 Financial Review of the Earthquake Commission

Earthquake Commission

Recommendation

The Finance and Expenditure Committee has conducted the financial review of the 2012/13 performance and current operations of the Earthquake Commission, and recommends that the House take note of its report.

Introduction

The Earthquake Commission (EQC) is a Crown entity, established under the Earthquake Commission Act 1993. It provides natural disaster insurance for residential property, covering the first $100,000 worth of damage to dwellings, the first $20,000 of loss to contents, and part of the value of damaged land. It also administers the Natural Disaster Fund, and funds research and education about natural disasters and ways of reducing their impact.

EQC’s 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.

Sir Maarten Wevers took up the role of board chairman on 1 August 2013 with the retirement of Michael Wintringham, who had held the position since 2006. The chief executive is Ian Simpson.

Performance and financial position

EQC’s work in 2012/13 continued to be dominated by claims from Canterbury, but it also paid out $13 million on more than 3,900 claims from other events. During 2012/13 the commission paid out $1.8 billion on claims from the Canterbury earthquakes, taking the total paid out to $5.7 billion.

About $6.7 billion of outstanding claims remain to be settled in Canterbury. When offset by the commission’s assets (reinsurance recoveries, cash, and investments), EQC’s net liabilities were $1.4 billion for the year, compared with $1.6 billion for 2011/12.

Audit report

Since EQC’s liabilities exceeded its assets, the auditor’s report on the commission’s financial statements draws attention to the going concern assumption, noting that the Crown is obliged under the Earthquake Commission Act 1993 to fund any shortfall in the Natural Disaster Fund, from which claims are paid.

As in the two previous years, the 2012/13 audit report notes several areas that need improvement in the commission’s management control environment and its service performance information and associated systems. (The commission’s financial information systems and controls were graded as “good”.) The Auditor-General acknowledges that the past three financial years have been extraordinary, requiring pragmatic responses to pressing issues; however, the office has recommended a number of improvements, and reports that the commission has taken appropriate steps to address them. The auditors
found that EQC has an appropriate degree of oversight, in areas including the identification, assessment, and management of risk.

The audit report also draws attention to uncertainties in the calculation of EQC’s outstanding claims liability. EQC’s chair said that the board has taken advice from expert international actuaries, and is confident that the valuation of $6.7 billion is a sound assessment of the maximum outstanding liability.

Reinsurance

The commission succeeded in securing a $3.25 billion reinsurance programme, at rates slightly lower than the previous year. It received $1.3 billion from reinsurers in 2012/13.

The commission attributes the slightly more favourable rates to the behaviour of the insurance market as time passes after the Canterbury quakes, but also to the work that has been done to understand liquefaction, and the resulting recognition that the same risk does not extend across the rest of the country. The Government’s approach with red zoning has also helped, by removing some of the riskiest areas from the portfolio insured.

Canterbury home repair programme

About 40,000 home repairs had been completed by the end of the 2012/13 financial year; 51,000 are now finished, and about 25,800 full repairs remain undone. EQC has announced that it aims to complete all repairs under the Canterbury home repair programme by 31 December 2014, a year earlier than originally envisaged. It considers that this target represents a big challenge, but one that can be met, with a stretch, given the strong commitment from Fletcher EQR, and it is making every effort to do so.

We asked whether the push to meet an end-of-year deadline for repairs would increase the risk of substandard work, or of higher project management costs, noting that the Auditor-General has already flagged such costs as fairly high. The commission said the project faces numerous risks, but overall project management costs are capped, and both EQC and Fletcher EQR are committed to completing repairs to an appropriate standard. The commission told us it expects to pay more for contractors as the pace of the rebuilding increases, and with it the demand from private insurers for workers. It is taking steps to manage this tension, including paying bills weekly, which can appeal to contractors for cash-flow reasons.

We heard that the main difficulty in meeting the end-of-year target is likely to come from multi-unit buildings. These are complex cases with some apartments insured and some not, some damaged and some not, and with several insurers involved, so it has to be agreed who will take the lead in arranging repairs. As the cost of damage in such cases would exceed EQC’s cap of $100,000, it would not be the lead agency.

Some other claims are awaiting new guidelines from the Ministry of Business, Innovation and Employment about foundation repairs, taking into account what has been learned about soil prone to liquefaction. EQC told us it expects the guidelines to be issued in the second quarter of 2014. It noted, however, that the issues will inevitably become more difficult as the last claims are dealt with.

1 Controller and Auditor-General, Earthquake Commission: Managing the Canterbury Home Repair Programme, October 2013.
The commission said that most claims involving damage of less than $15,000 had been settled, covering 69,490 properties, but claims on 9,876 properties, many of them multi-unit buildings, are still to be resolved.

Managing the risk of fraud

The commission is well aware that the scale of Canterbury’s reconstruction presents opportunities for fraud. It has a specialist claims review team and takes many precautions to minimise the risk; it also welcomes information from the public about suspected instances of fraud. Several cases have already been passed to the police, with some convictions. We heard that EQC had thus far determined that a total of $9.5 million has been saved, recovered, or targeted for recovery from fraud.

Handling of information

Privacy breach

In March 2013, the commission breached its customers’ privacy by sending an incorrectly addressed email, triggering the temporary shutdown of its email systems, website, claims processing systems, and social media channels. One other significant breach occurred during the year. The Privacy Commissioner carried out an audit of EQC’s internal processes, and the resulting recommendations have been implemented.

We asked how confident the commission is that its systems will now prevent further breaches of customers’ privacy. The board chair and chief executive told us there is always the risk of a breach, given the volume of information handled, but they believe the security measures now err, if anything, on the side of caution. Because it is not the right time to upgrade technology to a platform with better document management control, the measures involve manual double-checking in a peer-review process. While cumbersome, it has prevented any further major breach.

Requests for information

The commission is also working to improve the speed with which it handles requests for information. It encountered a surge in requests under the Official Information Act (OIA) after the Canterbury earthquakes, and allowed a large backlog to build up. As at 30 June 2013, it had 1,427 outstanding OIA requests, of which 1,210 were outside the 20-day statutory timeframe for response. A joint investigation by the Chief Ombudsman and the Privacy Commissioner found that EQC had failed to comply with its obligations under the Official Information Act 1982 and the Privacy Act 1993. Their report, published in December 2013, is currently before the Government Administration Committee for examination.

We heard that EQC is implementing the report’s recommendations. It has taken on additional specialist staff, and now has 48 people dedicated to OIA requests, probably the largest such team in Wellington. It has undertaken to complete all new requests within the statutory 20 days, and to clear the backlog by April 2014. We were told that it is on track to do so, and the 1,200 requests received since September 2013 have been answered on average in just over 10 days.

Some of us expressed concern that the commission allowed this problem to develop, agreeing with the Ombudsman and the Privacy Commissioner that access to information remains an important basic right, even in the difficult circumstances following a major natural disaster. A lack of basic information can hamper homeowners’ ability to negotiate
with insurance companies and move ahead with repairs. The chair of EQC pointed out that some requests sought commercial information, such as cost estimates for the scope of work, which could not be released without compromising the Crown’s position in negotiating a commercial settlement with Fletcher EQR as to how a dwelling was to be repaired. However, the commission accepted that it should have provided interim responses to claimants explaining the position.

The commission told us that a relatively small proportion of customers, roughly 5 percent of Christchurch households, found it necessary to use the OIA process to seek information. Nevertheless, EQC acknowledged that it needs to improve its communications. We heard that it operates liaison channels by which members of Parliament can enquire by phone on behalf of constituents, reducing the need for formal written requests for information.

As to whether responses to OIA requests by media or members of Parliament were referred routinely to EQC’s chief executive or Minister, we were told that a “no-surprises” principle applies; the Minister was informed of such requests, and some of the responses (less than 7 percent over the past year) crossed the desk of the chief executive.

**Surveys of claimants**

In reporting on its service performance, the commission is required to measure customer satisfaction against two targets: satisfaction with the commission as a whole, and satisfaction with repairs completed under the Canterbury home repair programme. Accordingly, it runs two surveys. We note that 82 percent of respondents were satisfied or very satisfied with their repairs, but that overall satisfaction was below target, with only 59 percent of respondents satisfied with their experience of the commission as a whole.

Some of us believe the commission would get a more realistic picture of clients’ satisfaction if it included in its sample those who are still waiting for their claims to be resolved. The commission said it could look at doing so, but believed the results could be difficult to interpret if people were surveyed while still only part-way through the claims process. It told us it carries out various surveys for different purposes, and surveys customers who call in, which would include people dissatisfied with progress on their claims.

**Events outside Canterbury**

EQC has been addressing claims from several other natural disasters around New Zealand that occurred in 2012/13 and the current financial year. The following data is of interest:

- Opunake earthquake (July 2012): 1,400 claims
- Auckland earthquake (March 2013): 780 claims
- Wellington storm (June 2013): 262 claims
- Cook Strait earthquakes (July and August 2013): 12,149 claims
- Eketāhuna earthquake (January 2014): 3,725 claims

We were informed that the earthquakes around Cook Strait in mid-2013 generated the strongest ground acceleration recorded in Wellington since the 1940s, resulting in the second highest number of claims EQC has received, after the Canterbury quakes. The commission told us it has applied lessons learned from the Canterbury experience in
managing this work, so it has not been distracted from the rebuilding task in Canterbury. It has set up a separate team in Lower Hutt to manage these claims.

**Planning ahead and reviewing the Act**

The Government announced in September 2012 that it is planning to review the Earthquake Commission Act to see if changes in existing disaster insurance arrangements may be desirable. We heard that the review process has not yet formally commenced, but the commission has been providing background information, based on the lessons from Canterbury, about the effectiveness of various aspects of the process. It is likely to be some years before the review of the Act is completed.

**Land trials and research**

EQC is undertaking ground improvement trials to test new scientific approaches to land remediation, which it hopes to apply with land prone to liquefaction or flooding. It continues to support research into natural disasters, and has helped to establish the world’s first chair in the economics of natural disasters at Victoria University. We commend such work, which not only helps to prepare New Zealand for natural disasters, but also secures an immediate payoff by increasing the confidence of international reinsurers, helping to reduce the risk premium New Zealand pays.

**Local body planning**

We agree with the commission that it is vital for the public and local bodies to apply lessons from the Canterbury earthquakes in housing decisions. There is now much greater awareness of the risks of liquefaction and flooding in certain areas, and it is critical that full and accurate information be included in LIM (land information management) reports about properties.

**Staffing**

The Canterbury earthquakes forced EQC to grow exponentially, from 22 staff to about 1,400 at present. It is expected to scale down again once the home repairs programme is complete. This will depend on decisions taken about EQC’s future form after the review of the Act, but it seems likely to end up with fewer than 300 staff. We asked how the commission intends to manage this change. We heard that all staff are still needed at present, but EQC has started thinking about how the scale-down will be managed. It is likely some staff will be redeployed within the organisation initially; later, it might use its recruitment team to seek outplacements for surplus staff with insurers, local and central government bodies, and local industry. Christchurch City Council has already expressed interest in seeing staff redeployed to other aspects of the recovery effort.
Appendix

Approach to financial review

We met on 5 March and 16 April 2014 to consider the financial review of the Earthquake Commission. We heard evidence from the Earthquake Commission, and received advice from the Office of the Auditor-General.

Committee members

Paul Goldsmith (Chairperson)
Maggie Barry
David Bennett
Dr David Clark
John Hayes
Hon Shane Jones
Dr Russel Norman
Hon David Parker
Rt Hon Winston Peters
Jami-Lee Ross
Hon Kate Wilkinson

Evidence and advice received

Earthquake Commission, Responses to written questions, received 18 December 2013, and 8 and 14 April 2014.

Office of the Auditor-General, Briefing on Earthquake Commission, dated 5 March 2014.

Organisation briefing paper, prepared by committee staff, dated 3 March 2014.
The Education and Science Committee has conducted the financial review of the 2012/13 performance and current operations of Education New Zealand, the Institute of Environmental Science and Research Limited, the Institute of Geological and Nuclear Sciences Limited, Landcare Research New Zealand Limited, Learning Media Limited, the National Institute of Water and Atmospheric Research Limited, the New Zealand Institute for Plant and Food Research Limited, and the New Zealand Teachers 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 Cam Calder
Chairperson
2012/13 financial review of the Electricity Authority

Report of the Commerce Committee

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Electricity Authority

**Recommendation**

The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of the Electricity Authority and recommends that the House take note of its report.

**Introduction**

The Electricity Authority is an independent Crown entity established under the Electricity Industry Act 2010, to provide regulatory oversight of the electricity sector. Its statutory objective is “to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers”.

The responsible minister is the Minister for Energy and Resources, and the authority is mostly funded by appropriations from Vote Energy. The Electricity Authority’s chief executive is Carl Hansen. Dr Brent Layton is chairperson of the board.

In 2012/13 the Electricity Authority’s total revenue was $65.796 million and total expenditure was $65.414 million. The total comprehensive income for the year was $378,000 (compared with $384,000 in 2011/12).

**Market competition**

**What’s My Number? campaign**

We asked the authority about its role as a market monitor and queried the effectiveness of its initiative to increase competition, *What’s My Number?*. The campaign encourages consumers to make comparisons between retail power providers. The authority asserted that the campaign had been very successful. The evidence presented by the authority to back this claim was that the target of 50,000 people to visit the website in the first month was achieved in the first three days, and 40 percent of consumers had switched provider in the last two years. During the 2012 campaign, there were 24,209 more switches than those recorded pre-*What’s My Number?* in 2010, with an estimated national average savings of $175 per switch and an estimated annual national saving of $4.2 million. Recent research by Covec has found that the campaign resulted in only a small impact on competition and no significant effect on retail prices. The authority told us that the research in question focused on allocative and productive efficiency effects, whereas the campaign was intended to affect the way investment is made and the dynamics of the marketplace. It contended that the research was too narrow to measure market competition properly. It believes that the campaign created an environment where retailers are more conscious of losing customers.

The authority argued that retail prices are not a good measure of market competitiveness. It explained that falling demand does not automatically reduce prices, as other factors also influence price, including the cost of supply. It said that it looked at costs relative to prices to assess the health of competition in the sector. The authority believes that the *What’s My Number?* campaign has led retailers to absorb $190 million of cost increases rather than pass them on to consumers.
We asked the authority if the What’s My Number? campaign has increased the rate of switching between retailers, and heard that it is rising steadily. The monetary savings have not been very high, but the authority believes the benefits to the consumer are wider, and include increased competitive pressure on retailers. We heard that switching between power companies is becoming easier, now taking three to four days, compared with about 200 days in 2003. The authority has trained Work and Income front-line staff and budget advisory groups in using the What’s My Number? site, in order to reach more vulnerable consumers.

The campaign is funded until April this year, and the retail advisory group is assessing the value of continuing it; their report is expected shortly. The board has made financial provision for carrying on the campaign. The authority told us that they had no information on the profile of users of the What’s My Number? campaign, and some of us expressed concern about the accessibility of the service for consumers without internet access.

**Labour minority view**

With respect to claims by the Electricity Authority as to the $175 average annual saving figure during the 2012 year, we note that the Minister of Energy and Resources cited in Parliament, using Christchurch as an example, potential savings of as much as $600 per annum, which is a vast difference from the figures quoted by the authority.

**Competitive behaviour**

We asked whether the authority thought that power retailers might be working together to keep prices artificially high rather than pass on savings to consumers. The authority told us that any such situation would be more appropriately dealt with by the Commerce Commission, but it was not concerned at present. The authority continues to promote competition between retailers, which is one of its statutory objectives. It believes that transparency in the industry is improving, and this will only benefit consumers. The authority is considering improving transparency further by establishing a retail database comparing all tariffs and offers along with consumption profile information.

**Lines charges**

The authority was established in late 2010, and could not carry out analysis of data about line charges before that period. Added to that, the authority said that the futures market for electricity has only become robust in recent years.

**Market dominance**

We asked the authority if the five big companies that dominate 95 percent of the retail power market might be squeezing out smaller retailers. These five are also generators, which the authority acknowledged gives them an advantage. It told us that among its efforts to promote competition and ensure smaller retailers are not disadvantaged, it has developed a hedge market, which has been very successful. The authority said the new futures market prevents big retailer-generators from rigging prices. It does not believe that a separation of retail and generation will be necessary if the futures market remains robust.

**Vulnerable and medically dependent consumers**

We asked about the authority’s role in monitoring compliance by retailers with the guidelines it has issued regarding vulnerable and medically dependent customers. We were told that the Electricity Authority had surveyed retailers about their compliance with the guidelines and were told that eight had been identified as being substantially behind.
Retailers that do not comply are notified in writing and encouraged to improve their performance. The authority told us it monitors the guidelines but had no role in ensuring compliance. The authority collects disconnection statistics, broken down by retailer, but it told us that policy responses are the responsibility of the Ministry of Business, Innovation and Employment. The authority’s statutory objectives limit its mandate to competition, efficiency, and reliability, excluding the social welfare aspects of retail power provision. It suggested that while it cannot enforce the current guidelines, it finds retailers responsive to its letters; further breaches may encourage the development of an enforceable code. Some of us expressed concern that there was no authority ensuring the enforcement of guidelines to protect vulnerable people.

**Drivers of energy costs**

We asked the authority about the reasons for increases in energy costs. It explained that peaks in residential consumption outpace the supply of power from renewable sources, requiring the use of gas and coal to meet immediate demand. These sources are more expensive.

The authority also said the cost of energy tends to fall in the very long term, while in the short term—if the market is working well—power use would move progressively from the cheapest option through to the most expensive. This means that in the medium term, costs will tend to rise if there are no major technological changes.

**International best practice**

The Electricity Authority’s annual report states its goal of being a world-class electricity regulator. We asked how it believes it compared with other regulators globally. The authority has hosted visits from a number of overseas regulators keen to learn from it. It will host an Asia-Pacific energy regulators’ forum later this year, an opportunity reflecting its good reputation. Senior authority staff are highly sought after by other agencies, and receive offers to speak at conferences. However the authority is conscious of the need to avoid becoming complacent.

**Tiwai Point**

We asked how a potential closure of the Tiwai Point aluminium smelter might affect energy prices. The authority said that existing lines infrastructure should be able to move the resulting excess power north, and power wastage would be unlikely. An initial reduction in wholesale prices would be expected, and hopefully healthy competition would ensure the savings would be passed on to consumers. The authority said, however, that not many in the industry are predicting a closure in the short term.
Appendix A

Approach to this financial review
We met on 20 February and 13 March 2014 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
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Evidence and advice received
Electricity Authority, Responses to written questions 1–167, dated 20 February 2014.
Electricity Authority, Responses to additional written questions 168–178, dated 10 March 2014.
Office of the Auditor-General, Briefing on the Electricity Authority, dated 20 February 2014.
Organisation briefing paper, prepared by committee staff, dated 8 January 2014.
Appendix B

Corrected transcript of hearing of evidence 20 February 2014

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Clare Curran
Kris Faafoi
Julie Anne Genter
Hon Jo Goodhew
Mark Mitchell
David Shearer
Dr Jian Yang

Witnesses
Brent Layton
Carl Hansen
Androula Dometakis

Young It’s good to have you here. I think it’s the third time you’ve come to report. You’ve done three annual reports since your conception.

Layton Yes, that’s right.

Young Let me just introduce the committee to you. [Introductions] If we could start off with your presentation. Thanks very much indeed for the slides you’ve sent to us in advance. We will go up to 10 minutes with your presentation, if that’s all right. Then we’ll come to questions.

Layton Thank you, Mr Chairman. We have only five slides to deal with. The rest are really background in case people ask questions about particular issues or whatever. The first slide that I have is labelled No. 2, and that just sets out what the statutory objective of the authority is. It is to promote competition and reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers. Unlike our predecessor, we don’t have any social welfare or environmental obligations. It’s not that they’re unimportant, but the decision was made by Parliament that they should be dealt with by the appropriate bodies and that we be required to focus on the electricity market.

As you’re probably aware, we were established in 2010, the very end of 2010, and we were the outcome of a ministerial review that was conducted during 2009, and I had the privilege and the honour to be the chair of that. That ministerial review was about improving the governance and performance of the electricity market. It made 29 recommendations, so that suggests that it concluded that there was a reasonable amount of
improvement to add to both of those areas—the market and the governance—and we were tasked by pursuing that statutory objective and we were required within the first year to undertake a number of specified items or else they were going to be dealt with by the Minister and the ministry. We did, in fact, achieve all of those—six, I believe—items it was.

Hansen Seven.

Layton Seven items. We are—and most people don’t realise this—effectively a third-tier legislator. Our predecessor was not. It was, in fact, an adviser to the Minister, and the Minister, in fact, authorised—

Member A third tier?

Layton Legislator. And that’s a rather unusual structure, and I’ll explain why it came about and what it implies. Parliament, of course, is the principal legislator, the first tier. It sets the law. And, of course, it passed our Electricity Industry Act 2010, under which we must operate. Then you have Orders in Council, which are officially done by the executive arm, but really it’s Ministers setting regulation is the second tier. And then the authority has delegated powers to actually set electricity industry participation code, which have legal effect and are like regulations but they can only apply to the electricity industry and they must meet a whole range of requirements. Parliament has seen wisdom in restraining our ability and our scope, given that we have a degree of delegation here.

So we’re an independent rule-maker—looking at the next slide—and that was adopted because the Electricity Authority and electricity itself—the electricity rather, rather than the Electricity Authority, is a very capital-intensive industry and also is an important industry. Generation, transmission, distribution all require significant capital investment. And modern life and a good economy also depend very critically nowadays on electricity.

Large industry energy users are also capital-intensive and make decisions on the basis of what they think may be future prices of electricity and the conditions of supply and its reliability of delivery, which is also an important element. Under section 12 of the Act—that’s the Electricity Industry Act which we were established under—the authority was set up as an independent Crown entity. Other provisions in that Act set the skills required by the authority. The authority is required to have advisory groups by legislation. It’s not an option for us; we have to have advisory groups. Those advisory groups have to have a range of experiences both from the consumer side and the industry side.

As a further check on the authority, section 39 provides that we must undertake, if at all practicable, cost-benefit analyses, and we must go through extensive consultation processes before we change any of the rules in the code that we have. And as you’re well aware, I mean, the law is quite clear about how consultation has to be had. We do have a provision that we can make urgent code changes, but they lapse automatically within 12
months if they are not renewed and gone through the proper process. So we have severe constraints.

We also have severe constraints on our ability to grant exemptions. The rationale of the policy advisers behind the Act were since we have the ability to set the code, we should not be going and making ad hoc exemptions. We should only do that if we really think there’s an issue and we should go through the proper process and change the code. Our predecessor had much wider abilities to give exemptions and did indeed give lots of exemptions. They were adopted as provisions by Parliament to provide assurance to the electricity industry, and that includes consumers as well, that rules will be developed and will be enforced based on impartial and professional analysis.

It happens to be the case that unintended consequences from rule or code changes are not only a very real possibility but can be also potentially extremely serious in the electricity industry. It is a complex industry. There are large amounts of capital both dependent on the supply of electricity and providing it and the ability to, in fact, make a quick judgment, make a decision, and not understand all of the implications is a very real problem in the industry. One can look internationally to see circumstances where that has happened. So Parliament in its wisdom decided we had to have those extensive consultation processes. We are an independent rule-making authority and I have already explained why we have that character.

In terms of the instruments we have, Mr Chairman, we really have to operate on two areas. We can alter the structure of the markets that we are there to, in fact, oversee and monitor and pursue our statutory objectives through, or we can alter conduct in those markets. I have given some examples of early things that fall into both those categories. But, to be blunt, consumers, who, in the end, are the parties that we are charged with pursuing the long-term interests of, aren’t really interested in the structure of markets or the conduct of markets. They’re interested in performance. They’re interested in the outcome. They’re interested in whether they do have security of supply, whether electricity is going to be delivered reliably and they actually have confidence it’s going to be delivered reliably—not just as the experience but they are confident that will be the case. They also want to see competitive prices in the wholesale market, and they want to see that translating through into competitive retail prices.

Each year the authority adopts a top 10 priority projects. We’ve listed the ones for the year you’re reviewing here in 2012-13. Of course, we have some for the current year, and what progress we’ve made on those, in slide 8. A large number of initiatives have been adopted in total since November 2010, and we give some more details of those, if you’re interested, in slide No. 9. It takes time for initiatives, initiatives working on structure, in particular, but also even conduct initiatives, to have their full impact on performance, but those are the levers we have available to us.

What do we think we’ve done? In my view, I think the authority has made very significant progress since it was set up in November 2010. In terms of
reliable supply, I’d remind members of the committee we had a sequence of dry year crises. That was one of the reasons why people were getting very dissatisfied with the electricity market. From 2001, 2003, 2006, 2008—in a number of those years we ended up with conservation campaigns. This was clearly undermining the confidence of consumers, including industrial consumers, about the reliability of the industry, and we think we have fixed that, although we will remain vigilant. We have had in 2012 the driest first 6 months of the year in the whole 82-year history, yet there wasn’t a problem. We also had a very dry 3 or 4 months last year, and we’re going into a period where we haven’t had much rain recently in the relevant areas, and yet the market is responding as we would expect it to and the conservation of water is occurring as is appropriate. So we think that’s a tentative tick, but vigilance is always required.

Competitive pricing in the wholesale market—some of you will recall a report by Professor Wolak to the Commerce Commission that appeared in 2009. It looked at what had happened between 2000 and 2008. While even Professor Wolak now agrees that he didn’t calculate $4.3 billion supposed super-profits—that was calculated by somebody else, and he has in a recent visit to New Zealand confirmed that that is not what he thinks was going on and it was a misinterpretation. But he did highlight an issue that the ministerial review picked up, and that was that there were occasions when wholesalers would have both the ability and the incentive to jack up prices in the market structure that was there when we reviewed it in 2009. Big changes were made. A bold move was taken to shift the ownership of two major generation plants, but also to put in place virtual hedges and to stimulate by requirement that there be market makers and the development of a hedge market. Recent research suggests that now it’s down to 2 percent of the time rather than about 20 percent of the time. That’s not to say that they actually do it in those times, but the potential has now been greatly reduced, and we are working through a code change that we’ve had recommended to us by the wholesale advisory group to deal with the 2 percent effectively.

Competitive prices, retail prices—we think there’s been growing signs both in the structural change there and now leading, as we’ve shown you in previous years with those colour heat maps that we’ve put out, that now we’re getting, in fact, behavioural change. There’s lots of discounts out there for people who are shopping around. We have quite a campaign of pushing it beyond the active consumer to the competition being there for the passive consumer. We want to make sure that people who are more passive about it are getting the reductions. We do have a problem that the actual price statistics don’t pick up all the special discounts which are a feature of the current market.

Young: Great. Thank you very much. We’ll come to questions from this side.

Shearer: Thank you very much for your publication thing that you’ve put out. Would you term yourself a watchdog as well as a regulator in the way that you’ve set up the Electricity Authority?
Layton Yes. In fact, one of the things that our predecessor, the commission, didn’t have in its roles or functions was being a market monitor. One of the changes that was brought in by the 2010 Act was that we are a market monitor, and we do actually have a whole unit that is involved in monitoring the market. We hold investigations and we publish the reports. Some of them are very technical in nature, but we have an open process of actually actively monitoring the market.

Shearer You’ve mentioned competitive prices as being the reliability, obviously, and that’s performed very well but on competitive prices—one of the answers to written questions that we put in as part of this process was the effect on competitiveness measured on the HHI. This is on page 6 of the financial review responses. It actually showed that the switching that you’ve put a lot of emphasis on didn’t show, or showed only a small amount of change in terms of competition, and that retail prices, in fact, there was no significant effect. Do you want to comment on that, and I guess there has been a lot of switching around and actually the retail price has continued to climb.

Layton Yes, I can give two lines of comment on that. Firstly, this is research that was conducted by MBIE, not by us, and the way that the research was conducted by Covec is that they were able to measure what you call the allocative and productive efficiency effects, because they’re much more easier. In fact, our whole policy was aimed at changing how investment occurs and the dynamics of the market place. So that they should come out with relatively small measures is not a great surprise. As you probably know I used to be an economic consultant. When I saw the report I wondered—and I was talking about this with one of my former colleagues a little while ago—why Covec actually carried on with the project, because it wasn’t going to get to the root of the issue. What has happened—

Shearer Have retail prices come down as a result of that, then? Significantly? Because they seem to be suggesting that retail prices, underlying prices are actually rising.

Layton Well, rising prices, of course, is not a good measure of whether a market is competitive or not. We’ve put it in a slide, which I can turn you to, in the back, just to explain the issue. We’ve noticed that in a large number of public comments that have been made by public commentators, that we have a number in the sector of, but also in blogs there has been an argument that the electricity demand has fallen—

Young What page is that on?

Layton —page 17 of our slides—and therefore prices to residential consumers should fall, and that if prices don’t fall, then that proves the electricity market isn’t competitive. It sounds, on first rush, to be a good argument, but if you actually think through it, the underlying assumption is that other things are held exactly the same, and, in particular, that the costs of supply are not increasing as well. My apologies to the committee, Mr Chairman, but I put some simple partial equilibrium stage 1 diagrams of demand and supply at the bottom of that thing, illustrating that if supply costs—that is, costs—are also rising at the time demand is flat or falling, then you may get
an outcome that’s one way or the other, that you have to look at what is happening to costs relative to prices to make a judgment as to whether competition is really having a bite or not. And that is what we’ve done on the preceding two slides.

Shearer I can see that when we look at even the cheapest supplier for medium-sized households over the last 3 years, places like Northland, the poorer areas of our country, gone up $457; Waikato $410; northern Taranaki and southern Taranaki $574; Christchurch, in the middle of the earthquake, earthquake hit, $322. These are big increases in price for these people.

Layton Yes, and the question is whether the costs justify it.

Shearer And when you look at the certainly the answers that we got back, the proportion of the bills which were due to, say, for example, lines charges, has actually, since 2008, has actually gone down rather than gone up. It’s the wont of many of the power companies to push all the costs on to lines charges and Transpower and various others, but, in fact, those costs have decreased.

Layton I suggest we have a look, Mr Chairman, at slide 14, because exactly the question you’re raising is one that we, of course, have raised, because we want to monitor the market. This goes back to when the authority started. There is a reason for that and that is this is easier to do when you actually have a robust futures market, which we have had in recent years. But if you go back beyond that, it becomes more difficult to carry out this analysis. But what this has done is worked out what are cost drivers for a retailer in the electricity market.

You can see, the blue is the energy cost, the wholesale energy cost; the red is the cost of distribution; the light blue is the cost of transmission; the orange are the overheads; and then there is also a grey for GST and the EA levy. You can see at the beginning that there have been significant transmission amounts come through in the chart in terms of the June quarters, but mostly in June 2012 and June 2013. The blue was rising, was providing cost uplift until you get to September 2012, but since then, as is well known, the wholesale prices have been falling away. And the grey—of course, there’s the GST going from 12.5 to 15 percent, and then every year you get a cost impost because if the prices go up—and the rate of the distribution, which again comes through in June. So that’s one picture which is showing what were the cost drivers, which is one element of it.

If you turn to the next slide, what we have done is looked then at—and we have taken MBIE’s quarterly survey data, which is not a good measure because it doesn’t include the special discounts. And as you start driving competition in the early phases, into a market, that’s where the reaction of companies is. They don’t want to discount everybody. They’d like to discount just the ones they think are going to leave.

Young Just their standard retail charge?

Layton Yes, this is the standard retail tariff, and that is the red line, where—the brown line is from that previous chart and shows what was happening to
costs. You can see that the brown line has gone up much faster. It’s gone up 21.5 percent over those 3 years since the authority was formed, whereas there’s only been a 12.5 percent increase in the prices to retail consumers. We’ve worked out the difference between those two, which is we think an underestimate of the reality, is that the increasing competitive pressure, and there’s still a lot of work to do—but the increasing competitive pressure, which, as we know, really started after June 2011 when we got our What’s My Number campaign up and rolling, has, in fact, led to the retailers having to absorb $190 million of cost increases and not be able to pass them on. We think that’s a measure that the market is becoming more competitive over time. We still have a work programme to do in that area.

Shearer In terms of that, one instant I just wanted to get your comment on—Vector, when they were compelled by the Commerce Commission to lower their prices by 10 percent, those savings were not passed on to consumers, perhaps with the exception of Meridian. Does that imply that therefore effectively the power companies acted together not to pass them on and quietly pocketed the savings?

Layton Well, you may recall not last June but last February at our stakeholders meeting—we hold regular stakeholder briefings here in Wellington; we held one a few weeks back—I actually did highlight that issue and suggested that the behaviour of some of them may be looking at signalling to one another about what they were going to do with prices. We got shock, horror. It didn’t stop us sending our concerns to the Commerce Commission, who deals with those issues and whom I have no doubt went and had a look at it more closely.

Shearer But it does signal a degree, certainly a degree of conversation between these companies, an uncompetitive behaviour.

Layton No, it signals that as a regulator we have to keep our eye vigilantly out there, and we do have to keep progressing on pushing more competition, and we have had a number of retailers say: “Oh, you’re going too far, you’re going too fast, you’re doing too much.” We expect that. Our reply has been our statutory objective is to promote competition, promote reliability, and promote efficiency, and that’s what we’ll continue to do.

Shearer Lower prices for good terms?

Layton No, it’s to promote more efficient prices, to make sure that prices reflect costs. If costs are continuing to rise, then you cannot expect prices to fall. What you can expect is restraining increases in prices to reflect efficient costs. Not historic costs but efficient costs, which can and usually are below historic costs.

Genter I accept the point that you’re making about the retailers having to absorb increased costs. The largest share of the increase in costs since the end of 2010, according to your bar graph on page 14, is in energy costs. I was just wondering, since we don’t have years previous, I wanted to drill into what was driving that increase in energy costs. I mean, presumably some of it was dry years. I’d like to be able to put this increase that’s in your line graph on
page 15 into context over the, you know, maybe a greater context, and also understand if you see energy costs increasing in the future; if so, why.

Layton If you go back further—we’re not responsible beyond 2010 but it’s an interesting point. There were very large increases in the costs of gas in New Zealand, and for residential customers they tend to have consumption that is very peaked around the breakfast time and then around dinner time and in the evening when they watch television. Those times, of course, we had to move from our renewable resources, which we have a very good base of, to using those gas plants and, in some cases, especially in winter, coal-fired to deal with those peaks. So that tends to make serving a retail customer a little more expensive. So really you can explain a lot, but not all, of that rise up to 2008 or 2009. The ministerial review I chaired concluded that we did need more competition in that sector, and that’s why the statutory objective of the authority was brought about and why we’ve been pursuing quite aggressively, in fact, very aggressively, a promotion of competition policy.

More recently, of course, you did have demand continue to grow until about 2008. You had extra capacity come on, and one of the characteristics of an electricity market is that while in the very, very long term the cost of energy tends to fall—if you go back over hundreds of years—in the shorter term, if the market is working really well, you would actually expect you to move from the low cost to the next lowest to the next lowest to the next lowest. So you would expect that the cost in that medium term if you don’t have a technological change will tend to rise as time goes by because you use the cheaper option before you use the more expensive option when you’re expanding capacity. We haven’t had expansion. We haven’t had a contraction but we haven’t had expansion since about 2008, 2009, but, as you can see, the trend since about 2012 has been that energy is no longer contributing here.

Genter Yes.

Young Can I come to a question—on slide 15 essentially here in your slide you’ve highlighted that $190 million of costs were absorbed by retailers. Rather than passing them on, they absorbed them, demonstrating, as you’ve said here, or implies a workably competitive market. The What’s My Number campaign, where consumers switched and they created churn, was that a contributing factor to retailer holding-back costs or what?

Layton In our opinion, yes, but in a dynamic sense, not in the static sense, which is what, because the limitations of technical methodology of economics, Covec clearly focused on. We think that it created a dynamic where firms had to start thinking about losing customers. Prior to that, what we found in 2009 was a market which is the result of the speed with which the retail and distribution arms have been split up in the late 1990s, you had the retail generators very much in silos in specific areas, and not competing across the board. We had to break that up, expand competition, and change that structure.

Young So that asset swap plus the hedge market plus the consumer switching created that sort of dynamic.
Yes, plus other changes, and I could go on endlessly. There’s a whole lot of much smaller changes that have been brought about that have helped retail competition.

Are we going to see any further changes?

We have a slide, in fact—if you look at slide 9—that gives more of those examples, but, again, only examples.

Can we anticipate further changes that will continue to drive this competitiveness?

Yes, you can. You will have probably seen the Business New Zealand report that came out that said generally that it was going well but one area was greater transparency for consumers in their bills. That’s important in terms of the more passive consumers. We already had in our work programme—I’m surprised they haven’t picked it up, because we consulted on it—for this year and going forward actually working on improving the transparency of the actual cost drivers. One of the problems in this industry has been in the past it’s been very murky. We used to have the same problem about petrol. Now we all sort of understand the refining margin of the international price and the exchange rate as a driver, and we’ve got to a point where we can feel confident that if it’s not moving as we think it should, then somebody—AA in that case—will be saying something. We need to be in that similar space, I think, in relation to electricity. But it takes a little while.

So for the passive consumer, perhaps those who maybe don’t go online and do the comparisons and things like that, what you’re proposing is that you’re going to create a more transparent retail space.

That’s one element, but another key element for the passive consumer is that the way the market’s worked—and it’s worked for quite some time about this—is that when you want to switch retailer, then it has to be changed at the registry. But that provides advance notice to your current retailer that you’re about to go, so they operate a saves regime—that is, they will go out and offer a special deal to people, as they do. This happens in banking too. I used to be on the board of a bank and we had a whole little computer system that did this. They also have a win-backs regime—that is, people who’ve actually gone, going back to them 2 or 3 years later. Now, when you think about it, they know the customer profile, they know whether they pay their bills, they know how much consumption they have, and we have been asking the question of whether that’s right. We’ll be putting out a consultation paper very shortly about that issue. We’ve raised it. I have to say, the initial reaction from the retailers was less than warm, but that’s the role of a regulator. They seemed to have warmed under threats of other things happening to them, which is quite helpful, and we will look at all the pluses and minuses as we have to do, and I think the likelihood is that that’ll be an activity that goes.

Mr Chair, the main objective of your authority is to create competition, which should benefit the consumer. So on that, you’ve just mentioned you
have run a programme, What’s My Number. So can you elaborate on what sort of response you got on What’s My Number—how many people switched over and how much benefit they got.

Layton

I’ll get the details from the chief executive, because his memory of those precise numbers will be better than mine. While he finds the precise figures, some things that you should be aware of is that it’s created quite a lot of interest internationally. It’s very interesting that the next group I have to go and talk to after this group are a group of Australian energy retailers who have decided to come to New Zealand—and there’s about 12 of them—to actually find out what’s going on here. The questions they’ve asked clearly indicate they’re not here because they think what we’ve been doing in the retail space is not something that a regulator, that they are, would not pick up. They’re looking at us, thinking their regulators should be starting to look at what we’re doing, and we’re finding that internationally. From memory, have you got the figure?

Hansen

Yeah, so we’ve had a steadily rising rate of switching going on. Our aim isn’t to necessarily create that kind of churn. What we want to do is raise the awareness that people can find better value in the market, and by that process that puts more competitive discipline on the retailers. But if you look at page 65 of the response to your questions, at the bottom, our response to question 152, we listed the increases that have been going on and we’ve shown it graphically on page 66. So what we’ve found is that the What’s My Number campaign, we know from when it was first introduced it was incredibly successful. The original targets were for 50,000 people to look at the website and consider switching in the first month, and that was actually achieved in the first 3 days. So it was one of those campaigns that came out, I think, at a fortuitous time. It hit a chord, people really got into it, and it’s taken off.

The actual savings have varied from year to year. In terms of just thinking about the direct savings of people that have actually switched themselves, it has varied between about $4 million to $8 million a year, depending on which year you’re talking about. But we believe that the benefits to the consumer are far wider than that because what we’ve seen is much more competitive pressure on retailers. They’ve altered their pricing decisions, and that has actually driven a lot of value for a lot of other consumers. And that is much harder to estimate, but we do believe that it’s in the range of about $16 million to $41 million.

Bakshi

You just mentioned that consumers have been switching from one company to another. So was it difficult before this campaign started? If you can just tell us about that.

Layton

It had improved considerably before the campaign started, but it still improved since the campaign. But if you go back to—this was one of the reasons for having a campaign—the early 2000s, in fact there was a very, very bad experience of consumers when the lines companies gave up being retailers and it shifted, and the average time then was in the hundreds of days.
Hansen  Yes, 200 days in 2003 it was.

Layton  Soon after we came in we lowered the standard, and that brought another chunk. We’re getting to the point now where the benefits of lowering it further—it’s down to about 3 to 4 days to switch and just involves either the click of a mouse or a phone call. Much beyond that and you start running into issues of people not having the time to actually think and change their mind about it, and that can be inefficient in itself. So we don’t have a campaign to drive it down to below that. Technically, you could, but it’s probable that the benefits of going further than that are outweighed by the costs.

Shearer  But nevertheless the Covec report does actually say there’s been no significant impact on retail prices, which—it’s the old story, really, isn’t it? If you’re a department store and every department store has a sale, then ultimately it’s not a sale; it’s just the new price. That’s in effect what you’re saying here, is that prices still have continued to climb. But I want to come back to your consumer saves, because it comes to the question really—and we’ve seen this with Genesis—that the number of consumer saves has doubled over the past year and probably in areas where there is very little competition. So, effectively, what they’re able to do is squeeze out small retailers and use their competitive advantage of having this wholesale arm attached to them as well in a sense to be able to do that. I’m wanting to get your thoughts on the fact that the market at the moment is 95 percent five big companies which are generating capacity, and the ability for small competitors to get into the market at the moment is actually pretty limited and they can be squeezed out as a result of the practices of larger “gentailers” in you like.

Layton  There are a number that have made entry, and, yes, in terms of the totals they have grown from a very small base quite significantly. I’m not sure whether we fitted that chart in. We did have a chart that showed the things.

Hansen  It’s about 100,000 customers for this group of small retailers. And it’s growing fast. The graph is pretty steep.

Shearer  Do you think that they have the savings of operation and the same ability to operate in this sort of environment when they don’t have a generating arm?

Layton  We see it as part of our promoting competition, of looking to have steps in place so that they aren’t disadvantaged in the market place, and that’s one of the reasons that we developed a hedge market. And we have been very successful in developing the hedge market. There is now well over 3,000 gigawatt hours of contracts open on the hedge market, which was the target that was set right back when he held the ministerial review.

Shearer  Do you think the hedge market works as well for small retailers—

Layton  Yes, it does.

Shearer  —without a wholesale base?

Layton  Because it allows them to buy by taking long futures contracts, up to 4 years out into the future, and there are open positions out in that distance, so that
there is a market, an alternative, that you can use to enter in that. And that’s one of the reasons, I think, at the moment we have nine parties, two of whom we think will start this year, but nine parties who are talking to us about entering the retailing space. If they thought it was impossible, we don’t think we’d have that number. We know of two others that have thought about it and then decided there wasn’t enough profit in it for them. It wasn’t that they didn’t think they could get in there.

Shearer

So you don’t think that the large, the big five, if you like, are using their competitive advantage of having a wholesale generating capacity to squeeze out other retailers, because that’s what other retailers are telling me—that it’s incredibly hard to be in that market against these guys that are, effectively, trying to leverage them out of the business.

Layton

Well, I think that the retailers, the new existing retailer-generator combinations, now have to face the opportunity costs of the futures market, and what it’s showing is an alternative source of supply which is robust. We require the four biggest to, in fact, make two-way prices in that for a specified volume. They do that voluntarily but it’s voluntarily in inverted commas, and what a two-way price means is that they can’t rig the price up because if they start doing that, one of their bids is going to be wrong—that is, they’re going to end up buying too much because they can’t put their bid of their offer more than a specified distance from the bid for the buy, so we actually, I think, have provided a market that is working pretty well, so well that we have had visits from Singapore and they have engaged a New Zealand consultant, not the ones we use, to replicate what we have done, and I don’t think they’re a bunch of people who don’t look for the best model in the world to emulate. They’re about the same size as us. They previously thought you couldn’t do it. I think we’ve demonstrated you can. You can always improve—that’s the point why we have a continuous improvement objective. It’s about promoting competition. If we continue to do it while there’s benefit, promoting reliability, we are required to continue.

Shearer

There’s no rationale, then, for separating out our retail from our wholesale companies so that retailers do actually have the same ability to enter the retail market as the big five have at the moment.

Layton

As you’ve probably found out from your research, I was a major advocate of the separation of retail and generation. I think that it was very unfortunate that it led to the silos coming in, and where they were able to step in it. The ministerial review looked at it very closely, and I agreed with the conclusion in the end that if you could get a futures market up and going and robust, you could achieve the same result without the unintended consequence of the chilling effect on investment that such an action may take. But it was dependent upon us getting that market up and rolling.

Shearer

So you’ve changed your mind.

Layton

I have. I think, you know, back in 2001, 2002, I think I would have done it. I wouldn’t now recommend you do it.
Thank you. I’d just like to go back to the comments that you made earlier on about cost not being the measure of an efficient market. I’m quoting you correctly there?

No. What I said was that historic cost isn’t a measure of whether the costs are efficient.

No, that’s not what you said. I think you said you can’t judge the market being competitive on what the cost is.

Just on prices, because there’s also a cost to you.

Just on prices. You have to compare costs with prices.

Efficient costs and prices.

Efficient costs and prices.

OK. So could I just segue slightly, because the regulator in our country, the Commerce Commission, has a different brief, which is essentially a competitive market in the long-term interests of consumers, so when you’re looking at the pricing side of the equation, there are a percentage in the population for whom price is very important and very sensitive. One of your briefs is to be responsible for monitoring compliance with the guidelines for medically dependent and vulnerable customers. I remember when you came before us last year I asked you some questions around that, and about how you actually monitor that compliance. I’m going to ask you that question again, because as an electorate MP in a part of the country where it’s (a) quite cold in the winter and (b) where there’s a high proportion of elderly and low-income people, those issues are really important. I have had probably in the last 6 months three distinct cases, usually on a Friday afternoon, of people coming into my office who have just had their electricity cut off through Work and Income, and they’re in very precarious states. One had a small baby. She was dependent on bottle feeding and couldn’t boil the jug over the weekend. That might sound trite, you know, to the organisation, but the only way that I could address that was to ring the chief executive’s office and ensure that the electricity got put on.

These are actually quite important issues.

Well, the fact is that these issues are quite important. They are continuing, and I have actually written to the Electricity Authority. I wrote to the retailer in question, and asked what their processes were. I’m very dissatisfied with the response. In your authority, what is the monitoring that you’re doing? How are you doing it and how is that comparing—for instance, I don’t see any report today on that. Has there been a change? Are you concerned? What are you actually doing to ensure that the retailers are actually taking account of the guidelines in this area?

These are actually quite important issues.

Yes, they are.
Layton I’ll hand over to the chief executive in a minute, but we monitor by—because as you’re aware, the requirements really that we have are about publicity and information and process. What we have done is survey those and looked at those, and where people haven’t been complying, we have—they are only guidelines—we have written to them. And when we have actually said when we didn’t think it had been fixed properly, fix it, and to our knowledge that had been done appropriately. And we’ve monitored the complaints. I have to say, I haven’t heard or seen your letter, so—

Curran Who are you surveying?

Layton We survey all the retailers.

Curran I mean, what are they going to tell you?

Layton We ask them to provide documentation as well to support their claims.

Hansen That’s right. So in the first survey we found that a small number were actually complying almost 100 percent with the guidelines, but we did identify I believe it was about eight that we thought were very substantially behind. We wrote them a letter, told them they have to improve on that, and gave them time frames, and I believe—I may have this mixed up with something else we were doing—that we have been under way doing a second-round survey of those eight. But, look, I’ll need to come back to the committee to confirm—

Curran Can I just make a point that just a few years ago this was a really serious issue of great public interest, where a woman died because her electricity was cut off and she was medically dependent. Now, it would seem to me to be in the interests that there is reporting being done, that that reporting is being made to a parliamentary committee, because affordability is a really critical issue. One of the people who had their electricity cut off in my electorate was somebody who’d been made redundant from the rail engineering workshop. He had a wife who was dependent on a medical instrument. She was dying of cancer. He came into my office on a Friday afternoon. Now, I managed to get his electricity put back on, but it took more than a weekend to do it. Is it the case that people have to rely on going into their local MP when these things happen, because what’s happening is the call centres are just basically not responding. They are following some sort of process that actually is not actually taking into account medical and vulnerable criteria. This has been my personal experience. I don’t know if this is happening right around the country. I don’t know how extensive it is, but it would seem to me to be this is the place where those things should be being reported to.

Layton What, the select committee or to the Electricity Authority?

Curran Well, it would seem to me the Electricity Authority. You have the responsibility. Who else has the responsibility for doing the monitoring? This is the parliamentary committee where perhaps this information should be being brought to and any concerns you have.

Layton In terms of the vulnerable consumers, our role is the disconnection statistics. We agreed to collect the disconnection statistics because it was the
most efficient way for them to be collected, but the issues about providing policy advice and what to do with it are, in fact, in the hands of MBIE. I’m not trying to duck the issue, it is an important issue, but, as I said right at the beginning, we were taken away from all the social welfare and environmental components, but that’s not to say they weren’t important they were given there. What does cause a little confusion is that we actually think it’s an efficiency effect having those guidelines because without it you get much more cost, because people don’t know, and we do monitor. We also thought it was an efficiency improvement that we actually take the statistics and pass them on to MBIE, but policy advice about that is not in our camp; it’s in MBIE’s camp, but dealing with the stats is ours.

Layton Disconnections are not part of what you’re looking at.

Shearer And they’re looking at a failure of the market or a failure of the system. The number of disconnections has rocketed up over the last couple of years.

Curran Is that information available and can it be provided to the committee? Do you have the information of the number of disconnections that occur?

Layton Yes. It’s on our website but we’re very happy to provide it to the committee. We’re even able to provide it broken down by firm, which in itself is a very interesting set of statistics.

Curran And the information where you’re working with the eight retailers, which seems to be rather a lot of retailers who aren’t complying with the guidelines for medically dependent and vulnerable customers.

Hansen Yes, I’ll certainly check up whether I got that right. I will provide to the committee whatever information we have.

Shearer Just to establish—you were saying that that’s not part of your purview, looking at—

Layton We do the guidelines for medically dependent and we do the guidelines for vulnerable consumers. But in terms of the policy response—

Shearer But you don’t monitor.

Layton Yes, and we monitor both of those, and we collect the statistics for disconnections, but what we do with those is hand them to MBIE who provide policy advice. Because it’s really a social welfare issue as well, because it’s not—the decision was made, rightly or wrongly, that the Electricity Authority should focus on promoting competition, promoting reliability, and promoting efficiency in the electricity market.

Shearer So the long-term interest of the customers, which you put in blue, which is I guess, these people are also customers as well.

Faafoi Just one more supplementary on that. So when you say “monitor” do you mean you only keep statistics? You don’t advocate in that area at all?

Layton We monitor them and hand them over to MBIE. We don’t have a role of providing a social welfare base for people.
Faafoi: So my question is, when you say—

Layton: And the reason for that is—

Faafoi: I haven’t asked my question yet. So when you say “monitor” you only capture the statistics around disconnections?

Layton: No, we also monitor whether people are complying with the guidelines.

Faafoi: So it is you role to—

Curran: Enforce. Who is the enforcer of the guidelines?

Layton: The guidelines have no enforcement. They are a guideline; they’re not a code item.

Curran: Just so that I can clarify—if I’m a retailer, I don’t have to adhere to those guidelines.

Layton: But you run the very severe risk that we might decide that we need a code.

Curran: So it’s only publicity, essentially, or an MP ringing up on a Friday night that will spur them to actually adhere to the guidelines. They’ve got no—

Layton: I would hope that the eight that we found that were out took action, and our follow-up, which we’ll report to you about, of the letter I wrote them, which certainly wasn’t a letter of “Oh, it’s all OK.”; it was—

Shearer: So you are the enforcer, in effect, then, aren’t you—if you’re threatening a code?

Layton: We’re the monitor of the guideline. A guideline doesn’t have the status of a code.

Bakshi: So is this a major issue which has come up in the past 3 years of your existence?

Layton: No, in fact, interestingly, yes, disconnections have gone up since the unfortunate case, but they also fell very sharply before that case, and they have only come back to the level they were at in the period before the case occurred, and they haven’t quite got up to that level.

Shearer: And—

Young: David, please do not interrupt. We’ve got questions and we’ve got other members who haven’t asked a question yet.

Yang: I’m very interested and impressed with, first of all, your confirmations. I think you’ve done an excellent job. On page 5, the three maps, we can see the differences. Obviously, the retail market concentration has been reduced substantially. I believe it’s because of competition. I also believe that the competition is always good for consumers. To me that’s a basic market rule. Now, I’m reading the chief executive’s report where you say that “Our vision is to be a world-class electricity regulator delivering long-term benefits for consumers and contributing to the New Zealand economy.” My question is do you believe that you have the best practice in the world, and also what’s your understanding of regulators in other countries?
It’s always immodesty to claim that you’re the best but—

Yes, they were, and that’s not the only feedback we’ve had. I am aware that some of our very senior management have had offers from other regulatory agencies to go and take very senior positions at them. Tomorrow, as I’ve already said, we have the Australian industry and the retail of energy front coming to find out about how New Zealand’s dealing with it. We’ve had not just one but two visits from Singapore, who tend to look around the world in all things to see where they were. We’ve also had China and the United States both agreed that we should be the host of the Asia-Pacific energy regulators forum meeting in August this year. Now, it was thought that it might be in China, but China when considering the possibility thought—along with the United States and the other members, Japan and Australia and so forth—that New Zealand would be an interesting place to hold that meeting. These are just signs that we are gaining some reputation. We have staff who get invited to give addresses at the expense of the organisers of the conferences. We don’t think we should be spending New Zealand energy consumers’ money about what we’re up to. So there are signs there, but I think you’re riding for a fall if you start claiming you’re the best.

I do agree that in China, I understand the China Government controls all the energy companies, but no competition there, and therefore people are not very happy with what they’ve got. My other question is, the What’s My Number campaign—what’s the plan? How long will it last? It may come to an end eventually, or it will become the norm for people to simply switch? Will it be there for some years?

I pass you to the chief executive for that.

The current multi-year funding ends on 30 April 2014. The retail advisory group has been doing quite a lot of work to see whether there would be value in continuing the campaign. That group comprises consumer representatives, an independent chair, and one or two distributors, and then one or two retailers. They are due to make their recommendations to the authority board, I believe, in the March board meeting, so that’s coming up. Once the board has received that advice it will make a decision about whether to go ahead or not with the campaign. But we have provisioned for doing so, and so in the financial information through to the Budget, we’ve provisioned $2 million a year to carry through with that campaign. The initial work undertaken by the retail advisory group suggests that there are some more targeted areas where the campaign could be very useful.

The other aspect they’re working on, as the chairman was talking about earlier, about transparency. We are looking at quite a major initiative in that space, and one of them is possibly around having a really significant retail database that captures all the retail tariffs and all the offers, and if we have that, along with consumption profile information, then we could leverage that through that campaign and probably reach a much wider group of people than what we have to date. But also we have a number of initiatives
under way to increase rivalry between the firms and particularly make sure we’ve got a level playing field for new entrants. Other members here have mentioned the saves and the win-backs work. We see that as really quite important work to ensure that we are able to further enhance competition in the retail space.

Young OK. Thanks for that. We’re drawing to a close. We’ve got a few more people who want to ask questions. We’ll just do that—Chris, then Julie Anne, and then Mark. Then we’ll complete our hearing. Thank you.

Faafoi I think you may have just started answering my question, but, going back to the What’s My Number campaign, do you have a profile about the kinds of people who are utilising it?

Hansen In surveys—and I didn’t bring it with me. I did think of it overnight and I forgot about it this morning. But I have seen surveys giving the profiles of the switching propensity of different types of consumers. But that’s not exactly the same as the profile of those that are using the actual website.

Faafoi OK. What’s your best knowledge of the kinds of people that are utilising it, then?

Hansen We don’t have that information, I don’t believe.

Faafoi OK. Because here’s my concern. My concern is that people who can probably pay their power bill are more likely to utilise it than someone who doesn’t have internet access and probably needs to be the people who should be saving money on their power bill. Do you get my drift?

Layton We had that same concern when we set it out, so how we dealt with it was we actually went and we trained all of the people in the WINZ offices on the use of the What’s My Number campaign, and also the New Zealand budgetary advisory groups. We held extensive training for the people involved in them. Because we realised that not everybody has the internet, and so those are very important. We’ve also formally dealt with a number of MPs that it might be useful, because we know that you get a lot of complaints at your office about power and it’s something that you can use.

Young We’ve run out of time but just as a courtesy to members, I’m going through.

Genter I’ve got a couple of questions about Tīwai Point. The Government has said that if Tīwai were to close, that the power from Manapōuri would be wasted. I’m wondering if the Electricity Authority thinks that if there was an 18-month notice or something of closure, would the lines be able to be built to get that power north, or would there be a substantial wastage of power, in your opinion.

Layton Well, I can go back to work I did before I came to the authority. The answer is that most of the time you can get most of their power there with the existing infrastructure that’s there.

Genter So potentially there wouldn’t have been wastage of power if Tīwai had closed.
Layton  
Not most of the time, and there are some plans that Transpower has for doing work. If I remember rightly, I saw they recently had gone another step with the Commerce Commission, who now has the responsibility for approving those, for southern upgrades. Remember, we now have a much bigger pipe across the HVDC than we used to have. We now have a new Pole 3 and an ungraded Pole 2 for the HVDC link. In December the largest transfers north, after the south, that had happened since 2007 occurred, because we have now got that in place, and it’s now coordinated. So we do have very big capacity once you get it to the Waitaki to take it north.

Genter  
What would the impact on wholesale prices be if Tīwai were to close? Do you have any knowledge of that?

Layton  
Initially, one would expect some reduction in the wholesale price, and one would expect, if we’re doing our job right, some competitive pressures would be starting to force that through to the consumers. If you look at the futures, they’re not actually picking, because we have futures going out all the way into the beginning of 2018 now, and they’re not actually picking that it will run, that it will take off, that it will disappear. They’re not picking a big drop in the futures price out there. That’s only one indicator but it would be worth watching that.

Genter  
How many people are trading on that?

Layton  
Quite a lot, and if you get it wrong, of course, you lose money. If you get it right, you make money. So there’s plenty of incentives there.

Genter  
Tīwai has the cheapest power in the country, but, effectively, because they're using such a huge proportion of energy, electricity that’s generated, that that has an impact on the highest price, the marginal price.

Layton  
Yes, that’s right.

Mitchell  
Just very quickly—I will be very brief—I just want to come back to the fact that if you find through one of your surveys that there’s non-compliance with a power company, as you’ve said you identified eight, and early in your presentation you said you had a remedy for that if you needed to with an urgent change to the code. Have you found that you’ve ever had to do that or look at that? Or when you send a letter out do you find that the power companies take that pretty seriously and respond to it?

Layton  
I have no evidence that they don’t take it seriously, but the evidence we got back was that they were bringing themselves into line, but then you do need to check that they have actually done it and not just tried to tell you.

Mitchell  
What’s your general experience?

Layton  
General experience is that people are fairly responsive, and especially when you get to the chief executive level, you know about things like win-backs and so forth. The push-back and the complaints about it happen two and three layers down, where, of course, it’s the way they do their job and so forth. Often, you find that the chief executive and the board can see a much bigger picture of what they’re working with in an industry and take a quite different perspective than the people at the regulatory level that we most
commonly have interaction with at a management level. The board, of course, deals with them all—very useful.

Faafoi Before everyone leaves, just through the chair, can I ask that they might be able to furnish the committee with some information about the What’s My Number scheme in terms of the profile of who is using it. Because seeing through the responses, it’s a concern they’ve had and some work has been done so I think it would be useful for the committee to see that.

Young I thought Mr Hansen said they couldn’t get that information—you didn’t have that profile information.

Hansen That’s right. We don’t have profile information about the users of What’s My Number, but I have information on a survey of different types of customers and their propensity to switch, their willingness to switch. I’d be very happy to provide that to the committee.

Faafoi OK. Thank you.

Young Thank you very much for appearing, for your answers and your presentation. Thank you very much.

**Conclusion of evidence**
2012/13 financial review of the Energy Efficiency and Conservation Authority

Report of the Local Government and Environment Committee

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Energy Efficiency and Conservation Authority

Recommendation
The Local Government and Environment Committee has conducted the financial review of the 2012/13 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 Vote Energy. 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, and renewable energy, and undertakes monitoring and research.

In 2012/13 the authority’s total revenue was $118.035 million and total expenditure was $115.548 million, resulting in a net surplus of $2.487 million.

Canterbury rebuild
During the hearing of evidence for the 2010/11 financial review of the authority we noted that it was talking with insurance agencies about responsibility for the cost of insulating houses being rebuilt, as insulating a house that was not previously insulated is deemed to be improving rather than replacing it, and thus not covered by replacement policies. While the authority said that such issues were slowly being resolved, we were disappointed to hear that no agreement has been reached on this matter with insurance agencies. The authority said that it wielded little influence in the discussions.

Commercial
Significant energy savings can be made if elements of a building project, such as heating and air conditioning, are factored in at the design stage. We were therefore pleased to learn that the authority’s design advice service for commercial building has had considerable uptake in Canterbury.

The authority has also helped fund an investigation into establishing a central heating scheme for the central business district. As a result, the Christchurch City Council has embarked on a tender process for such a scheme. We look forward to seeing its progress.

Ratings systems
Having discussed the National Australian Built Environment Rating System (NABERS) during EECA’s last financial review hearing, we were pleased to learn that the NABERSNZ star energy rating system for office buildings was launched in 2012/13, and that several private and public-sector owners and tenants have committed themselves to using it.

While the energy star rating system for household appliances such as whiteware and heat pumps is well established, a (star) rating system for the houses containing the appliances is less established. Furthermore, homeowners can unwittingly sabotage their attempts to improve the energy efficiency of their house by retaining or installing down-lights, which
negate efficiencies by requiring large gaps in ceiling insulation. The authority noted that newer LED downlights are much more efficient, and run cooler, disrupting insulation much less—but they are also more expensive. While it expects the cost to fall over time, it suggested that advertising the benefits of the newer lights and giving them a star rating could help reduce the price.

**Biodiesel and alternative forms of energy**

When questioned about the promotion of renewable energy sources, EECA made a distinction between renewable electricity generation and other kinds of renewables. Because there are so many electricity generation renewables “sitting in the queue”, it has made more sense for the authority to focus on renewable fuels such as wood waste for direct combustion, for example in boilers. We heard that EECA continues to prefer a cluster approach to its promotion of woody biomass as an alternative source of energy, targeting groups of potential users for supply efficiency.

Although milestones relating to the Marine Energy Deployment Fund were reached, the authority noted that no application had been successful. It puts this down to the fact that the development of marine energy is still at a prototype stage. It focuses on the deployment of “mature” technologies with proven benefits, and suggested that universities and Crown research institutes might be a better fit for working in the developing field of marine energy.

**Encouraging energy efficiency**

EECA reiterated that its main challenge is encouraging energy efficiency on the part of businesses and in the transport sector; it is not satisfied with the scale of efficiency measures in these sectors, and has refocused its efforts on getting traction.

We were interested to hear that it has changed its approach to businesses from presenting data and statistics to presenting business case models showing possible rates of return from energy efficiency measures. We think that this approach has potential, and that boiling it down to “the money” may indeed be more likely to capture the attention of businesses.
Appendix

Approach to this financial review
We met on 5 December 2013 and 30 January 2014 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
Paul Goldsmith
Claudette Hauiti
Hon Phil Heatley
Gareth Hughes
Moana Mackey
Eugenie Sage
Su’a William Sio
Phil Twyford
Andrew Williams

Evidence and advice received
Energy Efficiency and Conservation Authority, Responses to written questions, received 3 December 2013 and 28 January 2014.


Organisation briefing paper, prepared by committee staff, dated 2 December 2013.
2012/13 financial review of the Environmental Protection Authority

Report of the Local Government and Environment Committee

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Recommendation

The Local Government and Environment Committee has conducted the financial review of the 2012/13 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 entity which is responsible for regulatory functions concerning environmental management. The authority, established in 2011, incorporates various functions previously discharged by the Environmental Risk Management Authority, the Ministry of Economic Development, and the Ministry for the Environment.

Financial and service performance management

In 2012/13 the authority’s total revenue was $28.237 million and its total expenditure was $26.931 million, resulting in a net surplus of $1.306 million.

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 service performance information and associated systems and controls, the same as last year. We were pleased to note that the authority’s financial information systems and controls rating improved from “good” to “very good”.

Proposals of national significance

The Environmental Protection Authority administers applications for major infrastructure projects of national significance, and provides administrative support to boards of inquiry formed by the responsible Ministers to consider particular proposals. The 2012/13 financial year is the authority’s second year of operation. We felt it timely to review the process for nationally significant proposals.

From the date of public notification, a board of inquiry has nine months to make a determination. We queried whether this was long enough for submitters to prepare their cases, especially for individuals or small groups lacking the resources of large organisations. The authority stressed that it does everything it can to support submitters, including appointing a “friend” to provide assistance. It noted that, to date, there have been only two requests for an extension because of the complex nature of the proposals. It said that extensions can cost hundreds of thousands of dollars.

Notwithstanding the assistance provided, we are pleased that the authority intends to be more active in explaining the process for proposals of national significance, and will make it very clear that the process is more like a court case than a local authority hearing.

The process for nationally significant proposals is independently assessed and the authority noted that the results can vary depending on whether the survey is undertaken before or after the result is known. We also heard that the authority has reviewed its fee structure, and that it compares favourably nationally and internationally.
Hazardous substances

During our consideration of the 2011/12 financial review of the authority we raised the issue of compliance, monitoring, and enforcement, and expressed a desire for industries using hazardous substances to substantially improve their compliance. Although the authority exceeded its target whereby “at least 70 percent of enquirers seeking compliance information and advice acted on the advice given, where required”, we were disappointed to learn that insufficient compliance remains a problem.

We were pleased to learn that compliance will be surveyed again in the 2013/14 financial year. We note that from 2014 responsibility for the management of hazardous substances in the workplace will be transferred to WorkSafe New Zealand. We encourage WorkSafe New Zealand to consider implementing regular surveys.

While responsibility for the management of hazardous substances will move to WorkSafe New Zealand, the authority will undertake a two-year reassessment programme. At the same time it will participate in a Hazardous Substances and New Organisms Act 1996 reform work programme.

Genetically modified organisms

Under the Hazardous Substances and New Organisms Act the authority regulates the introduction and use of new organisms, including genetically modified organisms. Genetically modified organisms have progressed to a second generation and, if introduced, will need to be considered and classified. We asked what might happen in the event of New Zealand classifying a second-generation organism as not GM, while our trading partners classified it as GM. The authority thought such a scenario unlikely, noting that New Zealand is essentially GM free as it does not export genetically modified food.

The authority believes that some ambiguity has emerged in the regulations, and is working with the Ministry for the Environment. The regulations are about 10 years old, so we agree that a review might be in order.
Appendix

Approach to this financial review
We met on 6 March, 10 April, and 8 May 2014 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
Maggie Barry (Chairperson)
Jacqui Dean
Paul Goldsmith
Claudette Hauiti
Hon Phil Heatley
Gareth Hughes
Moana Mackey
Eugenie Sage
Su’a William Sio
Phil Twyford
Andrew Williams
Hon Maurice Williamson

Evidence and advice received
Environmental Protection Authority, Responses to written questions, received 4 and 21 March 2014.

Office of the Auditor-General, Briefing on the Environmental Protection Authority, dated 6 March 2014.

Organisation briefing paper, prepared by committee staff, dated 26 November 2013.
The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of the External Reporting Board, the Meteorological Service of New Zealand Limited, and the Testing Laboratory Registration 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
2012/13 financial review of the Families Commission
Report of the Social Services Committee

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The Families Commission

Recommendation

The Social Services Committee has conducted the financial review of the 2012/13 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 under the Crown Entities Act 2004. It was established in 2004 under the Families Commission Act 2003. The recently enacted Families Commission Amendment Act 2014 sets out the two functions of the commission: to act as an advocate for the interests of families in general; and to monitor and evaluate programmes and interventions in the social sector, and provide social science research into key issues, programmes, and interventions.

A new chief commissioner, Belinda Milnes, was appointed in July 2013 to oversee organisational changes and to establish a new strategic direction.

In the 2012/13 financial year the commission’s total income was $7.759 million, a 9 percent decrease from the previous financial year, largely reflecting a lower appropriation from the Crown under Vote Social Development. Its total expenditure in 2012/13 was $7.589 million, with a surplus of $170,000.

The commission received “very good” ratings from the Office of the Auditor-General for its financial information systems and controls. It received a “good” rating for its management control environment and its service performance information and associated systems and controls. The rating received for management control environment was lower than the rating received in 2011/12. The commission said that it had strengthened its management control environment following an independent review of its sensitive expenditure and procurement policies and processes.

Reform

In 2012/13 the Families Commission underwent reform to align its roles and functions more closely with Government objectives for the social services sector. The Families Commission Amendment Act gave the commission a new role: providing independent monitoring, evaluation and research to measure the effectiveness of initiatives for families and society.

During the financial year under review, the commission prepared to undertake its legislative requirements under the new legislation, which resulted in extensive change. A new chief commissioner and three new commissioners were appointed to the board, and a new chief executive started work in 2013. A new Social Policy Evaluation and Research Unit (SuPERU) was formed. According to the commission’s annual report, the unit’s purpose is to provide “robust, expert, independent evaluation and monitoring of government and
We heard that the commission is focused on ensuring that its outputs help social services agencies and NGOs deliver on their agreed outcomes for the sector in a way that represents value for money. We were pleased to hear the commission affirm that social issues needed not only to be identified and understood, but also addressed.

The commission also reviewed its strategic direction against its new mandate. It said that to deliver its new strategy it will make further changes to its organisational design, capability and culture, and business processes. We note that work is being done on exactly what changes will be needed.

The commission said that it has appropriate processes for mitigating risk associated with the necessary organisational changes.

### New Zealand family demographics

New Zealand society has undergone considerable demographic change over the last few decades. New Zealand is now a more diverse country and the dynamics of family are changing.

The concept of “family” differs between ethnic groups. On 1 October 2013 the Families Commission became responsible for managing New Zealand’s largest and most diverse longitudinal study, *Growing up in New Zealand*. It tracks 7,000 children and their families. The survey reflects New Zealand’s diversity: 25 percent of children identify themselves as Māori, 20 percent as Pasifika, and 16 percent as Asian. We heard that *Growing up in New Zealand* can track shifts in the character of the participating families, giving a rich picture of family dynamics.

The commission is working with government agency policy teams to ensure that the results inform Government policy. We understand that key findings will be reported from now on using smaller, more focused topic reports. These reports are expected to be more accessible and more relevant to policy than their predecessors.

We note that the current appropriation for the survey will end on 30 June 2015. This is an important, informative survey, and longitudinal studies derive their principal value from following the life course of subjects for as long as possible. We consider that the survey should be funded beyond the 2014/15 financial year.

### Māori and whānau research

One of the Families Commission’s goals is to improve the well-being of whānau by using evidence to inform debate, the formulation of policy, and the delivery and development of effective programmes. The commission has adopted a “braided river” approach of integrating Western science and kaupapa Māori research methodologies. The commission recently published two reports on whānau and Māori: *Families and Whānau Status Report* and *What Works with Māori: What the people said*.

We asked about the commission’s relationships with researchers and groups that research whānau. The commission said it has strong relationships with external Māori research providers, such as Ngā Pae o te Māramatanga. It is, however, reviewing the way it has worked with researchers to obtain information on whānau to inform policy.

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Pacific families

Problem debt among Pacific families has been brought into focus since the onset of the global financial crisis. The Families Commission published the report *Pacific Families and Problem Debt 2012* in November 2012. The report examines how Pacific families manage their finances, with the intention that this information will be used by providers of initiatives with Pacific families. The report recommends that such organisations develop and deliver targeted financial literacy and numeracy programmes to families.

We asked about the commission’s role in addressing family violence in Pacific communities, and specifically about rehabilitation initiatives under the Family Violence Project. The commission said that its role is to increase the use of evidence to influence the development of policies and programmes of Government, local government and community groups.

The commission is setting up a new Pacific Reference Group to ensure it is well aware of issues and impacts faced by Pacific families. It has advised the New Zealand Federation of Multicultural Councils that it is seeking to recruit members for this group.

Family violence prevention

One of the commission’s key roles is to increase the use of evidence to influence policies and programmes to reduce family and domestic violence. The commission is represented on the Task force for Action on Violence Within Families; it manages and funds the White Ribbon campaign, and funds the work of the New Zealand Family Violence Clearinghouse, which collates and disseminates information about domestic and family violence in New Zealand.

On 13 February 2014, the chief commissioner published an opinion piece, *More money not the answer to family violence*, in which she says that the key to success is to channel NGO and government resources towards achieving clearly established outcomes, with real government commitment, and consequences if targets are not achieved. She also says that in the fight against family violence “the answer isn’t more money.” The chief commissioner acknowledged that this view would be likely to upset many in the sector.

We asked how the Families Commission arrived at the conclusion that more money was not the answer to addressing family violence. The commission said that Government had spent $700 million on domestic violence prevention in the previous 10 years, without any appreciable effect for people suffering domestic violence. This led it to conclude that the approach was unsound, and that the Government therefore needed to determine where money could be spent beneficially before putting more money into the system. The commission drew its evidence from its own work and that of its research partners, spanning 10 years.

We know that until recently family violence was a “hidden” issue, and its incidence was under-reported. Recent initiatives such as the “It’s Not OK” campaign, which encouraged victims to report incidents, and changes to police procedures for recording them, have led higher statistics for recorded incidents. We acknowledge that this makes it difficult to ascertain whether the number of domestic violence incidents is in fact stable, falling, or growing.

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**White Ribbon campaign**

We noted in our 2011/12 financial review of the Families Commission that it was considering transferring the White Ribbon campaign to another organisation. We are very interested in the future of the campaign, and at our financial review hearing for the 2012/13 year we asked the commission to update us on its future. The commission said that, with the support of the White Ribbon committee, it is negotiating with a community-based charitable organisation for transferral of the campaign.

We consider this matter should be monitored closely.

**Management of conflicts of interest**

Families Commission staff and commissioners have a right to engage in political activity, but must maintain their political neutrality while representing the Families Commission.

We asked how the commission handles perceived or real conflicts of interest when staff or commissioners stand for office, which we note has happened in the past two general elections. Recently, a staff member and a commissioner declared their intention of standing for office in the 2014 General Election.

The Families Commission said that it had “just” updated its conflict-of-interest declaration procedures for commissioners “as a result of the last 12 months”, requiring them to take a proactive approach to disclosing interests.

The commission also said that, like all state-sector organisations, it is careful to ensure that staff maintain their political neutrality while representing the commission or carrying out its functions. The commission gives its staff guidelines from the State Services Commission on this matter. The commission considers that both it and its staff are clear about what it expects of the staff member in his professional capacity, and that he is conducting himself appropriately. The commission said it would continue to manage this situation, taking advice from the State Services Commission where appropriate.

The instance of Dr Parmar, a commissioner who intends to stand for office, is slightly different. The State Services Commission’s code of conduct for state servants does not apply to commissioners; however under the Crown Entities Act 2004 commissioners have a duty to act in good faith and not at the expense of the Families Commission’s interests. The commissioner was photographed at a public event alongside the Prime Minister, wearing a party rosette, allegedly without informing the commission of her intention to seek selection as an electoral candidate. Some of us consider that her actions raise the perception of a potential conflict of interest.

At the time we held our hearing of evidence, Dr Parmar had not declared her intention to seek office. The Chief Families Commissioner released a statement on 12 March, stating that Dr Parmar would be expected to stand down from her board role in the event that she was selected as a candidate. She released a statement on 17 March stating that she had informed the Chief Families Commissioner of her intention to seek nomination to become the National Party candidate for Hunua. The Families Commission considers that the commissioner had acted in her private capacity and did not damage the commission.
Appendix

Approach to this financial review
We met on 12 March and 14 May 2014 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
Melissa Lee (Chairperson)
Hon Phil Heatley
Jan Logie
Le’aufa’amulia Asenati Lole-Taylor
Hon Peseta Sam Lotu-Iiga
Sue Moroney
Alfred Ngaro
Dr Rajen Prasad
Mike Sabin
Hon Chris Tremain
Louisa Wall

Evidence and advice received
Families Commission, Responses to written questions, dated 21 January and 3 April 2014.
2012/13 financial review of the Financial Markets Authority, and the New Zealand Venture Investment Fund

Report of the Commerce Committee

The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of the Financial Markets Authority, and the New Zealand Venture Investment Fund, 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
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Genesis Energy Limited

Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of Genesis Energy Limited and recommends that the House take note of its report.

Introduction

Genesis Energy Limited is a state enterprise that develops and procures fuel sources, generates electricity, and trades in wholesale and retail energy. Genesis is New Zealand’s largest energy retailer, selling electricity, natural gas, and LPG. Its major physical assets include the Huntly thermal station, hydro stations, and a wind farm in the Wairarapa. Genesis also holds a 31 percent equity interest in the Kupe oil and gas field. It supplies energy to over 650,000 customers under the retail brands Genesis Energy and Energy Online. The Government has announced that a stake of up to 49 percent in Genesis Energy will be publicly floated on 17 April 2014.

In 2012/13 Genesis attracted total revenue of $2.07 billion, down from $2.265 billion the previous year. The drop was attributed to lower wholesale electricity prices, and warm weather affecting retail electricity and gas prices.

Electricity pricing

In the last five years Genesis’ domestic electricity price has increased by 25 percent, significantly less than the increase recorded in the previous five years. We asked exactly how prices are structured, and we heard that Genesis undertakes an annual assessment of prices, taking into account numerous factors including the strategic plan, costs of lines and transmission, and energy costs. Genesis considers its pricing competitive.

We heard that the energy component of electricity bills varies greatly between regions, but the average increase for a four-person household would amount to roughly 2 percent. We queried why electricity prices were increasing when national demand remained low. Genesis asserted that many cost factors were out of retailers’ control, and said in the last six months retail sales of electricity had actually increased.

We questioned whether electricity bills were sufficiently transparent, since prices from the retailer were often combined with lines and transmission charges. We were told that Genesis recently reviewed the communications sent to its customers explaining price increases. Its chief executive said they were confident they had been transparent with consumers about the reasons for increases. However, Genesis admitted that price increases involve many complex factors (such as transmission and regional lines charges), which can be difficult to communicate to consumers simply. We were told that Genesis had not sought customer feedback during the review, but was going to do so shortly. Its chief executive said Genesis was intending to cooperate fully with the Electricity Authority’s investigation into recent electricity price increases.
Fixed-rate electricity pricing

Genesis has offered their customers a two-year fixed price which is 9.5 percent above the current household tariff; we asked whether the company expected prices to increase steadily over this period. Genesis said their customers had expressed interest in the fixed price option and could choose whether to accept it; approximately 10 percent of those offered the fixed price had taken it up. We heard that the fixed price premium was based on forecast lines and distribution charges.

Prepay electricity

We were concerned to learn that in some cases Genesis’ prepay customers paid up to $694 more per year than those on monthly billing plans, and asked the company for comment. Its chief executive said the prepay option had high establishment and servicing costs, which required a premium to be charged. We were assured that Genesis is no longer marketing prepay as an option and the number of customers on the prepay system had dropped to approximately 4,000, from 11,000 four years ago. “Budget conscious” consumers are now given other options for managing their electricity bills, such as EvenPay which allows customers to spread their electricity payments evenly using weekly, or fortnightly, direct debit.

My Time Tariff

We heard about My Time Tariff, a multi-tariff plan which allows consumers to shift their electricity usage to off-peak times when lower charges apply. Genesis said that the product has been rolled out on two networks, and extensive trials found that households could save between 5 and 12 percent on their electricity bills in this way.

Customer disconnections

We noted that disconnections of customers had increased by 1 percent over the last three years. Genesis said that approximately 92 percent of its customers were residential and a relatively high disconnection rate could be expected. However, disconnection is used as a last resort and Genesis is looking for ways to lower the disconnection rate. We heard that smart meter technology allows customers to be disconnected and reconnected very quickly, and at a lower cost, once payment arrangements have been made.

Market share

We asked Genesis about its strategies for increasing its share of the retail energy market. Genesis has developed a retail package of electricity and gas which they consider has been very successful; further retail packages are being explored. We also heard that the company targeted South Island consumers after the acquisition of generation assets at Tekapō. The chairperson said Genesis does not currently have any intention of expanding overseas.

Customer retention

We asked Genesis about its customer retention strategy, and whether it could be viewed as anti-competitive. Genesis said it actively attempts to retain customers who seek to switch electricity providers, but does not believe this is anti-competitive behaviour; it is unapologetic about defending its market share. We were told the turnover rate in the electricity industry is increasing, with growing numbers of customers returning to Genesis. Retention measures also provide an opportunity for instantaneous feedback from customers about their reasons for switching provider.
Renewable generation

Approximately 30 percent of Genesis’ generation output comes from renewable sources; we asked if a single-buyer electricity model would affect its investment in renewable generation. The chief executive told us the model might have the effect of reducing large capital investment in generation in general; he was unsure whether it would increase thermal generation.

Indonesian coal

Genesis recently terminated its Indonesian coal supply contract; we asked about the costs incurred. Genesis said it assessed forecast coal requirements against its coal supply agreements. When an oversupply of coal became apparent, Genesis made the decision to cancel its contract with overseas suppliers (rather than its contract with Solid Energy) because of storage and transportation costs. The chief executive said the cancellation cost $16.2 million, which will affect Genesis’ 2013/14 financial result.

Emissions

We noted that two coal-fired turbines at the Huntly power station had been decommissioned and asked Genesis if there had been a resultant reduction in emissions. Genesis said that emissions had fallen significantly (by 12 percent in 2012/13) and the company was currently below 1990 levels.

Responses to written questions

We asked Genesis if it was constrained from answering our written questions fully because of disclosure restrictions relating to the impending share float. These questions related to public relations, contractors, and Official Information Act 1982 requests. Genesis said the securities provisions did not prevent the questions being answered; however, commercial considerations needed to be taken into account regarding information such as salary rates. We noted that a number of other entities (some of which are smaller than Genesis) answered the same questions. In the light of this, we have resubmitted certain questions to Genesis for written reply. We look forward to receiving more comprehensive responses to them.

Labour Party minority view

Labour members hold the view that the reputation of state owned enterprises must be maintained. That reputation is often embodied in the experience and character of board members. Labour members asked the chair of Genesis, the Rt Hon Dame Jenny Shipley, to explain her conduct in respect of Mainzeal Group Limited of which she was a longstanding director, which subsequently collapsed. These questions were also raised with Dame Jenny by Labour members at the previous years financial review. To date Dame Jenny has refused to answer those questions, and at the 2012/13 financial review of Genesis the committee chair chose to rule the question out as “irrelevant”, in contrast to the previous year where the chair allowed questions about Mainzeal to be asked of Dame Jenny. Although the two entities, that is Mainzeal and Genesis, are not linked, Labour members are of the view that reputational risks for Genesis do exist until a full explanation as to Dame Jenny’s conduct with respect to the collapse of Mainzeal are provided.
Appendix A

Approach to this financial review
We met on 12 March and 8 April 2014 to consider the financial review of Genesis Energy Limited. We heard evidence from Genesis Energy Limited and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Gareth Hughes permanently replaced Julie Anne Genter for this item of business.

Evidence and advice received
Genesis Energy Limited, responses to written questions, received 13 February and 10 March 2014.


Organisation briefing paper, prepared by committee staff, dated 8 January 2014.
Corrected transcript of hearing of evidence 12 March 2014

Members
Jonathan Young (Chair)
Hon Clayton Cosgrove
Kris Faafoi
Gareth Hughes
Mark Mitchell
David Shearer
Kanwaljit Singh Bakshi
Hon Chris Tremain
Jian Yang

Witnesses
Dame Jenny Shipley, Chairman
Albert Brantley, Chief Executive

Young
Good afternoon, Dame Jenny. Welcome, Mr Brantley. Good to have you here and sorry we couldn’t do this a couple of weeks ago, but the weather conspired against us. Now, today we have 1 hour with you, and we’d like to invite you to make some introductory comments. If we could keep that to around about 5 minutes, if possible, then we’ll go on to questions. Thank you.

Shipley
Well, Mr Chairman, thank you very much for receiving us. Can I, in retrospect, apologise for our not being able to show up last time. As you know, it was outside our control. But my chief executive, Albert Brantley, and I are very pleased to be here today. Our CFO is offshore currently, and so we apologise for him.

We’re here to, obviously, discuss the financial results for Genesis for the 12 months ending June 2013. If you don’t mind, I’ll quickly go over the full-year result. As we have just announced our results for the first half of the current financial year, I’ll briefly allude to the top line results in that half year as well. Then I’ll ask Albert to go over some of the key operational highlights of the company during that period.

In our view, the full-year result for 2012/2013 was pretty outstanding. Over the last few years our board and our management team have worked very hard to transform Genesis Energy into a highly disciplined commercial business focused on efficient operations and on delivering excellent customer services. Genesis Energy continues to be New Zealand’s biggest energy retailer, selling electricity, natural gas, and LPG to over 670,000 customers in more places across New Zealand than any other energy company. The company drives to attract and retain valuable customers by
providing practical innovation. Practical innovation was a key feature in drawing over 19,900 additional customers to Genesis Energy and Energy Online brands in the year under review.

We maintain about 27 percent share of the retail electricity market. If you cast your mind back a year, you will recall the country experienced low rainfalls during summer and autumn in both the North and South Islands. This did impact on our generation business. The associated warmer weather in April and May 2013 also meant our customers required much less energy for heating than had previously been the case. Despite the challenging market conditions, I am pleased to report, on behalf of the board of directors, a 21 percent improvement in net profit after tax of $105 million, compared with $86 million in the year before. The fact that the company was able to deliver a healthy financial result in a year in which two planned maintenance projects requiring major outages clearly indicated that the business can reliably deliver in a challenging market, including those with a long dry summer.

Revenues in that year decreased 9 percent, from $2,265 million to $2,070 million as lower wholesale prices and planned maintenance outages suppressed generation output from the company’s generation fleet and warmer weather impacted on retail sales in electricity and in natural gas. Our operating costs were also down 8 percent from $1,734 million compared with the $1,878 million in the previous period.

The value of Genesis Energy, in terms of its investment with Kupe, again was highlighted in this particular financial year, with Kupe’s contribution increasing 15 percent from $95 million to $109 million. Genesis Energy’s share of LPG and oil production is proportionate to its 31 percent shareholding in Kupe. The company’s share of the sales for the year in operation from Kupe oil and gasfield included 5.6 PGs of gas, 509,100 barrels of oil, and 24 kilotonnes of LPG.

Turning very briefly to the half year, our results—which you'll have recently noted have been released into the market. Competition for the electricity and gas customers between New Zealand’s 13 energy retailers, in our experience, has never been stronger. By the end of December 2013, Genesis had held its market share and experienced 2 percent growth in customer accounts. There is, however, increasing pressure on this space.

In the generation side of the business, a strong increase in South Island hydro inflows and warmer temperatures in the last 3 months of 2013 resulted in increased hydro storage and reduced wholesale electricity prices. These market conditions, plus a number of one-off items related to the cancellation of our contract of imported coal from Indonesia, impacted on our profits for the half year, which was down to $20 million, compared with $70 million in the same period in 2012.

It is Genesis Energy’s policy that the company will pay a dividend. So that provides shareholders with a consistent, reliable, and attractive return, even in periods of business cycle downturn. With this in mind, the board has already announced an interim dividend of $64 million.
I would now like to ask Albert to go through the operational highlights, but before I do, I just want to, as chairman of the company, say how proud I am of the company’s record in health and safety. This is a matter that’s dealt with first on our board, and we’ve just completed one of the biggest civil engineering projects in New Zealand, in the South Island, in recent years. Over two seasons it was completed without accident. I think in a week where this has been the subject of debate in Parliament it was worthy drawing that to your attention.

Brantley Thank you, Dame Jenny. Just a few brief comments. As Dame Jenny has mentioned, the last 18 months in the electricity industry have been very interesting. We’ve seen a lot of ups and downs, driven by a variety of weather conditions and some shifts in demand. But we’ve also seen that there are some long-term structural changes under way in the industry. We’ve seen some increased lower-cost renewable generation come into the market recently. That is certainly compliant with reduced demand from customers and a very aggressive competition around the retail sector. We, as a company, have responded in the last 18 months by making some key strategic decisions around our generation capacity and our fuel supply situation, particularly for the Huntly site.

As you know, Huntly is made up of six individual units, and while we continue to get great utilisation from our combined cycle turbine at Unit 5, we have seen decreasing utilisation of the coal-fired Rankine units over the last several years. At the end of 2012 we placed one of those Rankine units into long-term storage and, with continuing reductions in coal generation, we took the decision to place an additional Rankine unit into long-term storage at the end of 2013, and we announced that we would permanently decommission the first unit placed in storage.

That, obviously, required us to have a look at our fuel supply contracts, particularly our coal supply contracts and, as Dame Jenny has indicated, we did make a decision this year to exit our import coal contract. We have renegotiated an extended domestic supply contract with Solid Energy but at reduced delivery volumes to more closely match our ongoing coal requirements. This was not a decision that was taken lightly. It did have a short-term negative impact on the company’s performance, but it certainly seemed to be the essential thing to build in the flexibility around our operations that we needed. We still have substantial coal stockpiled on the ground. At the end of December 2013 it stood at 994,000 tonnes, and we’re continuing roughly at about that same level.

There certainly has been a lot of activity at Tekapō, as Dame Jenny indicated. The remediation programme on the canal was a major work. We did manage to do that work very effectively, and we’re pleased that that work is now completed. We are pretty comfortable that we completed this work at the bottom end of the range of the $145 million to $155 million range that we published to the market.

Health and safety does continue to be a great focus for us as a company. We’re very pleased with the results. It’s a fairly ingrained way of how we do
Young  Thank you, Dame Jenny, Mr Brantley. Thank you very much for that report, and congratulations on some of those very fine results. We'll come to questions now.

Cosgrove  Forgive my voice. I have got a little bit of a cold. Could I just ask you: in answering the questions that were put to you in writing by this committee, were you precluded—given the informal, if you will, part of the sale process that's happening in the mixed-ownership model—in any way from answering any of those questions? Or restrained in any way from fully answering them?

Shipley  Well, let me put it this way. We made a conscious decision to be as cooperative as we could within the advice we received, and I think—

Cosgrove  Advice from?

Shipley  The legal advice in terms of directors’ obligations, but I think we were able to very fully answer the questions that you posed to us and if there is a question you have that you'd like further elaborated, we'd be—

Cosgrove  Thank you. There are 22 of them, because other energy companies who are now public companies who’ve advised us—and these were the same questions sent to them—particularly Meridian Energy, that there was nothing precluding them from fully answering. So, without further ado—you refused to fully answer, you wouldn’t release the salaries of PR staff because you said it would somehow out them, if you will, or it was against privacy. Would it surprise you to know there are other SOEs with smaller PR staff than yours that have provided that to us? You refused to provide us the total cost of consultants. You refused to provide us with the number of contractors. Last time I checked that wasn’t commercially sensitive. You wouldn’t provide us with the cost of contract hourly rates. You wouldn’t provide us with comparisons of numbers of contractors to previous years. Nor would you provide us with the cost of contractors in comparison with the number of years. And there are at least five questions where you refused to provide the number of staff that were hired on term contracts.

You refused to provide the average time for OIA responses in at least six questions. You refused, by the way, just out of interest, to provide us with any catering costs you may have had. It might be insignificant, but we'd like to know. And, ironically, you won't provide us with the number of SMEs contracted with you. And the most bizarre one I thought of, I looked at, was you wouldn’t provide us with the job description of employees who undertook international travel, despite the fact you provided the details for those who took domestic travel.

Now, I've checked, and in all those cases, SOEs that are now public companies—and Mr Moller, I think it was, of Meridian Energy, we asked him the same question: was he precluded or restrained by securities regulation or stock exchange disclosure rules from completing this
questionnaire, and his answer was no and he checked. So I’d like to know why you’re different.

Shipley Let me be clear. What I said to you earlier was not a blanket explanation of we haven’t answered you fully enough that you could take from what I said that the securities provisions were preventing us from doing that. And, indeed, if there are particular questions that we need to elaborate further, subject to that advice—I mean, the only things we are constrained completely from discussing, as we speak today, is prospective information. So in the details you asked, Albert may want to elaborate further. Some of it, frankly—and let me pick one. Things like SME contractors—I mean, a company like this has literally thousands of them, and the question of whether that’s a standard question or whether you would like us to narrow it so we can assist you as to what particularly you’re wanting to know. If you think about the range of assets we’ve got, do you want to know every single person who’s ever been contracted on any basis to assist us on an annual basis? If these are questions you need to know the answers to, we’ll attempt to deliver them for you.

Cosgrove Well, with respect, to your first point in respect of securities advice, your advice appears to be contrary to the advice received by SOEs who are already public. This questionnaire was submitted to, for instance, Meridian, and as I said to you, Mr Moller, I asked him the same question. He said: “No, I’ve checked with my chief executive and my legal advice—even though I’m a public company, I am not restrained from answering any of these questions.” On the second point, the questions are self-evident. If we’d wanted to know certain numbers, we would have specified certain numbers. And other SOEs—you’re one of the smaller ones—have far more contractors, for instance, than you people, and have been able to answer those questions. I’m just wondering. They’re in English, they’re pretty basic.

Brantley If I may, Mr Cosgrove, in looking at the list, the questions that you’ve raised, there are no restrictions that I’m aware of under securities legislation for not having provided any of those answers. To be perfectly honest, there are some commercial considerations as an ongoing company that we would have. For instance, we would not normally disclose contract rates in commercially based contracts that we have established with various parties. Issues around individual employee salaries—as a general rule, where it’s not specifically required by disclosure regime, we wouldn’t provide that information.

Cosgrove Can I ask you on that point to revise your—and go away and have another think, because another SOE, a smaller SOE than yours, has provided us that. We asked for it in salary bands, as is the normal case, to protect anonymity, and you’ve got a larger PR team than some of the others, and they were quite happy to provide it. I’d be interested in your explanation as to why you can’t provide the average time for an OIA response.

Mitchell Mr Chair, can I take a quick point of order on this, because what Mr Cosgrove is doing is he continually is asking the CEO to comment on
previous financial reviews that we’ve done with other companies. He’s got no knowledge of that. So, really, you should stick to the financial review for Genesis, instead of continuing try and get the CEO to comment on previous financial—

Cosgrove: I’m not asking the CEO to comment—

Mitchell: But you keep using that as an example to him—

Cosgrove: Yes, I’m trying to assist him, actually.

Mitchell: He can’t comment on that. He doesn’t know—

Cosgrove: I didn’t ask him to comment on that. I used it to assist him, to tell him that other SOEs who are now public companies—

Tremain: I think he’s got that message.

Cosgrove: Well, he hasn’t. I think the CEO has. Thank you. So the average time response for OIAs? What’s the problem with that?

Brantley: It’s the simple fact that we have the requirement to respond within the 20 days. We just respond within the 20 days.

Cosgrove: No, but the question, on five questions, was what’s the average response time?

Brantley: Well, we can certainly go back and calculate it. There’s no particular issue with it, but we simply do respond within the 20 days.

Cosgrove: Well, I’d just be grateful, and Dame Jenny, you’ve been on the other side of the table and you probably are aware of some of the frustrations MPs feel. It would be just helpful. We don’t put these questions down for a joke. We put them down for a good reason. Some entities may see them as taxing, but we put them down to gain information. If that’s the case, then you’ve given us an answer. It could have been given to us beforehand. I just repeat my other point, to assist you, that other SOEs who are public and now, therefore, constrained by securities regulations find no problem in answering these questions. So if we resubmit them to you, are you quite happy to answer those questions?

Brantley: The questions that you’ve raised about commercial rates, we believe that that is commercially sensitive, and we would generally not disclose commercial rates and confidential commercial contracts. Individual salaries—as a general rule we don’t disclose because of privacy issues. We certainly are comfortable in doing in the band and—

Cosgrove: That’s what the question said—it was within a band.

Brantley: We will place those three individuals within the band if you would wish.

Cosgrove: That’s what the question asked for.

Brantley: We will do that.

Young: In terms of those three individuals in your communications team—disclosing the salary total, would you feel that that would start to give too much detailed information that could be extracted from that figure?
You’ll see it in the answer.

We could look at it again.

Yes, we could have a look at it, but I believe that we could report it in a band.

OK.

Well, that’s what the question asked for, because we wouldn’t be silly enough to ask, and it would be inappropriate to ask somebody for their salary. That’s why we do it, and it’s custom and practice. Likewise, providing the numbers of contractors, the total cost of consultants—these are pretty basic questions which appear year on year on year. How much time have I got left?

One minute.

I’ll conclude this session and come back to the next one.

Just want to change the subject slightly and have a look at the Huntly power station in regard to the closure or putting in abeyance a couple of the turbines there. First question, and I’ve got about three here: what is the percentage of renewables versus thermal generation for Genesis at the moment?

Our average annual output in terms of total electricity output in the country sits in that range of around 16 to 19 percent depending on the year, and approximately 30 to 35 percent of that total comes from hydro and wind generation for us.

Just coming back to the closure of the turbines, the thermal turbines or the coal-based turbines in Huntly, what has that led to, in terms of reductions in emissions, in terms of Genesis’ profile?

There’s been a significant reduction in emissions—certainly, quite substantial in the last financial year—and that’s driven by an overall reduction in thermal generation compared to previous years, and specifically a reduction in the coal generation.

Are you below 1990 levels?

Yes.

You are. Significantly below 1990 levels now?

I would have to calculate, but it is a significant reduction from 1990 levels. In the last financial year—it was a 12 percent reduction.

My next question goes to the heart of a new model of electricity purchasing that’s proposed in the market place going forward. I’d like you to comment on your perception of that model, the single-buyer model, in terms of its impact on incentivising, or not, renewable generation, and incentivising, or not, the reduction in emissions.

Well, we’ve certainly looked at the debate and we’ve seen comments that have been made by others. Our view is that it certainly will put some difficulty around significant capital investment going forward.
Tremain Into renewables?

Brantley Well, into renewables or into any generation. I think the cost of renewables has been the focus of recent comments. We believe that, potentially, if there’s a contracted price for thermal generation, it may stabilise how we have to compete into an open market around the thermal generation. But we have to wait and see the details.

Tremain So would that encourage bringing back into production a couple, or the two, thermal units that you’ve currently put into remission?

Brantley Well we don’t know one way or another if that would be the case. What we do know is that it will depend on the specific demand at the time and the ability of available plant to meet that demand. As I said, the first of the Rankine units that we pulled out of service in 2012—we have now made a decision to permanently decommission that unit. So that unit is no longer available to the market. So it is only the second Rankine unit that is placed in long-term storage with a 90-day recall to service. So it’s really the debate around what’s the longevity of whether that stays in storage or at some point in the future we make a further decommissioning decision.

Young Following on those questions from Mr Tremain, the quarterly survey of domestic electricity prices from the Ministry of Business, Innovation and Employment reports that from 2003-2008 your price increase rose by 64 percent, but in the last 5 years from 2008-2013 your price increased by 25 percent. Can you tell us what has enabled Genesis Energy to keep a lid on energy prices over the last 5 years compared to the previous 5 years, to that?

Shearer The Minister of Energy and Resources has supplied him with the questions that he’s got in a ring binder here.

Shipley Colleagues, can I assist? Each year the board—

Young Sorry, Dame Jenny. I just want to make a note to my colleague who has said that that is personal research that was done by myself. Thank you, Dame Jenny, away you go. [Interruption] We don’t have advisers sitting in the back like you guys do.

Cosgrove We’d never question your word, Mr Chair.

Young Sorry, Dame Jenny.

Shipley That’s fine. Colleagues you’ll note that I said in my introductory remarks that the environment’s highly competitive. Consumers have better access to information than ever before and, certainly, as a long-standing observer—that is a general comment—it’s a very competitive market. The board and senior management of Genesis Energy on an annual basis, as part of our strategic plan—so we look at the year, we look forward in our 3-year strategic plan, we assess the costs of lines companies, the cost of Transpower, and our own non-recoverable costs and energy costs and we make a decision. Every year we weigh all of those things up. Obviously, what I can say at the moment is somewhat constrained, but let me simply conclude by saying that it’s an annual, robust process. We, as a company, are committed to remaining competitive in each of the areas in which we
operate. So it’s a system-by-system review and it’s thoroughly done and we now make those decisions on an annual basis, business as usual. We intend and have, as you clearly can see, remained very competitive in recent years.

Shearer: So how much is your electricity prices going up this year? People have just got big bills in their letterboxes. Taking out Transpower and the lines companies, what would be your average increase to, say, a four-person home?

Brantley: It varies quite substantially within region to region—you know, with the 29 lines companies. What we have done is that we have communicated with our customers and indicated what the increase in lines charges and transmission charges—and we’ve indicated where we’ve increased. Those are variable, but it’s somewhere around, I think about 2 percent, on average.

Shearer: So the bill that I’ve got—I’ve got two or three Genesis bills here that people have sent—all have gone up. None of these people who have received these bills can distinguish between what the Genesis increase is and the lines companies. It’s all sort of merged in together. Do you think there’s a fair degree of transparency for consumers in terms of their ability to distinguish the various components of their electricity bill?

Brantley: Mr Shearer, are you talking about the bills or the letters indicating the changes?

Shearer: Both, actually. For example, I’ve got a pricing table here which has a whole series of different charges, all of which have gone up, which you’ve sent a customer. I can’t tell what part of that is the lines charge, the Transpower charge, your charge, the generator’s charge. I’m just asking whether you think—you’re saying that you’re competitive, but if you can’t tell where the source of the increase is, it’s difficult for people to make decisions.

Brantley: Mr Shearer, we’ve watched the debate that’s gone on over the last several weeks about transparency of charges and where they lie. We’ve gone back and looked at our communications with the customers and we’re pretty comfortable that we’ve been very transparent in what has driven the changes in relation to transmission and distribution charges and our charges. We’ve seen that the Electricity Authority has volunteered to do some investigations of that.

Shearer: Why do you think they’ve done that?

Brantley: Well, there’s been a lot of discussion about who’s driving what. So they’ve said we need to look at this and see if there is appropriate transparency. And we’ve looked at our own communication in relation to that, and we’re pretty comfortable with that review. We’re certainly prepared to cooperate fully with that review with the EA because we believe that we’ve been very transparent about costs that are driven by others and costs that are driven by our costs.

Young: Just regarding competitiveness in the market over the last 12-18 months in terms of the churn that Genesis Energy has been experiencing, can you give us an update on that and where things are at right now?
Brantley  If we look at churn statistics over, say, the last 12 months on a rolling average, we’ve seen a substantial upswing in the last several months on churn. It’s gotten quite high. We’ve looked at the last 12 months on a rolling average and our churn statistics by industry standards, I think, sit very slightly below the average churn. If we look at our churn statistics over the last 2 or 3 months, it’s at or above industry average and we’re looking at the causes for that so that we can actually control that.

Hughes  Thank you, Dame Shipley and Mr Brantley. My question goes back to electricity prices. Your average retail rates increased 3.6 percent across the country, 5.8 percent in my region of Wellington. Can you explain why, when demand is falling nationally and for your customers, you’re putting prices up?

Brantley  Well, if we go back to our half-yearly results, you’ll see that our average retail sales have actually gone up, not down. We anticipate that residential demand has been down over the last couple of years. We’re not clear whether that’s a long-term reduction or if it’s a demand reduction that’s driven by what’s been historically 2 extremely warm years back to back. We do believe that there is an increased tendency for energy efficiency appliances in the home and concentration around increased insulation. So it is likely that there will be some continued reduction. But, at the same time, we still continue to service our customer base and we have a cost structure that we have to respond to with costs that we can’t always control. Now, there are parts of the business that we can control, but there’s a significant portion of our electricity charges to customers we have no control on.

Hughes  You mean transmission and distribution?

Brantley  Transmission and distribution, and others.

Hughes  Well, can I ask you on that, because the latest survey of domestic electricity prices to November 2013 found that transmission and distribution price upgrades as a percentage of the increases was only 27 percent. That means the retail component, the electricity company’s component, was 73 percent. Is that consistent with what Genesis is doing?

Brantley  You know, we’ve seen a variety of statistics that float around, and it depends on which—

Hughes  Well, this is from the MED.

Brantley  I’m saying it depends on which statistics. MED publishes a set of statistics. Other agencies report different statistics. At the end of the day, we see a significant proportion of the bill, and we would estimate it slightly higher in terms of collective transmission and distribution charges. We would estimate slightly higher than that 27 percent. But, certainly, it is not the only thing. We have other costs that come into that which are both energy costs driven by metering costs, service costs, and development costs around products and services. So there’s a whole variety of costs that make up that energy bill.

Hughes  Given you’re offering your customers a 2-year lock-in, with a 9.5 percent price increase, is this Genesis conceding you envision future price rises into
the future and your costs are going to keep increasing, especially considering commentators are saying “I wouldn’t touch this with a bargepole.”, and they’re advising customers against taking it up?

Brantley Look, at the end of the day, what we do is we’re responding to what has been identified by our customers—an option that they would like to see. It’s very much like someone that has a fixed or variable mortgage. They choose the plan that they wish to be on. We put a price-lock option out for a 2-year period. We based that on what we knew were this year’s anticipated lines and distribution charges and what we expected would be next year’s. We put that out as a premium on existing charges, and it really is up to the customer if they wish to lock that in or not.

We are taking a risk on what the second-year charges may be or increases around transmission and distribution, and our own cost as well. At the end of the day it’s up to the customer if they wish to select that option or not.

Young That leads right into the line of questioning that I want to follow up with after Gareth there. In terms of the options you are giving your customers to reduce their energy costs, how many are actually taking advantage of those and what sort of difference does it make in their energy costs?

Brantley I don’t have the latest statistics right up to hand, but we’ve had a reasonably strong take-up on the price lock-in option. I think it’s been upwards of around 10 to 15 percent of offers that had been made, and I think that was much higher than we were expecting from the original sample size that we got. But is it still an offer that is open in many areas and it is an offer that is still being taken up. I could come back to the committee with some revised statistics, but those were the last numbers that I looked at.

Tremain Further to that, and to other initiatives that you’re putting into the market place to enable individual households to save money on their power bill, the one I’m referring to is the new multi-tariff product you’re talking about—My Tariff Time, which has been enabled by the advanced meter roll-out. What sort of savings could a household who committed to, say, that scheme, look to save by shifting to off-peak load use?

Brantley We did some fairly extensive trials before we rolled out that My Time Tariff—the differential pricing tariff. We did quite a lot of statistical work around that, and what we saw on average was about an 18 percent shift in load to those people in the sample size that we ran. We saw savings on the average power bill that were upwards of 5 to around 12 percent in the sample size that we ran. We’ve rolled that out on a commercial basis to the WEL Networks and to the Orion Networks, and we’re getting increasing take-up on the My Time Tariff. It’s been a relatively slow take-up because it’s a new product and we don’t have a lot of statistical data. But I’ve given you the indications that we have from the sample size.

Tremain So what you’re saying is that in the current market, where you’ve indicated a 2 percent price increase to your tariff, customers of yours could actually save money using this product?

Brantley Yeah, absolutely.
Can I ask another question just in relation to those billing types that you have? One of the others is prepay—the pay in advance system that you run in at least 5 different other regions. Are these often or most commonly the kind of people who have bad credit histories and they are placed on prepay as a way of being able to ensure that you can supply electricity and still recoup costs, obviously?

I don't know that I would characterise it quite that way, Mr Shearer. I'd characterise it as it's people that are very budget-conscious and look at ways to effectively manage their budget.

So you're saying that people are generally not obliged to go on to these types of schemes. It's very much their own free will.

That's right, yeah. What we did is, I think, up to around 3 or 4 years ago we had somewhere around—I'm going to give you some approximate numbers just to give you a feel for it, if you'll just give me a little bit of indulgence. I believe it's around 11,000 customers 3 or 4 years ago that we had on our prepay option. We did quite a lot of work around that prepay option and it was a very expensive option for us to offer. It carried a lot of service costs, a lot of set up costs, a lot of establishment costs. At that time we made a decision to stop offering that as an option and we looked at other ways to help people concentrate on their budget—an EvenPay solution, allowing them to pay a fixed amount per month on an average bill.

You've still got this, obviously, in process at the moment, because I've just done the—

Yeah, that's right. It's dropped down to about 4,000 customers now.

Those people who are on your prepay are paying up to nearly $700 more if they're on an advance pay scheme than if they're on a standard scheme. Given that you're getting the money up front and you're actually able to pocket that and put it on high-interest—or whatever you want to do with it, why is it that those people have to pay that surcharge for paying in advance?

Well, we looked at the decision that we made. Not offering that as a product any more was based on the fact that we were looking at the premium that had to be put on that product to cover the cost of actually providing the product, and it seemed to us that it was sort of defeating the purpose that we were intending to do in the first place, so we made a decision to look at other options that did not carry a premium. You are right; there are some that have a reasonably high premium. There are a lot that have premiums that are a lot lower—some as low as 4 or 5 percent.

In business you would've thought if you pay up front, and likewise if you pay promptly, you'd get a discount. It's extraordinary to me that you have not only that but in 2 years—say for example in Wellington—the difference between the prepay rate and the cheapest rate was $229, 2 years ago. Now it's $694. Why is it that these people are being stung $694 more now for going on an advance payment where you get the money and absolutely no risk of no payment?
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Brantley: Well, you might have a risk of no payment, but you still have the costs that come with providing that service. You know, you have to provide that service, you have to service that service, you have to service those customers, and they require a great deal more personal involvement than the normal customer.

Young: Are you talking about different hardware set up?

Brantley: Well, hardware set ups, call centre set ups, interactions with them—much more service cost to provide that. That's why we made the decision that we weren't going to offer that option, and we would look at lower-cost options that wouldn't attract the premium. That's why we actually are no longer offering that as a solution—

Shipley: Well, not marketing the prepay, anyway.

Brantley: We're not marketing.

Shearer: Not marketing—are we likely to see in another couple of years those people that are on that payment paying another 500 percent more than what the other people are paying?

Brantley: Well, the services that we're offering now for those budget-conscious customers—we're able to incorporate that into our normal activities around the call centre and our customer service activities. They don't attract the same premium because they don't require the same effort to sustain them.

Faafoi: The issue is you're saying that they're budget-conscious customers, but they are paying more.

Shearer: The answer is they're poorer customers.

Brantley: Look, it's the way in which they choose to manage their payment of the electricity bill. We're looking to provide lower-cost options for those people that wish to manage bills differently than the traditional system that most of the retailers use.

Mitchell: Under that system that we're talking about, just so I have an understanding of it, I understand you're not marketing it any more. Even if you did have a customer decide to go on that plan because they found it—

Shearer: The word “decide” is—

Mitchell: I didn't interrupt you, so if you'd let me finish the question. [Interruption] I interrupted you because it needed to be done—

Young: Anyway, moving on.

Mitchell: They may be faced with an additional $600 or $700 annually on their bill, right? And if they weren't under a system like that, could they risk using so much power and consuming so much power that they could actually end up with a $1,200 bill annually? I know that you're not marketing it now, but I'm just trying to understand myself. Was it a safeguard? Was it a safeguard for people that—

Brantley: It was a safeguard but as I said, what we're doing is we're actively marketing a different approach to it that is geared on people actually managing their
power consumption on a budget-conscious basis in a different way. You know, it's why we're doing things like the EvenPay that we can incorporate into our normal activities at a lower cost, which doesn't then attract the same cost. We're working with other agencies, we're working with other activities, that try to address those issues but in a lower-cost function. Now, we haven't moved the people off the prepay that are on it, because, at the end of the day, that's their choice, if they want to stay on it, if they find that—but if someone has an issue, we offer other solutions as the first port of call.

Hughes Could you explain if your fixed daily rates are increasing?

Brantley We have seen increases in fixed daily rates in many networks. We've seen increases in the distribution or transmission charges as well, and sometimes in some areas where it has been reported that certain lines companies have reduced the charges, they genuinely have reduced their tariff charges, but we've seen that they've increased their daily rate. So the net impact to us is that there's been an increase from that lines company.

Hughes Doesn't that just send a perverse incentive to consumers that even if you use less power, you'll still be paying more, and even if demand is down nationally, you'll still be getting a guaranteed income stream?

Brantley Yeah, but you have to remember we don't set the daily rates and those tariff rates. That's the rate that's set by the distribution companies. We don't set that rate.

Hughes You can though. I understand Meridian Energy's is going up substantially from around $1 a day to $2 a day.

Brantley Yeah, and I would suggest that the reason that that is going up is because they are actually being charged that by the particular distribution company.

Young All right. Probably a question to ask them.

Bakshi Madam Shipley, the question is to you that you have mentioned in your report that you're focusing on growing market and disciplined spending. You already have a customer base of 27 percent of electricity and share of 44 percent of the gas market, so what are your plans for how you are going to grow your market? Second, do you have any plans to do more capital investment in near future?

Shipley On the first question, just as an illustration, we've put a lot of effort into the dual sale package of electricity and gas, and been very successful there, so that in marketing to customers in areas where both are available, we've made significant inroads into those markets. There are other strategies where we've looked at innovation—in other words, what packages we could sell in addition to electricity and gas or LPG. While this is early days yet, we think that as consumers become more sophisticated, these may be areas that they wish to look at. On the capital expenditure, we have no major plans. It's been very well laid out. While we have a number of options, at this stage we haven't made any decisions that would lead us to increased capital expenditure.
Yang Now, you’ve focused on New Zealand. Do you have any plan to expand overseas markets?

Shipley Well, we’ve never said no, but principally this company is a New Zealand-based company. We think there is plenty of opportunity—

Cosgrove Not for long.

Shearer Not NZ-owned—

Shipley A New Zealand-based company, and we don’t have any intentions to expand our business offshore.

Faafoi Can I go back to an earlier question David Shearer asked about the transparency of the communications you had with customers about the breakdown of their bill. You said you did a review. Can you tell us when you did that and what the review was—what you did?

Brantley Yeah. Certainly, as we’ve seen the debate that has gone on in the media over the last several weeks, we went back and reviewed our customer communication letters. We looked to see if we were as transparent as we thought that we could be. The issue about communication between the industry and the customer is a very difficult one, and part of it is because you have to remember it’s an industry that has been largely controlled by engineers, and they tend to think in complicated terms. They haven’t always done a great job of doing very simple communications that are very easy to understand.

Shearer It’s an internal review, sorry?

Brantley Yeah, it was an internal review, yeah. We looked at our own communication. What we find is that we do believe that there is substantial room for improvement in the way in which the industry communicates with the customers. It’s trying to communicate what is a very complex interplay between a variety of things that actually drive pricing outcomes, be it wholesale energy prices, transmission charges, distribution charges, metering charges, service costs—you know, a whole variety of things. And it’s difficult to communicate that in an effective way where people can understand how it delivers what most customers really want to see, which is just the bottom line outcome.

Faafoi So this review was quite recent, obviously?

Brantley Yeah, as I said, we reviewed our communication letters that we recently sent out on the basis.

Faafoi Did you ask for any feedback from customers?

Brantley Yeah, we are asking for that and we are collecting that.

Faafoi So the comments you’ve made today are based on only what you think, not what customers think.

Brantley Yeah, look, I agree wholeheartedly. That’s why we’ve taken the step of moving to ask for more customer feedback so we can look at how we can improve it.
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<td>Faafoi</td>
<td>So you’re happy with what you’re doing but you don’t know what the customers think of what you’re doing?</td>
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<td>Brantley</td>
<td>We are happy that we were transparent and we weren’t telling our customers that all of this is related to transmission and distribution. We were happy that we said that part of it is us as well.</td>
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<td>Faafoi</td>
<td>So you’re happy with what you’re saying, but you don’t know if necessarily the customers are happy?</td>
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<td>Brantley</td>
<td>That’s right.</td>
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<td>Shipley</td>
<td>We constantly work with our customers.</td>
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<td>Shearer</td>
<td>I’ve got to say, when I got to pick up your electricity bill that people have been sending in to me, we flicked it through our research team. You’re not saying they’re all Einsteins, but for the life of me, we couldn’t understand—</td>
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<td>Shipley</td>
<td>Can I just clarify or explain one point. Look, unlike GST, which is across the country, passed through evenly, and everyone knows what it is and it’s not variable, the big challenge an energy company has at any time in the year when the board and senior management review, is that there are so many different regions and so many variable tariffs in each of these that then to give an answer in averages is almost impossible. Now, this is a challenge, I think, and it is probably worthy of people’s minds. We certainly will collaborate with either the regulator or anyone else to try and sort this out, but it isn’t as simple as just saying, well, what are the averages? Because with the multiplicity of lines companies and Transpower, and then even the way in which we have to work in different regions, given that we are in so many regions in New Zealand because of the nature of the company, I wish I could give you a simple answer, but actually there is no single letter. So we individually, region by region, write those letters as carefully as we can, and we always speak to customers first, before we speak in to the media, so that customers know where they stand. We have a very close working relationship with our customers, generally, which I think is proven by the numbers of people we’ve been able to both retain and win over the years in the market.</td>
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<td>Shearer</td>
<td>Can I ask a question on the back of your last statement there. From what we understand, there’s been quite an aggressive policy you’ve adopted in the recent past about bringing customers over, and the immediate suggestion is that that is linked to the fact that you’re actually about to sell, and so you’d put more emphasis on trying to bring customers over. That’s the first part of the question. The second part of the question is consumer saves, which is another part of trying to bring people over. I just wondered what your opinion of consumer saves is, and whether you believe it’s an uncompetitive type of practice in the electricity market?</td>
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<td>Brantley</td>
<td>I’m not quite sure what your first part of the question is, Mr Shearer.</td>
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<td>Shearer</td>
<td>The first part is really just asking—I mean, have you upped your—[Bell rung] Don’t worry, it’s not a fire alarm—whether you have upped—</td>
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<tr>
<td>Shipley</td>
<td>You mean recently?</td>
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Shearer —whether you’ve upped your attempts to win customers over in the past few months. Has there been an increase in dollars spent—

Shipley If I can comment, in the year under review in particular, after we had acquired Tekapō, we most certainly worked actively in the South Island market and went from zero to—the current numbers of customers—

Brantley About 16 percent of the customer base in the South Island.

Shipley So because we have up until then not had assets in the South Island of significance, we most certainly were very active, and those numbers went up during that period. And then it’s simply been retaining our competitive position.

Shearer And you used consumer saves, which have gone from 749 in 2012 to nearly 1,200 in 2013? The Electricity Authority is investigating this. They say it’s uncompetitive, and you have upped your rate of use of it.

Brantley Look, Mr Shearer, what we do is that we continue to defend our market share. It is an integral part of our business, and we continue to defend it, and we will make no apologies about defending our market share. The win-backs—or customer saves, as you call them—is a tool that we use, and our view is that if we have a competitor that is trying to cherry-pick our customer base, we should be able to actually defend our customer base.

Shipley Of course.

Shearer So you see it as part of competition, not—

Brantley Of course. Yeah. And it is certainly is our view. You’ve asked about have we increased recent activity. The thing about it is we’ve seen the churn rate in the industry generally come up recently. We’ve seen our churn rate, which has traditionally been lower than the industry average, come up to the same level. So we’re very concerned about erosion of our market share and we have been very active in customer win-backs, just trying to protect that market share. It’s an integral part of our business that we’ll make no apologies about defending.

Bakshi What happens to the feedback you receive back from your customers? What action is taken on those feedbacks?

Brantley What we do is that we have a system of collating the feedback that we get from customers, and particularly when we do the win-back activity, we need to really understand why did they consider switching. Was it purely price-driven? Was it customer satisfaction - driven? Was it a particular product and service that our competitor was offering that we weren’t offering? We try to understand the basis of the proposed switch in the first place, and if we can address that, oftentimes it’s some sort of an arrangement with the customer or a different plan that we can put them on or it’s a different service that we can provide them that meets their needs. So we get pretty instantaneous feedback around that win-back activity.

Shearer Your disconnects have gone up pretty dramatically from 0.2 percent to 1.2 percent in the space of about 3 years. Can you give us any explanation why
you’re disconnecting so many customers over the space of that time—why has it gone up so dramatically?

Brantley Well, if we look at our distribution of our customer base, we sit at around 92 percent in the mass market or residential space. And in the commercial and industrial it represents a smaller proportion of our total customer base. So I think you’d expect to see a much higher disconnect rate in that heavily weighted mass market area. We’re very concerned about those statistics and we’re looking at how we can actually address them. For us that disconnect is an action of very last resort, and we’ve been very proactively trying to develop new ways to actually avoid disconnection as an activity.

Shearer Put it on prepay. That’s a good idea.

Brantley Well, we don’t actually think that that is the appropriate solution, because we think there are better alternatives.

Shipley Can I also just mention that today, because of the smart meters, if a person is cut off and then can come to some financial arrangement, they can be put on very quickly. Three years ago the ability to firstly terminate and then reconnect a customer had a significant cost—much higher than it is currently today—and a time component. I haven’t checked but it may be something you’d want to follow up to see whether there’s actually a reconnection rate.

Shearer It’s quite a steep climb, relatively. That’s quite a large number of people that have been disconnected.

Brantley Yeah, but, once again, Mr Shearer, just remember that we’ve got probably a much higher weighting on that residential mass market than others, so you’d expect to see more activity in that area. And it’s unfortunate. We don’t like the statistic and we’re certainly looking at ways to address it.

Tremain I just want to ask a question towards the end here about the interim result. It’s back 72 percent on this time last year. I see a big chunk of that is disconnecting the contract with the Indonesian coal. Can you just give us a few words on that, how much that has cost you, and what were some of the difficulties you had to overcome.

Brantley Yeah. What we did is that we looked at coal requirements ongoing and we looked at what we thought were anticipated fuel burn around coal supply. We clearly needed to address an oversupply on contracted coal between Solid Energy and the import. The import coal was the logical place to do it, and that’s why if you look at the total value of the coal, it may have been cheaper coal, but by the time we land it at Huntly, it’s more expensive than the domestic coal supply. And then we took that same opportunity to extend out a revised delivery profile with Solid Energy. Good win—

Tremain So was there a break fee?

Brantley Yeah, there was a break fee on the international contract. We didn’t report that specifically in our half-yearly results. We reported a negative impact of $16.2 million, but included in that is that we have some contracts for storage of the coal at the Port of Tauranga—long-term lease on a storage
facility—and we have long-term leases on rolling stock with KiwiRail and a contract to actually truck the coal to Huntly. And we had to take the onerous contract provisions and take the full negative impact of not requiring those contracts to the account.

Shipley There was about $20 million, a reduction in our impact, that was one-off, of which the onerous contract was a significant part—far and away the majority of that number.

Cosgrove My question is about credibility and trust. You’ll recall some previous questions we had about your dealings with Mainzeal. You’re aware that Justice Patrick Keane ruled that the parent company of Mainzeal restructured their assets so that creditors were effectively disadvantaged, and their interests and the shareholders were advantaged, and I'll read you a quick quote.

Mitchell Point of order, Mr Chair. What has Mainzeal—

Cosgrove Well, I'm coming to it.

Mitchell What has Mainzeal got to do with Genesis Energy?

Cosgrove My question—well, it goes like this—that Dame Jenny is chairman, this company is about to be floated; it's an issue of credibility. The journalist says “I find it incredible that Shipley—”

Mitchell Point of order.

Cosgrove —“should still be chairman of a major public company amid so much murk about Mainzeal.”

Young Point of order.

Cosgrove You’ve chosen to make no explanations about this. You think you are a credible chairman to be chairman of Genesis.

Young Point of order. Mr Cosgrove, point of order.

Mitchell We had this situation last committee that Mainzeal is not relevant at all—

Cosgrove It is if the chairman’s ability is called into question.

Young OK. I’m ruling that irrelevant. I’m sorry that last year you went over the line and this year you’ve had another go, all right? I’m declaring the meeting over. Thank you very much, Dame Shipley, Mr Brantley.

conclusion of evidence
2012/13 financial review of the Hawke’s Bay District Health Board

Report of the Health Committee

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Hawke’s Bay District Health Board

Recommendation

The Health Committee has conducted the financial review of the 2012/13 performance and current operations of the Hawke’s Bay District Health Board and recommends that the House take note of its report.

Introduction

The Hawke’s Bay DHB delivers health services in the Hawke’s Bay region and the Chatham Islands. The DHB serves a population of about 156,000 people, of whom 80 percent live in or near Napier and Hastings. Its population has a relatively high percentage of Māori, people aged over 65, and people living in areas of high material deprivation.

Financial and service performance management

In 2012/13 the DHB had a total income of $474.817 million and its total expenditure was $472.821 million, resulting in a surplus of $2.081 million. This is the third successive surplus, and we note that the DHB is projecting another for the 2013/14 financial year. The DHB is using the surpluses to fund capital projects, and assured us that they were not being achieved at the expense of services.

The Office of the Auditor-General issued a modified audit report, which included an unmodified opinion on the financial statements and a qualified opinion on the performance information of the DHB. The qualified opinion relates to DHBs having limited control over third-party performance information—a sector-wide issue resulting in the Office of the Auditor-General giving qualified opinions on all DHBs.

Some deficiencies found by the Office of the Auditor-General in the 2011/12 financial year, such as a lack of capital asset management planning, have yet to be fully resolved. We were pleased to hear that an asset management plan should be ready in the near future, and that the board has resumed asset management briefings. We note the point that the health sector as a whole still has some work to do regarding asset management planning—particularly disaster insurance.

Diabetes services

During the year under review Hawke’s Bay DHB decided not to renew the General Practitioner with Specific Interest Diabetes Service contract, under which patients were referred to the service by their GP for a series of appointments to help them self-manage their diabetes before being referred back to their GP. We queried this decision, as the programme had run for eight years and appeared to be quite successful. The DHB said that the programme’s referral criteria had been “a little loose”, and that by bringing diabetic services in-house it can provide a better service that treats more people. It said that diabetes specialist nurses are working with GPs and practice nurses, and that preliminary results are on a par with those of the previous arrangement. We queried the decision and evidence upon which it was made. We will be interested in monitoring on-going results.
Although the DHB has improved its diabetes service performance measures, it did not meet its performance measurement targets in this area. We would like to see further improvements so that targets might be met.

**Mental health services**

In 2012/13 the DHB underspent its mental health funding by $2.2 million. This money has been transferred to the asset replacement reserve and will be used for the development of a mental health intensive care unit. We queried the use of service funding for infrastructure. We heard that the DHB deferred building the unit as it wanted to consider the service carefully and not “rush in”. We consider high quality mental health services and infrastructure to be very important and will be looking for progress in this area.

Although the DHB has improved its mental health service performance measures it did not meet all performance measurement targets. We encourage it to keep working towards meeting all its performance targets.

**Orthopaedic services**

On 29 January 2014 the Minister of Health announced an extra $10 million in funding for elective surgery, with a third of the additional operations expected to be orthopaedic. Hawke’s Bay DHB is to receive $1 million from this funding and has earmarked most of it for orthopaedic and ear, nose, and throat services. We are pleased that the DHB intends to carry out more orthopaedic surgery, but asked why it had performed fewer orthopaedic operations than targeted, and had raised the qualifying threshold for hip and knee surgery. The DHB said that demand had increased at the same time that capacity had decreased. It put this down to changes in the orthopaedic department, including staff retirements, which reduced capacity, combined with the ageing population boosting demand, and the global economic downturn resulting in fewer people having access to private hospitals.

**Maternity services**

During the 2012/13 financial year the DHB undertook a review of maternity services in Hawke’s Bay. As a result Napier’s three-bed birthing unit closed on 16 December 2013. We heard that the decision to close the unit was based in large part upon Hastings Base Hospital being the preferred choice of delivering mothers. The DHB conceded that there might have been some pressure from midwives trying to juggle clients in Napier and Hastings.

**Newborn hearing tests**

During 2012 the Ministry of Health found that some screeners with the National Newborn Screening Programme were testing the hearing of newborn babies improperly, sometimes testing their own hearing rather than that of the baby. Hawke’s Bay was one of the six DHBs affected. We were heard that the DHB is baffled as to why a screener would do this. We consider this behaviour to be unacceptable and unprofessional. We were pleased to hear that measures have been put in place to prevent this from happening again.

**Leadership and career development**

The Hawke’s Bay DHB is the first to establish a clinical council. Its purpose is to provide clinical advice on service changes, and local oversight of clinical quality and patient safety. We were interested to hear that clinicians are involved through the council in management meetings, and give advice to both management and the board. We agree that the
involvement of clinicians in decision-making can only improve the services provided within a DHB’s catchment.

We also note that the involvement of clinicians in the decision-making process can afford career development opportunities for medical staff.

While the Hawke’s Bay DHB is in the fortuitous position of having two cities (Hastings and Napier) in close proximity, the DHB noted that the relatively small size and isolation of cities in New Zealand can make developing careers difficult. It said that a more coherent plan for developing talent was needed, and it was concerned about remuneration constraints—especially for senior people such as chief executives. We consider that chief executives should be scrutinised on their performance.
Appendix

Approach to this financial review

We met on 12 February, and 5 and 19 March 2014 to consider the financial review of the Hawke’s Bay District Health Board. We heard evidence from the Hawke’s Bay District Health Board and received advice from the Office of the Auditor-General.

Committee members

Dr Paul Hutchison (Chairperson)
Shane Ardern
Paul Foster-Bell
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Scott Simpson
Barbara Stewart
Poto Williams
Dr Jian Yang

Evidence and advice received

Hawke’s Bay District Health Board, Responses to written questions, received 7 February and 7 March 2014.

Office of the Auditor-General, Briefing on the Hawke’s Bay District Health Board, dated 12 February 2014.

Organisation briefing paper, prepared by committee staff, dated 28 January 2014.
2012/13 financial review of the Health and Disability Commissioner

Report of the Health Committee

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Recommendation

The Health Committee has conducted the financial review of the 2012/13 performance and current operations of the Health and Disability Commissioner, and recommends that the House take note of its report.

Introduction

The Health and Disability Commissioner is an independent Crown entity, whose role is to promote and protect the rights of people using health and disability services. In June 2012 the Mental Health Commission was disestablished and its functions transferred to the office of the commissioner, where a new Mental Health Commissioner was appointed.

In 2012/13 the office of the commissioner had a total income of $10.704 million and a total expenditure of $10.963 million, which resulted in a deficit of $258,985. The office’s budgeted income and expenditure for 2012/13 were $10.325 million and $10.908 million respectively, so the actual deficit was considerably less than the budgeted deficit of $583,000. We note that the office of the commissioner has been running deficits for four of the last five financial years, and is forecasting smaller deficits in 2014/15 and 2015/16. Funding from capital is not sustainable, and we encourage the commissioner to make every effort to bring his office into surplus as soon as practicable.

Complaints

The commissioner received a record number of complaints during the 2012/13 financial year, representing a 25 percent increase in volume over the last five years. We congratulate him and his staff on also closing a record number of complaints, 20 percent more than the average over the last five years. We do note, however, that the number of complaints increased faster than productivity, causing some slippage regarding timeliness targets.

Although a growing volume of complaints is not a phenomenon specific to New Zealand, the commissioner is considering carefully why his office’s caseload is increasing. Possible reasons include better accessibility, such as the facility to lodge complaints on the office’s website, and a higher profile. We note, however, that the complexity of the complaints is also increasing. There is no evidence as yet that the increase in complaints reflects an increase in issues about the quality of care; and although complaints about quality are increasing more rapidly than other types of complaints in strictly numerical terms, the increase is proportionate to increases in other kinds of complaints.

A large proportion of complaints are resolved, and rightfully so, by health providers. During the 2012/13 financial year the commissioner has worked with district health boards on the quality and responsiveness of their complaints systems. We were pleased to learn that this work will continue into the next financial year and will focus on strengthening these systems so that more complaints may be resolved “on the front line”.

Aged care complaints

The proportion of complaints received by the Health and Disability Commissioner involving the aged care sector is currently around eight percent. While this is considered a
low to moderate proportion, the total number of aged care complaints is increasing. We heard that insufficiency of data makes it impossible to determine patterns of complaints with any confidence. The commissioner noted that it can be difficult to isolate particular issues because of the number and variety of providers in the aged care sector, such as GPs, home nursing services, and rest homes. We were pleased to learn that the complaints coding system will be improved to make it easier to pick up patterns in specific types of complaints, including those about non-medical home support.

Mental health

In 2012 the functions of the Mental Health Commission were transferred to the commissioner, making the 2012/13 financial year one of transition for mental health. We were pleased to hear that the Mental Health Commissioner, who previously chaired the Mental Health Commission, has kept up her programme of sector visits to district health boards and that the Mental Health Commission’s final publication, *Blueprint II: Improving mental health and wellbeing for all New Zealanders*, has been adopted. We were interested to learn of a new monitoring framework, developed over the last year, which provides the commissioner with real-time feedback on mental health issues.

During our consideration of the 2012/13 financial reviews of district health boards we have become aware that not all district health boards have met their mental health performance targets. The Mental Health Commissioner told us that, while complaints about the level of mental health services provided have been received, she is not seeing a trend emerging. She acknowledged concern about the status of money previously ring-fenced for mental health services. We were glad to hear that the commissioner raised this matter with the Ministry of Health, which sent a letter of clarification to DHBs in response. We remain concerned that mental health funding should be protected within each DHB, and not eroded for other services. We believe that this issue should be monitored closely.
Appendix

Approach to this financial review
We met on 12 March and 9 April 2014 to consider the financial review of the Health and Disability Commissioner. We heard evidence from the Health and Disability Commissioner and received advice from the Office of the Auditor-General.

Committee members
Dr Paul Hutchison (Chairperson)
Shane Ardern
Paul Foster-Bell
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Scott Simpson
Barbara Stewart
Poto Williams
Dr Jian Yang

Evidence and advice received
Health and Disability Commissioner, Responses to written questions, received 7 March and 4 April 2014.
Office of the Auditor-General, Briefing on the Health and Disability Commissioner, dated 12 March 2014.
Organisation briefing paper, prepared by committee staff, dated 28 January 2014.
2012/13 financial review of the Health Promotion Agency

Report of the Health Committee

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Health Promotion Agency

**Recommendation**

The Health Committee has conducted the financial review of the 2012/13 performance and current operations of the Health Promotion Agency and recommends that the House take note of its report.

**Introduction**

The Health Promotion Agency leads and delivers programmes to promote health and wellbeing; prevent disease, illness, and injury; and reduce personal, social, and economic harm. The agency was established on 1 July 2012 and incorporates various functions previously discharged by the Alcohol Advisory Council, the Health Sponsorship Council, and the Ministry of Health.

**Financial and service performance management**

The agency’s revenue for 2012/13 was $28.933 million and its total expenditure was $28.667 million, resulting in a surplus of $266,000. In the agencies’ first year of operation the Office of the Auditor-General gave a “very good” rating to its management control environment, and “good” ratings to its financial information systems and controls and its service performance information and associated systems and controls.

**Establishment**

The Health Promotion Agency came into force on 1 July 2012, and brought together various functions and staff from the Alcohol Advisory Council, the Health Sponsorship Council, and the Ministry of Health. We were pleased to learn that the transition went smoothly and that the agency is working cohesively. We note that the Office of the Auditor-General gave its management control environment the highest possible rating.

**Mandate**

The promotion of health and wellbeing is the agency’s primary function. While it provides advice and research on alcohol issues, the agency admitted to some frustration that its mandate does not allow it to expand into related areas such as psychoactive substances. This would require legislative change, and we believe there is merit in considering it.

**Working with other agencies**

As a health promotion organisation, the agency works closely with the Ministry of Health. We were pleased to hear that it also works with many other agencies whose responsibilities bear upon health; most recently, it had worked with the Ministry of Justice, the Police, and local government authorities on implementing the Sale and Supply of Alcohol Act 2012.

**Alcohol**

In May 2013 the agency launched the *Say YeahNah* campaign—part of an “ease up on the drink” strategy—and is aimed at reducing peer pressure to drink. We congratulate the agency on a successful campaign that has led to the catch-phrase “yeah nah” entering the general lexicon. We were pleased to learn that the agency is working on the next phase of
the campaign. The incidence of women binge drinking is on the increase, and we were interested to hear that the agency is considering targeting women in the next campaign.

The Alcohol Drug Helpline is 50 percent funded by agency, and works closely with it. We heard that the helpline has accommodated changing preferences in communications media, and that people are now as likely to text as phone the helpline. We were also interested to hear that people are as likely to contact the helpline about other people’s drinking or drug taking as they are about their own.

**Pre-pregnancy health**

While the agency is involved in various programmes that touch on pre-pregnancy health (some, such as warning labels, were begun by its predecessor agencies), it said it would like to specifically add promoting pre-pregnancy health to its work plan and take a wider, more holistic approach. It is however, constrained by current funding arrangements.

Asked about the agency’s work with vulnerable groups and maternity care, it admitted that it has few links outside the primary health organisation sphere. We were pleased to hear that it was seeking to expand its sphere of interaction, and will look forward to monitoring its progress.
Appendix

Approach to this financial review

We met on 29 January and 12 February 2014 to consider the financial review of the Health Promotion Agency. We heard evidence from the Health Promotion Agency and received advice from the Office of the Auditor-General.

Committee members

Dr Paul Hutchison (Chairperson)
Shane Ardern
Paul Foster-Bell
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Moana Mackey
Scott Simpson
Barbara Stewart
Dr Jian Yang

Evidence and advice received

Health Promotion Agency, Response to written questions, received 27 January and 11 February 2014.


Organisation briefing paper, prepared by committee staff, dated 28 January 2014.
2012/13 financial review of the Health Quality and Safety Commission, the Health Research Council of New Zealand, the New Zealand Blood Service, and the Pharmaceutical Management Agency

Report of the Health Committee

The Health Committee has considered the 2012/13 financial review of the Health Quality and Safety Commission, the Health Research Council of New Zealand, the New Zealand Blood Service, and the Pharmaceutical Management Agency. With Crown entities and district health boards we resolved to undertake formal hearings of evidence on a rotational basis. This year no hearings of evidence were held for the above Crown entities.

The committee has no matters to bring to the attention of the House, and recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
# 2012/13 financial review of Housing New Zealand Corporation

Report of the Social Services Committee

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Housing New Zealand Corporation

**Recommendation**

The Social Services Committee has conducted the financial review of the 2012/13 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. Its mission is to provide housing to people in the “greatest need for the duration of their need.” It currently manages a portfolio of approximately 69,000 houses and flats, lived in by more than 200,000 people, and undertakes research on housing issues. The corporation has two subsidiaries, Housing New Zealand Limited and Hobsonville Land Company Limited.

**2012/13 performance**

In 2012/13, the total revenue of the corporation, including its subsidiaries, was $1.122 billion and its total expenditure was $944 million, resulting in a surplus of $120 million. We were told that a planned amount in dividends is returned to the Crown each year, and that the corporation continues to invest in new property for its portfolio. In 2012/13, the corporation’s revenue included $39 million in insurance revenue, following the settlement of its claim for earthquake-damaged properties in the Canterbury region.

The corporation and its subsidiaries received a “good” rating from the Office of the Auditor-General for its management control environment and financial information systems and controls. In 2011/12 the corporation received a “needs improvement” rating for its service performance information and associated systems and controls, as a number of concerns were raised in relation to its performance framework. We were pleased to learn that the corporation received a “good” rating for this aspect of its performance in 2012/13, and that a number of recommendations made by the office in 2011/12 were followed up. The corporation has re-evaluated and is developing its framework for collecting and managing service performance information. It is working to connect the reporting of financial and non-financial performance. We understand that the improvements being made are enhancing the clarity and effectiveness of the corporation’s reporting.

**Social housing portfolio**

Housing New Zealand Corporation is the main provider of social housing in New Zealand, managing a portfolio of 69,000 properties housing approximately 200,000 people.

At present the corporation’s portfolio contains too few properties in areas where there is high demand for social housing, and many of its properties no longer cater to the demographics of the families that need them, which have changed over time. However, we heard that there is an abundance of properties in areas with little demand for social housing. We heard that the corporation is implementing a 10-year Asset Management Strategy, to forecast supply and demand and thus align them more accurately. We heard that in 2012/13 the corporation has been upgrading and reconfiguring its portfolio,
developing new houses and accommodation types in areas with high demand for social housing. The corporation made a large investment in the housing stock in the Canterbury region, where many of its properties were badly damaged in the 2010 and 2011 earthquakes.

Work has been undertaken to progress the Government’s social housing policy and establish a sustainable sector of community housing providers. Some of us expressed concern about the planned sale of between a quarter and a third of the corporation’s properties to private-sector social housing providers. We were assured that the intention is for private-sector providers to supplement the corporation’s ability to house those in need.

The corporation was asked how many houses it should have in Auckland, and in which areas these should be located in ten years’ time to meet demand. The corporation was unable to provide ten-year projections regarding supply, but provided a five-year projection regarding demand. We were told that the corporation intends to reinvest profits from the sale of properties in building more properties better suited to current demand. The corporation does not expect the current size of its portfolio to change much.

**Vacant properties and turnaround**

Reducing the number of vacant state houses and the length of time they sit vacant between tenancies was a major focus in 2012/13. As at 30 June 2013, we heard that 3,597 properties were vacant. They included properties being redeveloped, and properties considered unsafe to live in or that did not meet the corporation’s needs. We heard that others could not be tenanted, for example, because they were not configured properly to accommodate those in need. We learned that the number of vacant properties had decreased to 2,957 by the time of the review, and of this number, 761 were ready to be let to new tenants.

The corporation has a target turnaround time of 45 days for re-tenanting properties. In 2012/13 on average properties sat vacant between tenancies for 101 days. We were told that the corporation finds it difficult to repair damage and carry out routine maintenance within its target timeframe. It believes that damage to its properties is often more extensive than is typically seen in the private rental sector, which affects its ability to re-let its properties. However, we were told that the 45-day target is comparable with international turnaround times for social housing. The corporation also acknowledged that it can do much better, and assured us that reducing the time properties sit vacant remains a high priority in 2013/14. We understand that the average turnaround time has fallen recently.

**Damage to properties**

In 2012/13, the corporation spent approximately $15 million repairing property damage caused by tenants. We asked what proportion of this damage was caused wilfully. The corporation does not record whether damage is intentional, but noted that the vast majority of it results from accidents. Where it is established that property damage is caused wilfully, the corporation charges tenants for the cost of repairs, but its ability to recover this debt is limited. It can be difficult to locate tenants who abandon damaged property. We were pleased to hear that the corporation strives to be proactive in preventing damage to its properties, and is attempting to strengthen relationships between tenants and housing managers to reduce its incidence.

**Warrant of Fitness scheme**

We were interested in the corporation’s trial of the Government’s property Warrant of Fitness scheme, which commenced in March 2014. The scheme seeks to ensure a
minimum acceptable standard of housing for the corporation’s properties, taking into consideration factors such as whether a property is insulated and dry, safe and secure, and provides essential amenities. The scheme will provide the basis for robust reporting on the quality of the Government’s housing stock.

We heard that the corporation expects 96 percent of its 500 trial properties to meet the proposed standard, and four percent to require work to comply. The chief executive told us that the scheme would not be used as an opportunity to sell properties; however, properties may be sold if they fail to meet Warrant of Fitness standards and are uneconomic to remediate.

Transfer of social housing needs assessment

Since 14 April 2014, needs assessments for the corporation’s properties have been taken over by the Ministry of Social Development. We heard that this may result in an increase in demand and waiting lists for the corporation’s properties, as the ministry has a larger national presence and client base. Some of us are concerned that this means the corporation may have been missing eligible tenants in its previous needs assessment process.

Canterbury earthquakes

Repairing and rebuilding Housing New Zealand properties is a major focus for the corporation at present. A big investment has been made in the Canterbury region, where approximately 95 percent of the 6,000 state houses in the region were damaged in the 2010 and 2011 earthquakes.

The corporation repaired and re-tenanted 212 properties in 2012/13. We were pleased to hear that it is on track to repair the remaining 5,000 damaged homes by late 2015, two years earlier than initially planned, as a result of a $320-million insurance settlement reached during the year. We heard that the corporation, working with the Department of Corrections, has had 32 earthquake-damaged state houses moved to Rolleston Prison for inmates to repair. We commend the corporation on this initiative, which provides inmates with an opportunity to obtain formal skills training and to help increase the supply of social housing in Canterbury.

In 2012/13 the corporation decided to construct a further 700 new properties in Canterbury, to replace properties damaged beyond repair by the earthquakes, and to support a growing demand for social housing in the region. Construction began in May 2013, and the corporation has made a commitment to completing this project by the end of 2015.

We agree that Canterbury is an important focus for the corporation and acknowledge the efforts it is making to increase the availability of social housing as quickly as possible.
Appendix

Approach to this financial review
We met on 5 March 2014 and 16 April 2014 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
Melissa Lee (Chairperson)
Hon Phil Heatley
Jan Logie
Le’aufa’amulia Asenati Lole-Taylor
Hon Peseta Sam Lotu-Iiga
Sue Moroney
Alfred Ngaro
Dr Rajen Prasad
Mike Sabin
Hon Chris Tremain
Louisa Wall

Evidence and advice received
Housing New Zealand Corporation, Responses to written questions, dated 2 and 20 December 2013, and 21 January and 27 March 2014.

Office of the Auditor-General, Briefing on Housing New Zealand Corporation, dated 5 March 2014.
# 2012/13 financial review of the Human Rights Commission

Report of the Justice and Electoral Committee

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Recommendation

The Justice and Electoral Committee has conducted the financial review of the 2012/13 performance and current operations of the Human Rights Commission and recommends that the House take note of its report.

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.

Financial and service performance management

In 2012/13, the total revenue of the commission was $10.121 million and its total expenditure was $11.074 million, resulting in a net deficit of $953,000 (in 2011/12 the commission reported a net surplus of $123,000).

The Office of the Auditor-General gave the Human Rights 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 ratings are consistent with those of the previous year.

The commission completed an internal organisational review in 2013, and it expects to implement changes in response to the review in 2013/14.

Canterbury earthquakes

We asked about the commission’s approach to the Quake Outcasts, a group of uninsured Christchurch landowners legally challenging the Government’s offer to purchase uninsured residential properties and vacant land in the red zone for 50 percent of their 2007 rateable value. We heard that when the commission intervenes in judicial proceedings it does so as a friend of the court to present information regarding the human rights situation, and it has criteria for intervention in legal cases. In respect of the Canterbury earthquakes, the commission’s focus is on human rights and property rights, and particularly the importance of the home to personal freedom and human dignity.

Staffing

We asked about the commission’s 18 percent staff turnover in 2012/13 and heard that an organisational review has resulted in 35 new roles being established and 38 existing roles being disestablished. Recruitment is in progress for some positions, but the commissioner is confident that the organisation has the capability it needs. However, he is seeking to increase its capacity in human rights law and lived experience, and expertise in disability and representing Pacific people. We commended the commission on its gender profile.

Direct reporting to the Prime Minister

We asked about the Prime Minister’s response to the commission’s report to him on proposed legislation concerning the Government Communications Security Bureau and
mass surveillance: “They need to pull their socks up. If they’re going to continue to be a government-funded organisation they should meet deadlines like everyone else did”. The commissioner said the comment showed a misunderstanding of the situation; the commission did not make a submission to the Intelligence and Security Committee, but exercised its statutory right to report directly to the Prime Minister on a matter, for which there is no deadline. The chief commissioner has been assured that his organisation’s baseline funding will not be reduced.

**The elderly and ACC**

We wanted to know if the commission had received complaints from elderly people who have found they are ineligible for ACC upon turning 65 years of age and receiving superannuation. The commissioner was not aware of this matter being the subject of complaints; complaints are dealt with by the chief mediator, and commissioners are alerted when recurring complaints indicate that an issue has become systemic. We heard that should such a complaint be raised with the commission, the anti-discrimination disputes resolution team would probably contact ACC.
Appendix

Approach to this financial review

We met on 20 February and 26 March 2014 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)
Paul Foster-Bell
Joanne Hayes
Raymond Huo
Alfred Ngaro
Denis O’Rourke
Hon Maryan Street
Holly Walker
Hon Kate Wilkinson

Evidence and advice received


Organisation briefing paper, prepared by committee staff, dated 5 February 2014.

2012/13 financial review of the Independent Police Conduct Authority

Report of the Law and Order Committee

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Recommendation
The Law and Order Committee has conducted the financial review of the 2012/13 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 reassure the public and Parliament that policing standards are the highest possible. It examines independently and reports constructively on issues within the Police or regarding the interaction of members of the public with police.

The authority’s total revenue for the 2012/13 financial year was $3.861 million, and its total expenses were $4.288 million, resulting in a loss of $472,122.

Capacity and resources
The investigation the authority called “Operation Eight” concerned the handling of the police investigation into apparent military-style training camps in the Urewera forest, and took up significant resources, resulting in a backlog of other investigations.

The authority is adopting a new way of working to prevent such a situation from recurring. The implementation of the changes is nearly complete. The changes include better filtering; prioritisation of incoming complaints; more emphasis on timeliness, teamwork, and efficiency; a better arrangement with the police for the early identification of issues of practice and policy; better communications with the police, and access to their BlueTeam complaint management database and the police national intelligence database; and investment in peer reviewing for quality assurance.

We asked the authority if there was any likelihood in the immediate future of the authority having to decline cases because of lack of capacity to handle the incoming volume of complaints, and whether it believed it needed more funding. The authority replied that it is keeping up with the current workload, as well as working to diminish the backlog, and the improvements it has made as a result of lessons learned in Operation Eight have been showing results.

The authority would be reluctant to ever decline cases, although should a large and complex investigation, such as Operation Eight, be started imminently, it would be difficult to avoid a backlog ensuing. The authority would consider making a case for increased funding only once the improvements have been implemented and their effect measured.

Powers of the authority
Initiation of investigations
Under its current powers, the authority can initiate an investigation only as a result of a complaint. We discussed this with the authority in previous reviews, where it told us that it believes a power to initiate investigations autonomously would be useful in some cases. We asked about progress on this matter, and were told that the authority had been
concentrating on clearing its backlog of cases and improving work practices in the period under review. Having the power to initiate an investigation without having received a complaint would add to its workload, so it has not moved on it in this period, but still believes that, as an official oversight body, it should be able to do so. Some of us believe that the authority should be given the power to initiate investigations.

**Coercive powers**

Unlike similar authorities in other countries, the authority has no powers to arrest or prosecute police officers. It believes that this leads to a positive relationship with police, as they can talk openly to the authority with no fear of reprisal. In contrast, in England, the Independent Police Complaints Council does have these powers, with a result that police officers often seek legal advice and representation in proceedings, making the proceedings, in the authority’s view, unnecessarily acrimonious. The authority is pleased with the level of cooperation it has with the police.

**Publishing and reporting powers**

The authority has the power to publish its findings, and also to report to the House if any of its findings are not accepted or rejected. It is pleased that it has never had to report to the House, but nonetheless values it ability to do so. It has never had a recommendation rejected by the Police, although it accepts that a proportion of its recommendations are not implemented, and that some take time to implement.

The authority believes that the police react well to the publication of its findings.

**Performance measurement**

The authority is reviewing the way it measures its performance. It does so at present by asking complainants if they are satisfied with the outcome of their complaint. The authority concedes this may be a flawed procedure, as many people will not be satisfied if their complaint is not upheld. It is looking at other ways of assessing its performance, for example, by asking the complainants if they felt they were listened to and treated with respect.

**Restorative justice and conciliation**

We asked the authority to comment on the increase in cases being classified as suitable for conciliation. It said that the nature of the complaints it receives has not changed, but rather the way the authority deals with them. It examined the way some British police forces use restorative justice and reconciliation to deal with complaints, and found it sensible to quickly and proactively apologise for any inappropriate behaviour, and work out with the potential complainant how to proceed. The authority believes that there is a potential for the Police to build on their relationships with the community in this way. The approach has already been adopted, to the benefit of all concerned, in some parts of the country, but not all police have yet been trained in it. The authority expects more to be done in this area in the next year.

**Comparable foreign organisations**

The authority told us that it had learned lessons from the experience of the Independent Police Complaints Commission in England. The commission acknowledged that it can produce work of a poor standard, heightening the perception that it is not fully independent. Its relationships with the various police forces were adversarial, largely
because of its power to arrest and prosecute officers. There was also widely publicised
discussion about the commission’s perceived lack of resources, and even some calls for its
abolition.

The authority considers that it is valuable in the New Zealand context to have a balanced
mix of investigators, some with a police background and some without, despite
reservations in England about the effectiveness of non-police investigators. A mixed
investigation team avoids the appearance of bias and takes advantage of team members’
complementary experience.

The authority learned a lot about quality control and relationship management by
examining the experiences of the commission and the related police forces.

**Technology**

We asked the authority whether it believed that the growing use of technology, such as
tablets, smart phones, and other recording devices, would affect its work. It told us that
there are benefits from an evidence-gathering perspective, as devices can be tracked, and
audio and video recordings can be examined for the purpose of investigating complaints.
Thus technology is likely to make the authority’s investigations easier, and reduce the need
for independent witnesses. The authority gave us an example of its use of closed circuit
television coverage in investigating an arrest that went wrong. It found that viewing the
coverage was much faster than interviewing up to 12 witnesses, and removed the problem
of conflicting testimony.
Appendix A

Approach to this financial review
We met on 19 March, 9 and 16 April 2014 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 Controller and Auditor-General.

Committee members
Jacqui Dean (Chairperson)
Jacinda Ardern
David Clendon
Hon Phil Goff
Hon Todd McClay
Ian McKelvie
Mark Mitchell
Richard Prosser
Lindsay Tisch

Evidence and advice received
Independent Police Conduct Authority, Responses to written questions, received 17 March and 9 April 2014.


Independent Police Conduct Authority, Output Agreement with the Minister of Justice for period 1 July 2012 to 30 June 2013.


Organisation briefing paper, prepared by committee staff, dated 19 March 2014.
Corrected transcript of hearing of evidence 19 March 2014

Members
Jacqui Dean (Chairperson)
Jacinda Ardern
David Clendon
Hon Phil Goff
Ian McKelvie
Mark Mitchell
Richard Prosser
Lindsay Tisch

Witnesses
Independent Police Conduct Authority
Judge Sir David Carruthers
Brent Anderson

Dean Good morning, Sir David. Welcome to the Law and Order Committee. We have set aside an hour for this hearing—if you would like to give us some opening comments, and then take questions. Thank you.

Carruthers Yes, certainly. Thank you. Can I start by first of all acknowledging members of the committee. [Introductions]

Dean Thank you. We'll just get everybody settled because—thank you.

Carruthers Thank you for the chance of saying something briefly, in opening. When I spoke last year to this committee I identified the main issues which I thought were facing the authority and which related to independence, to profile, to timeliness, and to accessibility. I then said that I wanted to see the authority become a world-class organisation, doing the highest-quality work with benefits that would flow on to strengthening public confidence in the police and helping to support our Police becoming a world-class police force.

One of the issues raised by members here last year related to our use of ex-New Zealand police officers as investigators, and the appearance of bias that that might create. I wanted to say that I took those comments seriously, and we’ve made a number of changes. But first, we do continue to employ ex-New Zealand police officers because they come to us fully trained and they know the work and they know the environment. We have two employees who are ex-United Kingdom police officers, which blunts the criticism slightly. But our investigators now work as part of project teams. For each inquiry we establish a team, so the investigator works alongside a
legally qualified report writer and others, such as analysts and so forth, and those teams report to our new manager of investigations, who’s a senior ex-United Kingdom lawyer, not police, and all decisions are made collectively by the team and then ultimately by me as chair.

So in that way we seek to avoid the criticism which is so easily made, but I need to add to this committee that I have the greatest of respect for our ex-New Zealand police officers, who are strong and independent and do not hesitate to condemn police activities or conduct if they think it’s below standard. In that respect they echo simply what I’ve heard from senior police officers in New Zealand anyway, who share the same view about substandard work. We are also in the process of training a further investigator who is not from a police background, who is a New Zealander.

Another of the challenges was about publicity, profile, and accessibility. The authority has decided that we will report publicly on all independent investigations, unless in a rare case there is an overwhelming private interest, and we haven’t found one of those yet. But the majority of complaints that we receive we do not independently investigate. We send those back for the police to do that, and we oversight that, either very actively or at the end of the police reinvestigation. Most of the complaints are concluded by way of direct correspondence with the complainants.

In the year under report at the moment, we received just under 2,000—1,997—complaints. We opened 62 investigations. We produced nine public reports—that is, reports from investigations which were publicly released—but that has accelerated. As a matter of interest, we have produced 15 public reports already this financial year, and there are several more—about the same number—imminent. As a result of our independent investigations, 39 recommendations were made to the police.

By far the largest public report released was related to the police investigation called Operation Eight. This involved an enormous amount of work. We completed that with excellent cooperation from police, who fully accepted its criticisms of police conduct and behaviour, and all recommendations made in the report were accepted by the Police. I have recently received from Commissioner Marshall confirmation of the implementation of those recommendations. Probably one of the most important aspects of the recommendations related to the need for bridges to be rebuilt, particularly with Tūhoe. The commissioner has made it clear in his recent letter to me that they have proceeded to do this at the direction of Tūhoe leadership. They have not thought it appropriate to impose their own timetable. They are anxious to meet. They have been meeting on several occasions, but they have not had yet a formal “in conclusion” meeting, and that is dictated by Tūhoe leadership. It’s advancing well, he tells me. It’s heading towards a formal meeting shortly, but, sadly for him, it won’t be whilst he is commissioner because that’s coming to an end now. But that very substantial investigation report was responsible for eating into our reserves, and that’s reflected in our financial position.
We’ve been concentrating on completing a backlog of cases, which was necessarily built up because of our preoccupation with Operation Eight. I’m able to report today that the backlog has been largely dealt with. Only a small number of historic cases now remain, and they will be all completed this year. All the current cases are under firm control because we’ve changed our way of working to avoid further backlogs. That new way of working includes much better filtering; prioritising of incoming complaints; a greater focus on timeliness, teamwork, and efficiency; a much better arrangement with the police in the early identification of issues of practice and policy; better communications with the police, and access to their BlueTeam complaint management database and the police national intelligence database; and our significant investment in peer reviewing quality assurance.

We’re also working hard with the police to move our culture of engagement from always being one of blame to prevention within the boundaries of the law. We think that’s much more worthy and worthwhile. The result of all that is that we’re now producing work which I think is comparable to our best international counterparts. I’ve had very pleasing comments from colleagues around the world about the quality of the reports that we’re producing now from this work.

So the problems that we seriously had with the delay in timeliness, which were part of the challenge last year—with the leadership of Warren Young I must acknowledge—have been dealt with through better teamwork and more focused planning and review. We’re not quite there, but we will be very soon.

We’ve also made changes to the way in which recommendations are actioned by the Police. We now discuss and negotiate with the Police prior to the issue of our reports, and not on the basis of an easy consensus. We retain the right to disagree, but mostly we find that we can agree on recommendations that are action-based, easy to implement, and easy for us to monitor so that we’re not doing work that is unrealistic or not connected with real life. We’ve done that with the cooperation of senior police and the involvement of our senior leadership with the police operational advisory groups.

Of the two other matters that I want to quickly cover, the first is related to finance. We’ve budgeted for a deficit in the financial year under review because of the demands of Operation Eight. We’re very aware that we have to be sustainable. We’re on budget to do just that this year. A problem for us is that we’re always able to work within our resources because we’ve got the ability to take on investigations or not as our resources dictate. But a concern for me is that we may come to a point when we are declining to attend cases that we should actually be investigating, and not fulfilling our statutory mandate. So I’m reviewing our position, with Brent Anderson’s help at the present time, about that, with a view to seeing whether a case should be made for an increase in our baseline funding. We’re just conscious of the fact that we would always be OK, but we have a statutory job to do and we intend to do it.
We’ve also reviewed and changed our work under the OPCAT protocol. That’s the reviewing of detention facilities. We’re a national preventive mechanism. We’ve changed the way in which we’re doing that. We’re now working with the Police on the development of national standards for detention facilities, and that work is well advanced. When those standards are established, and we have a number of models from overseas we’re using as well, we will then be seeking from the Police a planned programme for the upgrade of detention facilities throughout the country, and that will enable them to plan for the necessary capital expenditure across a number of years, instead of us requiring the Police to respond to ad hoc inspections, which has been the case in the past. We will still carry out inspections, but we expect that to be a lesser function. We will expect the Police to audit themselves against their own agreed standards. There will be some detention facilities they won’t want to upgrade and will be closed. We will continue to monitor—probably more important than what the facilities are like is what happens in them. We have adjusted our database so we’re capturing activities in detention centres as part of our OPCAT obligations, which we look to for patterns of behaviour and so for patterns of complaint.

Last year I also said that we wanted to improve our contact with other oversight systems around the world. I visited the United Kingdom, spent time with the English, Scottish, and Irish counterparts, and now we’re in regular contact with our Australian colleagues. There is a lot of activity going on. There’s a very serious review following criticisms of the United Kingdom IPCC, which we’re following very closely, and there are quite serious lessons for us to learn from that. One of the most important lessons, I think, which I gleaned from my visit, is the importance about the quality of the relationship which we have with the Police, and our relationship is an excellent one. We’re not friends, because we keep a distance, but we have a very respectful, cordial relationship, and I wanted to acknowledge the leadership of the retiring commissioner, Peter Marshall. In that respect he’s been outstanding. I also want to acknowledge our board members: Angela Hauk-Willis and Dianne Macaskill. I report to them formally every month, and they don’t hesitate to give me frank, clear, robust—I’m looking for words here—helpful advice, which I take seriously.

Last year I said that I expect to be judged on the performance. We’ve been facing the challenges that we’ve identified. We’re mostly on top of them. We’ve got a little way to go. But I’m happy to answer any questions, as are my colleagues. Thank you.

Clendon Thank you for the briefing, Sir David. Could I just comment, firstly, thank you for the update about the issue of having other than serving police officers involved—or former police officers—in the investigation team. I know we had quite a conversation last year on that. I think the committee, or some of us, felt they’re just bringing a different perspective into those teams, with no reflection or no disrespect to the police officers. So thank you for that. The question is around the issue that again we talked about last
year. I’m interested that you’re talking about wanting to move to a preventative mode. You cannot, I understand, initiate investigations—

Carruthers That’s true.

Clendon —other than in response to a complaint.

Carruthers No, we don’t have own motion jurisdiction.

Clendon Right, so, again that’s something we considered last year. Is your feeling still that that power would be useful for the commission?

Carruthers Yes, I haven’t thought about it more deeply because I’ve been trying to concentrate on doing the job well with the powers we’ve got, but from time to time it has still occurred to me that that would be a useful thing to do in a high-level case where I see a lot of public interest and attention, but if we don’t receive a complaint, then we don’t have any way of acting. It has seemed to me to be somewhat foolish to be an official oversight body in something which was exciting public interest of a serious nature which we were powerless to look at. But I balance that against our need to get right on top of the work we’ve got at the moment, and I haven’t been in a hurry to add to our jurisdiction.

Clendon Yes, so there would be capacity issues around that clearly, but that aside—

Carruthers Perhaps, but if it were high-level work, I think I would still support such a change. It’s your decision, not mine, but I respectfully put that forward.

Ardern It strikes me that we’re asking you to do a lot with very little. I think you’re operating on a budget of something like $3.8 million. You mentioned having received almost 2,000 cases, and although I know you’re working very hard to up your case completion rate, you’re still only looking at about 68 percent of cases being completed within 12 months, taking into account those that are outside of your control. How close are you to having to decline investigations on the basis of capacity issues?

Carruthers It’s very hard for me to answer that. What I can say is that we are keeping up with current work well. In the last few reports that we’ve issued I’ve looked at the time of the incident and the time of the report to see what the delay has been, and it has been something like 5 months—in one case 4 months, another 7 months, and then two or 3 at about 1 year and 1 year and 2 months—so much better. We’ve got two or three coming out shortly which have been about 4 or 5 months only. In my mind, a period of 6 months is a desirable target, because after a significant lapse of time, opponents are going to be more bitter, rather than less, about the lack of action, and the ability to make sensible comments about change starts diminishing as well. So we’re doing very well with current work at the present time, and working hard. We’ve still got a little bit of a backlog to clear of some work that is actually disgraceful in terms of delay. So I just have to say that as it is.

Will we have to decline work? If we got another Operation Eight, we couldn’t handle it at the moment without putting a whole lot of work significantly delayed, and I’d hate to do that. We understand that we can’t
ask for any more money, particularly in today’s climate, until you’ve had a really hard look at your own organisation to be as smart as you can and as hardworking as you can. We’re mostly through that—a bit further to go—and then we’ll be having a serious look at time costing some of our work, seeing what we can manage, and whether we have a case. So it’s middle ground at the moment.

Ardern You say that if you had another Operation Eight, you couldn’t cope—

Carruthers No. Well, we could, of course.

Ardern —but you’ve got, for instance, a significant case on your hands in the Roast Busters investigation. Not having that extra capacity to be able to cope with a significant case—isn’t that a problem in itself? In your answer, could you please also touch on where you’re up to with the Roast Busters investigation?

Carruthers Certainly. Righto, we’re going well. There are complications in it, which you’ll be aware of, and so it’s going to take us a little bit longer to finish that we thought it would. One of the complications is ongoing criminal investigation by police, which we have to be careful about for obvious reasons. But that has not been as resource-intensive as we thought it might be. I’m satisfied that we can accommodate that within our present circumstances. As for a time when we’ll report, we’ve mostly done the investigation work we want. We’re now getting to the stage where we’ll bring all those conclusions to a head and start looking at what sort of decisions we’ll make. So 2 or 3 months, probably.

Ardern Two or 3 months, OK. One more just quick supplementary off the back of that. The hold-ups that you often experience sometimes are out of your control. I know the Police have a period where they are able to review your investigation before release. How often are investigations being held up because of that element of the process?

Carruthers We get very good cooperation from the Police, and it’s one of the significant things about the way we work in New Zealand, which is not common to other particularly Commonwealth jurisdictions. I think it’s largely because we don’t have the coercive powers that other jurisdictions have. We don’t have the right to prosecute, we don’t have the right to arrest police officers. Some jurisdictions do. And because we don’t have those powers and there is a confidential provision as well, police officers can talk to us knowing that there’s no other consequence from their discussion with us, so they’re encouraged in that way to be open and frank, helpful, and to concentrate, as they often do, too, on what would have prevented this from happening. So we have that sort of respectful conversation very well and haven’t had difficulties in getting information. We have access, as I mentioned, to BlueTeam database and to NIA. Police are very good at letting us have what they’ve got. In the middle of an investigation, there’s obvious pressure about that, but they haven’t been insurmountable. I contrast that with what I’ve seen, particularly in England, where I speak to police officers who lawyer up as they go and talk to the IPCC, don’t answer questions, right to silence, and so forth. That would impoverish our work
dreadfully, so we, at the moment, I think, are very fortunate with the legislation we’ve got and with the cooperation we get from police. So I’m not conscious of—

Ardern Even though you’re only getting 67 percent of your recommendations picked up by the Police?

Carruthers Well, we haven’t had any recommendations declined by the Police.

Arden They just haven’t been implemented.

Carruthers Yes, that’s right.

Ardern They don’t say no; they just don’t do it.

Carruthers No, no. I’ll just recover for a moment.

Dean It’s your choice how you respond to that, obviously, in as much as you are able.

Carruthers Thank you. Our year falls in a funny way. If we make 20 recommendations just before the end of our financial year, then there’s 20 outstanding, and we can look foolish in the face of unanswerable questions. But what we have found is we’ve got a new way of working with our recommendations. We have a shared spreadsheet. We have had no recommendations that have been rejected by the Police. Sometimes they take a while to get implemented. But, for example, Operation Eight, we had very serious recommendations about search and seizure, about stopping cars and roadblocks and so forth, all accepted, all part now of police practice, so they’ve implemented those immediately. There are some that are longer term, that’s all.

But our final power, if you like, is the power to publish and the power to report to Parliament. We publish, and the Police are very sensitive to that and respond to it, in my experience, brilliantly. We’ve never had to table in the House recommendations that have not been accepted or rejected, which we wouldn’t hesitate to do if we thought we were being faced with unreasonable attitudes. We’ve been very fortunate. Not to say something won’t come, and we will guard our independence zealously, but it hasn’t happened yet.

Mitchell Yes, Sir David, I mean, it’s very hard—you’re not equipped with a crystal ball, so you can’t see when an Operation Eight or a Roast Busters is sort of coming charging at you. But do you feel that as an organisation you’ve actually—well, it certainly sounds like you’ve got much better at being able to mobilise to start an Operation Eight investigation whilst also making sure that you’re managing the existing case files or the files that are sort of coming through. Do you think as an organisation you have got more efficient and better at being able to tackle those sorts of situations?

Carruthers Well, I’m not ever going to criticise what happened before my time. We’ve been very lucky. We’ve got Dr Warren Young giving us some help at the moment and that’s been a catalyst for sensible change. We have a much more rigorous process of categorising cases, so we do that, although we are open to the idea of reviewing that too, because we’re all dependent on the
information you get. So Rewa is a good example. Originally, we turned that
down for what I thought were good reasons—20 years old, etc. Public
anger and dismay about all that made us think about it again and police
asked us to re-open it and so we did. So we’ve got to be open to
recategorising, but we do that very hard now. We try to prioritise. We’re
much smarter about overseeing police investigations, so we’re very keen
on timeliness now for that. So we have time lines and projects for that as
well. So short answer—I could go for ever, but short answer is yes. I think
we’re doing very good work at the moment. There’ll always be something
better to do and we’re open to that, but we’re focusing very hard on being
honest and fair and courageous where we have to be.

Goff  Firstly, David, thank you very much for the work that you’re doing and the
style in which you do it, which is always appreciated. You mentioned
Operation Eight being incredibly resource-intensive. Operation Eight
appeared to many members of the public—not to mention parliamentarians
on both sides of the House—to be over the top. Another incident that
looked pretty much over the top, of course, was the raid on Kim Dotcom’s
mansion. If it was Al Capone and there were machine gun squads inside,
you’d understand it, but for copyright infringement it just seemed a little
excessive. Have you been asked to do an investigation into police conduct
over the Kim Dotcom raid?

Carruthers  No.

Goff  And that’s not something you can initiate yourself. So that has to come by
way of a public complaint.

Carruthers  Exactly Mr Clendon’s point. No, we are not able to do that. We have an
edge of Kim Dotcom work, which we’re doing at the present time, but it’s
not to do with the raid.

Goff  That would be a case, if referred to you, that would require a similar amount
of time and energy?

Carruthers  Yes, well, it would. It was obviously a big police operation. But sometimes
it’s a matter of just trawling through a lot of material which is available
without having to investigate much more, because if there’s very good
CCTV coverage, if there’s very good video—

Goff  There seems to have been that.

Carruthers  Yes, well—quite. And if those things are available, then the job is much
easier, particularly if there are the silent witnesses that can’t be gainsaid. So
whilst there would be a good bit of work in it, there are some cases where it
it’s just a matter of going through the files to see what’s happened, making
sure the files are complete, and picking up other things like laser footage
and CCTV and recorded interviews and so forth. So that’s easier and
simpler than getting out and interviewing witnesses and trying to dig for
things that have not been exposed.

Goff  Thank you. My second question is about a case that you reported just a
fortnight ago and that was the Shane Cribb case where a young 17-year-old
seems to have been set up by two police officers and blamed for a crash
that wasn’t his fault. That happened in 2005. That’s 8 to 9 years ago. I’m not putting that responsibility on the IPCA—

Carruthers: Well, we’ve taken some responsibility for that. We said in the report that we contributed to the delay. Again, other work pushed it out for us, but it wasn’t all our fault.

Goff: But that seems to be a classic case of justice delayed is justice denied. That young man is now 26 and he’s lived with that conviction all the way through. What are the lessons that the police can learn from that and the IPCA can learn from that to avoid that sort of undue delay and the continuing injustice involved in that delay?

Carruthers: Right—he hasn’t lived with that all the time of course, because the conviction was overturned as a result of a rehearing, but it was some years later. Well, one of the lessons for us is in the past we have always not been involved until criminal proceedings were over. We did that with Operation Eight and you remember that went on for 5 years or something before the Supreme Court finally decided. And we’ve always said criminal proceedings first, then we’ll come in and look at conduct.

What we’ve learnt is that there are some occasions—actually quite a few—where we can actually do our job at the same time without interfering with people’s rights and the criminal processes, make our decisions, make our filings, report publicly, and get out of it without interfering with the criminal process. And where we can do that we should do it. So, I think we’ve been a bit precious about hanging back. We will always consult with the officer in charge and make sure that police agreed that there wasn’t a likelihood that we would interfere with proper processes, perhaps with defence counsel. But there are a number of cases where we have done that just recently and not waited for an inquest, not waited for the criminal proceedings, done our piece of work, and got out.

Cribbs is an interesting example because until an independent witness came forward there was very little support for the very strongly held views which were the subject of the complaint. The independent witness changed all of that. And then, of course, there had to be a lot of digging about what went wrong, what went wrong with the police reinvestigation and so forth. So it was a disgraceful length of time—absolutely right about that. We contributed to it and it was hard on people. It was hard, actually, on a police officer involved too. I don’t know if you read the report but there was a young woman who actually—as the report makes clear—was asking for help to do the investigation because she felt out of her depth and didn’t get the help she needed. Eventually she made a mistake herself and she suffered for it and that’s proper. But she also—the delay for her was cruel and she expressed to us recently her enormous relief that the whole story is now out. So other staff, quite apart from those who are innocent.

Goff: You said in the report that you didn’t believe it was a police conspiracy, but where did the fault lie with the police apart from, obviously, the constable and senior constable directly involved?
Carruthers: I think the report says what we wanted to say about it all, with great respect, and I don’t want to add by saying “Well, what we really meant was so and so.”, because that would be silly. But there were problems of supervision and support, which we are assured are now overcome.

Mitchell: Sir David, I don’t want you to get the impression that this committee is a defence counsel for Kim Dotcom—it’s not—and I certainly don’t like second-guessing the tactics of our New Zealand Police when they had such a large property to try and secure with known firearms in there. I’d rather see our police men and women go home safely at the end of the day. But one thing that I did want to ask you was around the IPCC and the visit that you’ve made to them. You said that there were some very clear lessons that we could take from what’s happening with the IPCC. Is there any chance you could elaborate any more on that? Because I’m quite interested.

Carruthers: Yes, certainly. Well, there are interesting developments in England that we’re watching closely, particularly now we’ve got personal connections with them. One of them is about quality of work. They produce some very poor work indeed, which I think they frankly acknowledge. They’re having to redo it. Those terrible football riots was one of them, and the Lawrence inquiry, which you’ll be aware of. Some work added to the perception that they weren’t fully independent, weren’t able to do a robust investigation and come up with courageous answers to difficult problems. So quality control is one of the lessons for me from all that.

The second and very important one is the police relationship. I spoke to a number of the police forces—because, as you know, there are a lot in England, and they are all subject to the IPCC—and the comments I heard were scathing about the inadequacy of the people doing the work. There were comments about non-ex police investigators, which they welcomed—the police forces did—because they could pull the wool over their eyes really easily. They didn’t know what they were doing. They didn’t know the job, which had impact on me. They had comments about the adversarial relationship, about the lack of working together or constructively, the way they felt that they were on the back foot straightaway and it was a criminal proceeding straightaway and that they needed protection. So there’s a lack of cooperation. All of those things, and then IPCC itself was talking about the lack of resources. It said that in the House of Commons. They haven’t got people to do the job, and now there’s quite difficult talk going on about transferring resources from police forces to the IPCC to do the work better and calls for the abolition of the IPCC and the constabulary because there’s not enough work being done about prevention rather than just blaming—just my point again.

So, a number of those and then some sort of work-related things too, which we’ve taken away. Those are the big ones. And of them all, I think the relationship is the key. If they didn’t get cooperation from the police, then it wasn’t going anywhere.

Mitchell: Can I just congratulate you on that, because I think you’ve raised a very important point—that it’s such a fine balance of being able to have a very
strong relationship with our police service and also being seen to remain independent. I think that you and your team have got that balance absolutely right.

Carruthers Well, senior police understand that really well, too, so we have an advantage in this country.

McKelvie I always think that the way you report gives your organisation credibility. I think it’s very important and I like the way you report to us.

Carruthers I think I’m innocent is probably the answer. I’m naïve.

McKelvie I was going to say that you always speak to people like that, so I’m surprised you get any complaints. I was wondering about some of your monitoring—the measurements you use to monitor the way you perform. I guess that pretty much everyone that comes to you with a complaint feels like the victim.

Carruthers Yes.

McKelvie So if that’s the case, you then ask for those victims whether they’re satisfied with your performance. Is that a reasonable way to measure yourself?

Carruthers We are completely looking again at our measures about satisfaction because I don’t think they make any sense, frankly. That’s probably another naïve comment to make to the select committee, but Brent’s heading some action for us now about satisfaction and performance surveys. I don’t know if you want add anything.

Anderson Well, only that yes, we are working quite hard to come up with a new set of performance measures, and that’s one of the ones we’ve focused on, to try to improve that. The group, rather than just talking to the victim is talking to the people end to end who’ve been part of our investigation and inquiry.

Carruthers I think we’ve also found that it’s silly to say that you’re happy about the outcomes because a lot of people won’t be. It’s just the nature of court proceedings, really. But sometimes you can ask other questions and you feel that you are treated with respect or you’re listened to. You think that they’ve got a fair grip on what you are saying about your complaint—things like that, which add up to something useful. But we’re reviewing that because we’re not satisfied with that reporting.

McKelvie I’m pleased. I think that’s excellent. I think that really the measurements were a little bit harsh on your organisation, frankly—you’re opening yourself up—for the results to be what it is.

Carruthers Thank you for that comment. Next year when I report, if I’m still alive—

McKelvie And if I’m still here.

Ardern I don’t think we’ll take any bets on either side. I just wanted to ask you a couple of questions around the nature of the cases that you’ve been investigating and whether or not you’ve noticed any significant changes. Generally, I see from your last report that you generally see the same kind of allocation of cases in terms of their seriousness year on year. Except I see that this year, under category 4, which I believe is the one that you deem to
be appropriate for conciliation—so issues like timeliness, race issues, race-based complaints, whether or not information is being used inappropriately by police—seems to have jumped reasonably significantly. I wondered if you could comment on whether you’ve seen a change in the nature of the complaints that you’ve received?

Carruthers I don’t think there’s been—I haven’t noticed a change in the nature of the complaints, but there’s certainly been a change in the way that we are reacting to them in our categorisation, and I’m hoping there will be a further change. I have been very impressed with the number of British police forces and the use of restorative processes to deal with complaints themselves. I have just been getting a lot of information from Greater Manchester Police and Durham and a couple of other places police forces that are doing this work, which is conciliation in a sense. It is about relationships—meeting with people in a sensible way, saying sorry, working out what people need to move on, and so forth, and doing that immediately, rather than waiting for a formal process.

I think our conciliation structure, which we’ve been trying to enhance a bit, shows that increase. But, in fact, it’ll be much more effective if we can use some overseas experience to get that sort of work done much earlier in the process. A lot is done already. I know that from police around the country who either on the day or a week later, knowing things went wrong, try to arrange a meeting and talk to the people involved etc. But actually it’s not always done. People are not trained for it. It’s not always done that very well. There is, I think, a huge potential for us to do much more of the relationship building—for police to do that—and then for us to also cherry-pick some of the cases we’ve had where there needs to be that sort of conclusion in order to restore some relationships at the end of a very hard time. So you’ll see something more of that in the next year, I hope.

Ardern Yes. You talk about the influence of overseas jurisdictions—the work that they’re doing, the way they’re changing, how that’s influencing your work. Have you looked at body-worn cameras, in relation to the impact they can have on—

Carruthers Who’s that?

Ardern Body-worn cameras. They’ve been adopted in the UK—the lapel cameras. From what I’ve seen of the police who have used them overseas, they claim that conduct issues and complaints have declined since they have come into use. Have you looked at that and do you have a view on that?

Carruthers We haven’t. Look, I’m aware from my general reading that, as you know, when people know they’re being recorded or are under scrutiny, they behave differently.

Ardern I don’t know what you’re talking about!

Carruthers Look at me now. So I’m aware of some of the studies that I’ve seen about the change in police behaviour. So those are Police decisions and I know that they’re looking at that as well, and they’re not decisions for us. But, you know, it’s an interesting thing, because what we do have at the moment is...
that when Tasers are used, there’s a video camera attached, so we get a film and sound of the run-up to it and the Taser itself. It’s amazing how in the heat of the moment everyone forgets it’s being recorded and captured. So later on it’s really instructive to read the job sheets and the reports on the number of different witnesses, and then see what an independent electronic witness says about it. It’s not purely dishonest, but it’s all about how we perceive things sometimes and then change them slightly afterwards to fit in with our views.

Ardern Our recollection.

Carruthers Yes. So I would think that that’s all very helpful, that sort of technology, and that one day that’ll be much more done. But we’re getting a lot of help at the moment from CCTV, from the Taser footage and so forth, and now, of course, from everybody who has got these mobile devices that take photos.

Ardern You’re seeing an increase in that kind of evidence being submitted to you?

Carruthers Yes. And, no doubt, we’ll get a lot more now that every police officer’s got one of those devices too. So that’ll be interesting.

Ardern One final quick question. You are able to conduct full audits randomly of police files as well. I believe you’ve audited 50 files in recent times and some of the issues that you’ve raised in that random audit include issues of timeliness, conflicts of interest, and the need for greater consistency in investigation standards. I wonder if you could comment a bit on each those, particularly the timeliness issue.

Carruthers Timeliness by police or by us?

Ardern By police. I imagine that if that’s what you’ve found when reviewing their files, that it was related to the police.

Carruthers Well, what we’ve found has been unevenness across the country. Very recently Warren Young and I have travelled around the country, meeting with district commanders in every district to talk about each district because they’re all, in an odd sense, almost separate police forces sometimes—have to be for operational purposes—and each has got different problems. And where we’ve been worried about timely investigations by police themselves, we have raised that. We’ve had assurances and we have access to the people in charge if we find those again. So there have been areas where we’ve been quite worried. We’ve raised those with the people involved and with the commissioner at our regular meetings. The places that worried us have improved dramatically since that work. So I’m sure we’ll still find those problems from time to time, but having raised them openly with police and police leadership, we’ve got access to—

Ardern What’s been the cause that you’ve identified?

Carruthers Oh, I think, in some cases, legitimate prioritising of police people and work. So they had to do a lot of work with the people they’ve got and work out where they’ll put their folk. Sometimes, sort of indirectly, we’ve been responsible, I think, too, because we haven’t been sharp about saying when
we want stuff, by what time, etc., and we are now. So we've allowed a situation of delay to occur and then jumped up and down at the end of it, which is pretty useless, so we're on top of that. Sometimes there have been people faults, as there always are, and people not well, not able to cope with the work they've got—so things like that, which are human things, really.

McKelvie You raised the issue of technology a minute ago. I just wondered whether you had a view on whether the increased use of technology—I'm talking about iPads and phones, really—by police will have an impact on the way complaints come to you and the speed with which you can manage those complaints.

Carruthers I haven't thought about that. I've been to command centres where I've seen now that every police officer is trackable, so you can trace who's where and what they're doing, so it looks like really good resource control, from a police point of view, and an ability for us to know where people were at the time, because that can be retrieved always as well. I suppose it's too early for us to say what the results are going to be, from our point of view, of that new technology for police. I would hope it's going to be helpful because the more we get independent evidence which can be recaptured, then the easier for our people.

For example—and this is going back now in technology, although some of us are still challenged by these things—texting, you know, is really easy for us now to trawl through and find out exactly what was said and when that happened. We can get a lot of phone conversations now; we couldn't before, and so on. So we're getting more and more coverage of things that can't be argued against, which don't require independent witnesses. I expect that to continue. It'll depend on how imaginative officers are about the use of these devices, how well they use them, and the sky's the limit, I would've thought. We're meeting the challenge. Again, Brent's doing this, because we've set up a team of our people to look for the—the future is clearly electronic, and so we have to be ready for that too. And Brent is much cleverer than he looks, and Stacey.

Anderson Younger, too.

Carruthers Really? He is leading that work for us, which is very important for us to be right up with that.

Mitchell Just on this, I think the technology is a really good point. With the growing use of technology and the technologies being—you know, for the police there's been a big roll out in terms of what they have available, the iPads, the iPhones. So you'll get more and more evidence like that, which you would assume would make it easier on your investigators to put a file together, but how are you going to be able to treat that evidence? Is it going to be able to actually expedite and make it easier to gather evidence and complete a file? How are you going to be able to treat that evidence? Or is it still going to take the same amount of time?

Carruthers Depending on the nature of it, I think it'll be a lot easier. For example, I've just been looking at a report, which we haven't released yet, but it's about
an arrest that went wrong. We’ve got CCTV coverage of it. It’s very simple and very quick to look at that. It takes 5 or 10 minutes. Because there are several angles, you can see the whole of the incident. And you can suddenly see in a very graphic way what went wrong, what decisions made on the spur of the moment—which is easy for us to criticise, but we have to be wary of that—were made that exacerbated the situation, how a dog was used, and so on. So very much quicker than interviewing 12 witnesses, all of whom have got slightly varied accounts of the same thing. That’s very much quicker for us. It means we don’t have to see—we’d see key people, still, in case there’s something else, but we don’t have to see everybody. It should be much more efficient, I think.

Dean All right, Sir David, thank you very much for your appearance today. We do appreciate the work that you are doing and we can see a fundamental shift in the way you are operating as an IPCA. I’d venture to say it’s not just around the technologies, which we’ve just been discussing, but I can see a more fundamental shift in the way you are operating, and congratulate you on that. We look forward to seeing you next year.

conclusion of evidence
2012/13 financial review of KiwiRail Holdings Limited and the New Zealand Railways Corporation

Report of the Transport and Industrial Relations Committee

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KiwiRail Holdings Limited and the New Zealand Railways Corporation

Recommendation
The Transport and Industrial Relations Committee has conducted the financial reviews of the 2012/13 performance and current operations of KiwiRail Holdings Limited and the New Zealand Railways Corporation, and recommends that the House take note of its report.

Introduction
The New Zealand rail sector was restructured at the end of 2012. The KiwiRail business, which holds the ferries, trains, railway tracks and other assets and liabilities, was moved from the New Zealand Railways Corporation to a new company called KiwiRail Holdings Limited. The Railways Corporation retained the railway land, from which no financial return is expected.

Financial and service performance
KiwiRail’s operating revenue of $727 million in the year under review was an increase of 1.6 percent compared with 2011/12, but we note that its operating surplus of $108.2 million, although an increase on the previous year, was 9.3 percent below target. KiwiRail has estimated that several disruptions to its business in 2012/13, including damage from major weather events, and a reduction in Solid Energy’s coal volumes and revenue, resulted in the surplus being reduced by at least $20 million.

Aratere ferry
We are aware that the Interislander ferry business accounts for 17 percent of KiwiRail’s revenue. We expressed our concern at the loss of a propeller from the Aratere on 5 November 2013 when a drive shaft broke as the ferry crossed Cook Strait. The propeller was retrieved and returned to Wellington on 10 December 2013.

We were told that there had been no deferral of or delays in maintenance of the ferries in the period under review, no problem had been picked up during routine maintenance or inspections, and no concerns had been raised by crew or staff that might have alerted KiwiRail to the problem.

KiwiRail does not believe the breakage is related to the “stretching” of the Aratere in 2011, when the ferry was extended by inserting a 30-metre section into the middle of the ship. Despite this operation costing more than was budgeted, KiwiRail believes it was a good business decision. We are aware of a history of problems with the 14-year old ferry, including some prior to its purchase, but KiwiRail said that it has no other concerns about it, and does not consider it to be a “lemon”.

The Aratere is the most productive ship on Cook Strait, and was making about 38 journeys a week before the propeller incident. While it is unavailable, KiwiRail is meeting commitments to its freight customers by using nearly all of the capacity of the remaining ferries. We heard that all the Cook Strait ferries, including those of KiwiRail’s competitor
Strait Shipping, had stopped taking new vehicle bookings until the end of January 2014, although foot passengers could still travel with or without a booking.

We were told that KiwiRail had sought to secure an interim replacement ship; and we subsequently learned that a European ferry was chartered, and would enter service in January 2014. We understand that the Aratere was approved on 9 December 2013 to operate on a single propeller, as a freight-only service, until it can enter dry dock in the new year for repairs.

We are concerned about the financial impact of the episode. It has not yet been assessed, but KiwiRail said it will be “substantial”. We encourage KiwiRail to establish whether any of the cost can be claimed under warranty or under insurance. We were assured that KiwiRail will look into seeking damages if a party is found responsible for the breakage.

We asked KiwiRail how the removal from service of the Aratere will affect staff. We were told that seasonal staff had not yet been hired, and that existing staff would be asked to use any leave owing before redundancies would be considered.

**Freight**

We recognise that freight is the key earner for KiwiRail, and note that, excluding the setback caused by the Aratere incident, its performance in freight has been sound. Freight revenue has grown by over $100 million in three years, and we were told that customers using the service have been very positive.

We understand that KiwiRail now has 40 new freight trains, and eight more are under construction. It has 835 new wagons, and several hundred new curtain-sided containers. We were told the market has responded well to these new capabilities.

**On-time performance**

We are pleased to note that there have been substantial improvements in the timeliness of rail services over the past five years. Tranz Metro trains were on time 94 percent of the time and freight trains 89 percent of the time. While only 82 percent of ferry arrivals were on time, we appreciate that ferries are more vulnerable to conditions, and there have been several bad storms in the past year.

**Turnaround plan**

We asked how KiwiRail’s turnaround plan is tracking. We heard that the original plan has been reviewed continually in the five years since it began. Until recently, KiwiRail expected to need approximately $200 million more Crown capital. We were informed, however, that the final figure will be higher. The capital top-up is being discussed with the Government.

KiwiRail is confident that the business can be economically self-sustaining once the rail system has been brought into proper condition. We are aware that, to date, approximately $900 million in Crown capital has been spent on the network.

**Napier-Gisborne line**

We questioned KiwiRail about major damage to the Gisborne line in March 2012 caused by a storm in combination with some blocked, old, and damaged culverts. The viability of the line was under review at the time and a decision was later made to mothball it.

KiwiRail confirmed that maintenance on the line had been minimal because its closure was considered very likely, but the suggestion that this amounted to deliberate sabotage of the
line was denied. While there had been under-investment in the line for many years before the March 2012 washout, inspections and maintenance had still been carried out, albeit at a lower level. KiwiRail told us that the line was not economically viable and would have closed whether or not the washout had occurred.

**Auckland metropolitan trains**

Nearly $2 billion has been spent on Auckland’s rail infrastructure in the last five or six years. We heard that several major projects were under way to improve the capacity and reach of the Auckland network.

We were pleased to hear that the electrification of Auckland’s rail system is nearing completion. KiwiRail has done much of the work at night and on weekends, and has planned a shutdown over the summer to speed up progress. Delays in completing the electrification have been caused by the policy of keeping the lines open during work wherever possible. We note that when the big projects have been completed next year, stoppages will be much less frequent. KiwiRail acknowledged that the scale of disruption over the last five years has been extraordinary, and it does not expect this to be repeated.

We accept that routine maintenance will always be needed and that this will inevitably mean regular, planned shutdowns at weekends and in the quieter summer period. KiwiRail told us that it has no plans to build in resilience features, such as a third track, to improve service during shutdowns for maintenance, signal failures, earthquakes or other reasons.

**Staffing**

In the last financial year, KiwiRail cut 158 jobs from its infrastructure and engineering unit. We were told that these staff were not replaced by contractors: the redundancies were made because there was less work. We were assured that, contrary to indications in an earlier leaked document, there are no plans for more staff cuts, as this would not be productive to the business.

**Safety**

We sought an assurance from KiwiRail that redundancies have not compromised safety, particularly in the light of the Kaimai tunnel incident, where contractors’ staff were exposed to carbon monoxide, and an emergency evacuation was necessary. KiwiRail told us it is committed to ensuring that all workers, whether employees or contractors, are properly trained and equipped for working on the network.

We were assured that KiwiRail’s processes for reviewing incidents are open and thorough, and were told that all reports on the Kaimai tunnel incident are now in the public domain.
Appendix A

Approach to this financial review
We met on 21 November 2013 and 30 January 2014 to consider the financial review of KiwiRail Holdings Limited and the New Zealand Railways Corporation. We heard evidence from KiwiRail Holdings Limited and the New Zealand Railways Corporation. We received advice from the Office of the Auditor-General.

Committee members
David Bennett (Chairperson)
Chris Auchinvole
Carol Beaumont
Dr Cam Calder
Darien Fenton
Andrew Little
Simon O'Connor
Denise Roche
Mike Sabin

Evidence and advice received
KiwiRail, responses to written questions, received 21 November and 20 December 2013.
New Zealand Railways Corporation, responses to written questions, received 21 November 2013.
Office of the Auditor-General, Briefing on KiwiRail Holdings Limited and New Zealand Railways Corporation, dated 21 November 2013.
Organisation briefing paper, prepared by committee staff, dated 21 November 2013.
Bennett Welcome to the financial review of KiwiRail Holdings and New Zealand Railways Corporation. If you’d like to give us a brief introduction, John, then we can open up for questions.

Spencer Thank you, chairman. Good afternoon, ladies and gentlemen. Thank you for the opportunity to speak before the Transport and Industrial Relations Committee. Also with me, as the chairman has acknowledged, is Jim Quinn, our chief executive, and David Walsh, who is general manager of corporate and finance.

We are now well into our 10-year plan to develop a sustainable business. Since the company was officially established 5 years ago, despite the impacts of events outside our control, such as the global economic downturn and natural disasters, growth has continued. In the last 3 years, we have increased revenue by over 25 percent, with freight revenue alone growing by over $100 million in just 3 years. Investment in the business to improve performance and robustness has also continued. Over the last 4 years, capital expenditure, excluding the hundreds of millions spent on the metro networks, has exceeded $1.3 billion. This is made up of $750 million from the Government and $620 million from earnings and other sources, such as capital grants and land sales. While the revenue result was only 1 percent below our SCI target, our operating surplus was 9 percent below the $119 million target. We have estimated that the combination of damage from major weather events, the drought negatively affecting the milk season, threatened industrial action against the Interislander, and the reduction in
Solid Energy’s coal volumes combined with their unsustainable contract prices, reduced our surplus by at least $20 million.

On 31 December 2012 we implemented a balance sheet restructure, which resulted in the assets and liabilities of the New Zealand Railways Corporation being transferred to KiwiRail Holdings Ltd, a new State-owned enterprise. This decision was made so that the company is valued on a commercial basis as our assets need to reflect their productive value. While we have to maintain our focus on improving our financial performance, this cannot be at the expense of ensuring the safety of our people, customers, and the community.

We have made a commitment to further embed a safety culture within the business, and have put in place ambitious targets. The combination of staff requiring medical treatment and/or time off work because of injury has reduced by nearly 20 percent in the last year alone.

I have already mentioned some achievements over the past year, but I wish to emphasise the pace of change to turn round this business has not lagged. While our progress is still encouraging, there are still risks to further growth, including uncertainty surrounding Solid Energy’s future operations, potential costs of further earthquake strengthening, and a forecast increase in extreme weather events. We expect to have a more detailed understanding of these impacts over the coming months.

Our strategy continues to provide the framework to achieve financial sustainability. We are now moving into a new period of change and improvement as we gain the benefits of improved productivity, a greater focus on safety and reliability due to new equipment, culture change, and a more robust network.

Just a brief update on the Aratere—we are very aware of the impact this has had on our customers and our businesses. We are working on short, medium, and long-term options, and at this stage the cause of the incident is still being investigated. Thank you.

Bennett Thank you very much, John. I just want to thank you and your team, and especially Jim, for your years of service to the rail sector and to the rail industry in New Zealand. You’ve been a special team that has done a very good job. I think all members of Parliament would like to convey to both of you our thanks for your hard work, and your dedication to a sector that is very difficult at times, but one that you have done a great job with, so well done to both of you. And also to you, David, as well.

Fenton Just in case he is getting left out.

Bennett Yeah, yeah. Okay, Darien.
Fenton: Good morning. Thanks for coming along to the select committee. I’ve got two lines of questioning. One is obviously about the Aratere, and the other one is about safety and some of the incidences you’ve had in the last year and reporting around that. Just starting with the Aratere, and I know there’s a lot of interest in this, have you located the propeller?

Quinn: No, we’ve not. It’s still being looked at. We’re probably past the point where the commercial salvage makes much sense, but I think forensically we, and I’m sure some of the investigators around us, would like to find it if we can do.

Fenton: Right.

Quinn: We’re pretty clear where it came off, so it’s surprising to me it’s not been found, but it’s pretty deep there.

Fenton: Right. Was there any routine maintenance of the Aratere or any other ferry delayed or postponed in the last year that you can think of?

Quinn: Maintenance postponed?

Fenton: Postponed or delayed.

Quinn: No.

Fenton: On the Aratere or any other ferry?

Quinn: Not specifically. You make judgment calls day by day depending on workload and things, but in any material way, no, nothing. The ships are largely maintained hot. Engineers are on board, engines are taken down while it’s sailed, all of those things. And the maintenance of the ships, I think, historically, has been able to be done at a much higher level than probably the railway was, because with rail you’ve got another lever to pull historically, or at any time, and that is you slow it down, and there is no parallel to that in shipping.

And it’s important to point out that ships’ maintenance is something that the asset owner obviously is interested in but there’s a whole bunch of people outside of any shipping firm who have accountabilities—the classification society and Maritime New Zealand. We’ve always worked our way through all of those well. So, look, no, there is nothing that’s been deferred that would have any material balance. I’m only sounding vague because I’m sure somebody would say there’s that little thing down there, but there was nothing of any major note.

Fenton: Bit of a ship of horrors, though, isn’t it? It’s got a bit of a story behind it.

Quinn: Yeah, look, I do understand that. I don’t subscribe to good luck/bad luck things, but that’s a personal view. But I think that there was no doubt there were commissioning issues with the ship when it was first built and there was a lump of stuff at that point that was dealt with, and there was a lump of events around the time the refit was done in the stretch. If you take those out—and I’m not trying to gloss it up—then it actually hasn’t performed that bad. And it’s important to contextualise that. It’s by far the most productive ship on the strait. It does about 38 journeys a week, whereas the
Fenton Did any of your crew or staff raise any safety concerns about the *Aratere* in the last year or so?

Quinn There are inevitably things that folk will raise because we have health and safety teams on board, so there are the standard, business process-y things. There will have been things, but there’s nothing that I can point to that would go back to anything material again. There’d just be the normal things. What we do is we have a process. We deal with things. We schedule any issues into maintenance. The ship was going away and will still go away for a scheduled dry dock next year. We’ll just make sure that the repair is part of it, so it doesn’t go away twice.

Fenton So why do the crew call it the “*Aratanic*”?

Quinn I don’t know. Look, the crew I’ve talked to don’t. In fact, the crew I’ve spoken to over the last couple of weeks have been deeply distressed by the incident. They are very proud of the ship. I'm sure there are varying views, but I haven’t had that phrase used at me at all.

Look, people were frustrated with the issues when it came back from Singapore. I understand that.

Fenton OK. So are there any other concerns about other mechanical issues with the *Aratere* or any other ferry that you know of?

Quinn No.

Fenton So it’s only the propeller?

Quinn Just to be clear, it’s the drive shaft, not the propeller; the propeller’s attached to it. No, there’s nothing. And we will, as you would expect, take full responsibility to understand it. When we know what the cause is and we are clear on that, we’ll be public about that. We have been open all the way through. We’ll continue to be open. I don’t think it’s helpful at all to speculate, because I just don’t have the facts, and people way smarter than me from an engineering perspective can’t explain this to me, so I shouldn’t be trying to guess.

Fenton What sort of financial hit do you think you’re going to take from this?

Quinn Oh, look, it’s really hard to answer that right now. It’s again an area that’s really difficult to speculate on. We are working very hard to plan the repair and how long that will take. There’s a range of options for that, and the answers to that are some of what will drive that. We haven’t had the opportunity—I mean, our thrust over the last 10 days to 2 weeks has been to get the customers moving again, and we haven’t been too worried about counting it up at this point. We’ve got a whole review now to work through how much revenue has this cost us—because we clearly don’t have the same capacities—what extra cost to be taken on board.
We’ve still got some decisions to make in terms of what the short, medium, and long-term solutions are while the repair is being made. Until I’ve got all of that, the answer is just not clear, and I don’t think making it up is going to help you at all.

Spencer: What I will say is it will be substantial.

Quinn: Oh, absolutely.

Spencer: All right? So I’m with Jim; we’re not going to talk numbers. We don’t know. The board are asking exactly the same question. We’ve got a board meeting tomorrow and we’re working hard to find out, but it will be substantial.

Fenton: All right. Yes. And what’s the impact on crew and staff of the Aratere being out of service?

Quinn: To date, nothing, in the sense that the people are still doing what we’d expect them to do. And as we get to the point where they’re not productive we’ll try and use leave and those things, and then there are some decisions, options, that we may be able to take that will mean that’s no issue at all. The answer is nothing at this point, and once we are clear what decisions we’ll make in terms of other ships and the medium-term solution that will or won’t affect things, then we can deal with those things then. So, again, it’s just a bit early to really have a clear answer on all of that, but we’re doing our best to make sure—

Fenton: There’s a bit of concern about redundancy if the Aratere becomes—

Quinn: Oh, I’m sure people are concerned, because uncertainty is a nightmare. I’ve looked them all in the eye and said: “Look, bear with us. As soon as we’ve got all the facts we can talk to you about what your options are and what we’re trying to do.” So it’s probably more disconcerting at the moment for people like the cabin staff, but it was at a time when we didn’t have to bring our part-timers on, so we didn’t have quite as many on board as we would have done a few weeks after this. So that’s mitigated some of that, but the food-type staff are the ones who are pretty affected right now, because the mechanical engineering – type folk are still busy maintaining. You can do a lot when a ship is parked up, so the teams are doing things.

Fenton: You’re going to be able to get all the passengers where they want to go over Christmas?

Quinn: We’re fully booked now until the end of January. Our competitor is fully booked, I understand, most of that time now as well. So everybody who’s booked should be OK. I think the things that concern me is (a) further bookings is not possible until extra ships are available. There are no other ships that I could have in place this calendar year. I think it’s possible we could have one in place during January, and we’re doing everything we can to do that. There is one possibility that might create some freight capacity, which would enable passengers—and I should be clear: when people talk about passengers on our ships, we’re talking about people with cars, not walk-ups. So walk-up we can handle fine. It’s the car space that’s the capacity constraint.
Fenton Yeah. There was a story in the paper, I think yesterday, some suggestion that you were having discussions with the Defence Force about the use of the Canterbury. Is that true?

Quinn We’ve talked to everybody. I think your job in these times is to exhaust every possibility. Not every possibility is practical, but we’ve talked to lots of folk about where we should look and what we can do. I’m not going to go through who I’ve talked to at this point and whether they’re going to land, but, look, there are hurdles almost everywhere I look. I mean, one of the problems you have is this isn’t like a rental car thing. We’re in New Zealand at the bottom of the world and most of the things that you would want to grab are nowhere near us, and Australia, their seasons are the same as ours, so it’s a busy time. It’s busy for them as well, so most likely any tonnage would come from Europe somewhere because it’s in their downtime.

Fenton Right. But you’re not ruling out the Defence Force and that use of the Canterbury?

Quinn I think it’s unlikely, but we’re working through every option we can find. I mean, at the end of the day we want to find answers commercially that will give the networks who require support the best possible outcome we can, and we’ve got a few options that are possible, but most of them are looking pretty difficult to land practically.

Fenton So do you think the Aratere will be back in service at some stage?

Quinn Yeah.

Fenton You do?

Quinn Yeah.

Little Just on the issue about the propeller, is that covered by any warranty, or is it covered by—and putting aside business interruption—any insurance?

Quinn The event is insured, so the repairs will be insured. For there to be a warranty claim you’d have to assume you knew what the cause was, and as we don’t yet—so the event will be insured regardless, because it is. Anything wider than that like warranties would assume we know what caused it and therefore where that occurred.

I know there’s been speculation as to whether this had anything to do with the stretch. Just for your knowledge of that, the propellers were added at the same time but not part of the stretch. That was just a fuel efficiency thing. We did a lot of other work up there at the dry dock—just normal sort of things, and you maximise time away when ships are away. But the motor through the shaft to the back of the ship are all in the same section exactly where they were before, untouched, because the stretch was forward of that, if that makes sense. So these shafts weren’t added at that time. It’s the shaft that snapped.

So until we’re absolutely clear on the cause, warranty or claims back on other parties is clearly not an option I can even consider.
Spencer And can I—Jim, sorry—just add, Mr Little, it’s one of the reasons why we need to find out what happened, of course, so we can go back if there is a guilty party somewhere.

Little Can I just clarify—had the ship been surveyed between the time it left the dry dock for the extension and the time of the incident? Had it been surveyed?

Quinn It hadn’t been to dry dock again since then. The next dry dock is this year. I’m sorry I don’t, off the top of my head, have what other inspections locally have been done. I just can’t answer that, sorry. It’s not a question I’ve asked. But, look, I can tell you, where this shearing has occurred there is no practical way to have inspected that in the water. It’s the way the propeller fits and butts up against the cap where the shaft goes into the hull. There’s nothing you could have done to have looked at that underwater. You can look at it, but you wouldn’t have seen anything—that’s my point.

Little No, but previous dry dock surveys would have—if there was a problem evident with the risk of shearing or failure of the shaft, that would have been picked up. So we are pinpointing a time between the extension and the incident happening. That’s an obvious conclusion.

Quinn Look, I think that’s an assumption. Maybe you’re a better engineer than me, but, I mean, at the end of the day this is a big lump of steel. If it’s a steel issue, it may not have been at the surface visible at that time. It was clearly out of the water in Singapore, but it’s still a big lump of steel. At that time I doubt if any non-destructive testing was done, because that would have been an unusual thing to have done at that point.

But, look, all of these things are conjectures. What you’ve got to do is get the metallurgists, which we’re doing, and the engineers to look at what they can see factually and go back to where it is. I’m not saying it’s not there; I’m just saying I don’t know. People who are way smarter than you and I in terms of the knowledge of this stuff aren’t giving a ready answer yet, but we ain’t going to rest, because we have to know whether the other shaft has a risk, and so we’re not going to do a damn thing until we’re sure.

Fenton You’re not going to have it sailing through the Tory Channel.

Quinn Yeah. So—

Little Well, there’s hundreds of ferries around the world, and, you know, thousands of other ships as well, and a propeller shearing off, the shaft shearing off, is a pretty rare event.

Quinn It is a rare event; it’s not an unheard-of event. And I agree, so I’m not trying to gloss this in any way at all. We agree, but you and I aren’t going to solve this. We’ve got to get the facts, and I think that the thing that really concerns me at the moment is people are making assumptions, and I want the investigation to do this in a really open mind and actually establish really what occurred, and then we can talk to the right parties about it at that point. The worst thing, I’m sure you’ll agree, is investigating things with an assumption of where to look. I think you’ll risk going down a blind.
Sabin: Thanks for that. To some extent this question goes to it around freight movement. How is KiwiRail performing in terms of its freight movements?

Quinn: Performing? Because of this, or in a general sense?

Sabin: Well, obviously, it relates to some extent, because, obviously, you have some reduction in capacity, but in a general sense what I’m asking is how is KiwiRail’s performance around freight movement?

Quinn: In a general sense, our performance has been great. From a personal perspective, this incident this year is a deep frustration because we’ve seen such good growth. Customers are committing both their freight but also their money around the network. You know, we’ve seen the investment that Toll, Mainfreight, Peter Baker Transport, Fonterra, and others have invested on the rail corridor. Customers are really invested. They support what we’re trying to do, and we’re seeing the growth as a consequence of that.

This clearly creates a major hiccup in that we’re working really collaboratively with everybody who’s got capacity, whether it’s the domestic coastal ships, the Bluewater coastal ships. We’re working with the trucking firms to make sure this clears. And I have to say that the industry has been fabulous in its support and its engagement. Our customers have been amazing, actually.

Sabin: OK—in terms of time performance, then, and meeting targets in that respect, can you give a comment to the committee both in terms of your general performance around time performance and also in light of the circumstance with the Aratere?

Quinn: Our on-time performance this year has been good, and our progress in that area over the last 5 years has been excellent. I think our premier trains were performing late-60 to mid-70 percent in 2009. Sabin: So that’s going back a bit further than I was expecting it.

Quinn: That’s right, yeah. And it’s been performing until this at about 90 to 95 percent. So we’ve had significant lift. The Wellington Metro—you’ll remember when we began we were on the front page of The Dominion, it seemed, every day. We’re rarely there anymore, and our on-time performance is sitting at the high 90s. The passenger trains are performing well, although I think we’ve got a long way to go. The Interislander has been, until now, pretty good, although it gets tremendously affected by storms. As you know, we’ve had a couple of pretty decent blows through here, so when it’s off it’s been horrible, but when the weather has allowed us, performance has actually been pretty good—again, until now.

It’ll be pretty sad over the next couple of months because to put as much capacity on the only ship we have that can do what the Aratere does, and struggles, is the Aratuna, which can do three turns a day. The others—both our competitors and our own, the Kaitaki—can do only two turns a day. They just simply cannot fit another one in. The time it takes to load, unload, and all that stuff for them, the way they’re configured, it just can’t go.
Genter Thank you so much for your presentation. I notice that you seem to have pretty healthy operating surpluses in all of the groups, except, perhaps, infrastructure and engineering, which would be expected.

Quinn Yes, I agree with that.

Genter And your freight revenue growth has well exceeded GDP growth, but with the Government not investing, continuing to put money into the network, is there a risk that you’re going to have to cut back on investment in the network over the next few years in order to achieve the goals of the turnaround?

Quinn Look, the business has to continue to invest. We’ve got decades to catch up on—800 wooden bridges in the network is an example. The 10-year plan was to get to a point of cash sustainability, so it was creating its own cash. Until we reach that point, investment is required. There’s no doubt that when we began, the business simply couldn’t have done it itself. I know you’re looking at our annual report there.

Genter In the statement of corporate intent it says that you got a revised plan with less capital investment over the next 10 years.

Spencer Yeah, but that was because we’re getting ahead of ourselves in terms of growth, OK? But I’ll answer your question straight up. I’ve already talked to the Government, right? We’ve started discussions already on the fact that there will be more money needed to put into rail because of the incidents we’ve had. I got no kickback at all. We’re yet to finalise the numbers and I’ve had no commitment. I wouldn’t expect it. But we need to finalise it, of course. And this is before the Aratere came along. So we are in those discussions. The answer is yes the Government will need to put more money into rail.

Quinn When you look at the annual report, we account for the rail’s CGU—which is the freight rail, the corporate costs, and the network costs—as one thing. So that gives you a sense of where the freight railroad is. As we’ve always said, the freight railroad performing to its best is the solution to getting KiwiRail standing on its own feet. The other pieces have to perform as well. They can’t fix it but they can help. The freight railroad, including the network, has to be the one that delivers the cash.

Genter But is it realistic to expect freight business to generate enough revenue to invest in an essential asset as part of our transport infrastructure, given that the more freight that’s carried on rail, there are benefits to the road network.

Spencer I think to answer that question you’ve got to look at it in two ways. If you’re talking about what I call catch-up capital—in other words, money that should’ve been spent—then the answer is that you can’t. But once you get up to that speed and get the network in proper condition, then freight should be able to pay. It has to.

Quinn And that’s on the context that government—whether it’s local or national—fund the metro networks. There’s a slice of that. So we are just talking about the freight piece.
I still believe that the business can be sustainable. It'll take us longer than we first thought, but I think it can be. I don’t think the business will be in any state to build big extensions. I think that is a New Zealand Inc. thing, in my frank view. But, look, that’s miles away. Our job at the moment is to get this business standing on its feet, doing the best it can, and I think we’ve made great steps.

Genter But there is there a threat to the ongoing growth of rail freight and passenger movements if we don’t have investment in the network?

Quinn So that reduction was a considered one, and we believe the answer to your question would be no about that specific piece—the $200 million. But long term the business has to continue to reinvest and it has to get itself up to that point, and it can’t do it alone. So I think we all agree on the context, but within the gross context, year by year the business has to sit down, look at the priorities, look at what the genuine—and we’ve done a lot to make sure we think about the market demand, where the priorities are that the market wants the investment to be, and then we consider the investment into the asset, whether it’s rolling or round assets, against what the market wants.

It’d be lovely if Santa Claus was here and we could just splash it, although, actually, you couldn’t enough track time even if you did. So you’ve actually got to do it in a really considered way. I think it’s good to have the tension to think through really what the market wants. But, look, I know you’ve talked to some of them. The market really like what we’re doing. They are impatient for it to do more. But everybody understands there is no pixie dust in rail. You’ve just got to keep working on it.

Genter There are a few building new motorways. Can I have one more question?

Calder I think this may have been answered but I didn’t actually hear the figure, and it’s to do with capital expenditure that you had committed to improve performance. Did you actually mention a figure there? I heard you say you thought you probably needed more investment, but what figure had you planned for before this one actually hit with Aratere?

Quinn Well, we’ve spent about $900 million to date of capital that’s been granted to us as equity. We’ve had terrific support. We thought we would need another couple of hundred million north than that. I think it might require more. But we’ve got to just continue to work through this year by year, make the right calls, and make sure we’re investing properly for sustainability. I think taking short calls, which cut that off, would be a narrow view, and nobody’s asking us to, to be fair.

Peters Can I ask you, with respect of the Napier-Gisborne line, the reasons you gave this committee was that it was combined with some blocked, old, and damaged culverts, and that is what caused the huge slips.

Quinn No, we didn’t say that. I think the culverts were at the bottom. The slips occurred, which took the culverts out, and I think there was some comment that the culverts may have been partially blocked, which made that event worse, arguably. I’m not going to get into an argument about it.
Peters: Well, I quote railways: “This combined with some blocked, old, and damaged culverts is what caused these huge slips.”

Quinn: OK—sorry, I think you got confused. There was a big weather event that brought water and slips with it, which hit the culverts and blew it out, and, yes, they were somewhat blocked. So that’s what was meant. If we’ve misled, that wasn’t our intention.

Peters: Well, I’m reading your answer to this committee.

Quinn: I know. I understand.

Peters: I ask you this: are you prepared to say to this committee that those culverts were checked regularly to ensure they weren’t blocked before the event of any seasonal change or weather change?

Quinn: We had a maintenance regime on the Gisborne line that we were quite public about, which was just keeping it alive. We were under-investing, and had been for quite some time, while the debate as to whether the line would stay open or closed. And to be clear, my personal view is that it would’ve closed that year, regardless.

Peters: Yeah, but my question is can you tell this committee whether or not your maintenance teams were properly inspecting those culverts as they should have been doing, if the intention was to ensure that blocked culverts were not the cause of significant damage?

Quinn: I can say to you, as I just said, that we were clearly under-investing in that line, but we were doing the maintenance and inspections that we would expect to do in the regime that we were in at the time. Do I think that’s the perfect way to run a railway? No, I don’t. But we were in a debate at the time and very clear that we were minimising the expenditure to that line. Our team were inspecting and I think history will show that some of those culverts were more blocked than we would have liked.

Peters: Well, then, if you’ve got minimalist attention to a serious issue of maintenance, such as blocked culverts, then why wouldn’t someone be reasonable in concluding that this is deliberate sabotage to this line?

Quinn: Because I don’t think it’s true. We were very clear about what we were doing, and I don’t think that’s a reasonable statement, at all.

Peters: Well, if you didn’t intend to maintain the line properly and check the culverts as you would have in the past, why shouldn’t one conclude that something led to the circumstance that now becomes an excuse for you to close the line?

Quinn: Mr Peters, as I said, the line had under-invested in for many years, not just the period, and then we were continuing that. We were very clear that that was true. That line has always been susceptible to weather events. And, as I said to you, weather events or not, in my view that line would have closed within a month or two regardless. It wasn’t and is not a commercial line.
Peters So you're standing before this committee, and you're saying that the maintenance that you did was the great and frequent and proper maintenance required of that line?

Quinn In the context of how we were managing that line, we were doing our job, yes.

Genter I wanted to ask about the electrification of the Auckland network, which was hoped to be completed in September this year, but only 75 percent, I think, was done at the time of the printing of your annual report.

Quinn Yeah, it depends on how you measure it, but, yeah, that's fine. There are three main events. There's the poles going up, there's the wires going up, and the tensioning of the wires, whatever that's called. “Registering” I think is the word. Look, there's no doubt we're running later than we would have liked. We're not going to hold the trains up. The summer block, which we've been working with our partners in Auckland Transport on that—the summer block of line is the period where we close the network to get really intensive work done—is well planned and the programme is planned so that as the electric trains start to run, the network will be ready and going for them. Yes, it's taken us longer than we thought.

It is interesting, actually—we've watched Adelaide do a similar exercise during the same time, and they took the choice to close the network and string the poles and wires, and then open it again. I can't quite imagine us doing it here, but, anyway, good on them. That creates an enormously productive outcome because you can just smack into it, for want of a better word. We've been doing it with trains running and with a lot of weekend block of lines, and we're doing a lot of work at night, and then the big Christmas block. So, yes, it's taken longer to be as productive as we like. The south portion, the Wiri section, has been the most complex because it's a very busy bit of track with trains.

Genter Do you have a revised timetable? When will it be complete?

Quinn Look, it's a phased thing. I'm sorry, I don't have it in my head. Yes, we do. We're working to it, and it's all clear. The testing of the trains is going extremely well. We've tested the top speed. We've got live parts of the track where trains can run and training is being done, and all of that. So, sorry, the answer is yes, we have a timetable. Yes, we are clear where it is. And, no, I don't have it in my head.

Genter Do you know whether it will be done by April? The whole thing?

Quinn Ah, sorry, I don't have in my head. The trains that need to run—when they need to run, it'll be done for them. The trains come in phased as well, because of the things—I'm not trying to duck; I just don't have it in my head.

Fenton I drove the simulator the other day.

Quinn Oh, did you?

Fenton Yes, I did.
Quinn Of course you did.
Fenton It was great.
Quinn Pretty cool, isn’t it?
Fenton The trains are beautiful.
Quinn Yeah.
Fenton Can I ask you about—
Sabin You drove the what, sorry?
Fenton The simulator, yeah, for the new trains. Yeah. You should go and visit.
Auchinvole How did it go?
Fenton I was very good, actually. I found the horn. They put a car on the track to trick me.
Sabin You’ve been waiting to get that in all morning.
Fenton Can you tell me what the status is of the infrastructure and engineering business plan for 2013-15 that was leaked last year?
Quinn The status of it?
Fenton Yeah.
Quinn We are continuing to manage the asset prudently and carefully. We took the reductions in staff numbers in the last financial year. We are not going to do more of those in the way that we had thought at that time, because our view is, in line with what I said before, that we had to cut our cloth to suit the context, and things have changed around us in the market. So we’ve taken that step, but we feel that to cut any further would not be productive. So, as I said, we take a very measured view year by year, month by month, quarter by quarter, on what’s in front of us, what the market wants. The original turnaround plan was one that was very broad, and as the 5 years have gone by, we have reviewed, reviewed, and reviewed. Our knowledge of the business is far more enhanced. The alignment across it—because you’ve got to remember that we’re bringing three or four disaggregated pieces together. The alignment across the group is strong. So it’s a much better informed plan.
Fenton But this goes to maintenance, you know, the maintenance of the infrastructure, doesn’t it? That report caused quite a lot of alarm because it said in financial year 2014-15, the asset will decline, disruption risk will grow, asset failure risk will grow, and the legacy bow wave will get bigger.
Quinn In some scenarios.
Fenton So has anything changed?
Quinn Yeah, no, no, we are operating the network to code. We have very clear codes. Just as ships have very clear things you need to do, so does the
railway. We are operating to our code. We make our calls based on priority of money where we spend things, and, as I said earlier, there is a range of things you do in rail. You look at the standard, you look at the speed you want to travel at, and you look at the money you’ve got available. We would never not spend the money if it was unsafe, which is not a place we would go. And, more than that, we are trying very hard to bring the standard up grossly anyway. But it does come down—as the roads don’t. We’re not managing the network as one amorphous mass; we have the main trunk line, which is like the motorway; we have the Hamilton and Tauranga piece, which is similar to that; we’ve got other areas of the track that are more like a country road from a use perspective and so forth. So we have asset plans that are congruent with all of that.

O’Connor Yes, it’s a quick question around investment that you are putting into Auckland and Wellington. I suppose I’m a bit biased as an Auckland MP, but can you explain what sort of investment or levels of investment you’re putting in there? I was conscious of—

Quinn (A) we don’t invest. So we are the agent for the owners of the asset, which is funded through the usual regime of the local council, whether it is greater Wellington or Auckland Transport. And then they have arrangements with NZTA for the FAF funding, whether it’s a capital item or not. So our role in all of this is that we own the assets. We are the advisers, technically, in terms of what is the good way to do it and the bad way to do it. They get the call as to how many stations they want. They get the call as to what level of service they want. And in Wellington, as you know, we run the trains. In Auckland we don’t operate the trains. So we work in a very collaborative model with the different agencies involved. And we’re the agent to deliver the work. We corral the contracting agencies around us where they’re needed.

O’Connor Just as a very quick—those new freight trains that we were at the launch of, Julie Anne and I, what would be the relative cost there as an example?

Quinn Oh, sorry, so, the freight trains—that’s all us. We’ve now got 40 of those on the network. They’re running extremely well. We’re proud of those. We’ve got another eight under construction as we speak. Wagons—we’ve delivered 835 of those, and some 300 or 400 or it might even be 800 curtain-sider containers, which you would have seen at that launch. And the market acceptance of us providing capability that meets how they want to load, how they want to use us, has been extremely high.

Peters You told the committee that the shaft, the piece of the propeller, was all in the rear end of the non-extended part of the ship, right?

Quinn That’s right. Yep.

Peters Is there an inference, then, that because of that, the extended part would have no effect on the rear part of the boat?

Quinn No, it wasn’t what I was saying. All I was saying, Mr Peters, all I was trying to explain was when the stretch was done, the ship was that long, cut in half—
Peters: No, I got that part.
Quinn: I’m just saying—
Peters: I got that part.
Bennett: Winston, let him explain, OK?
Quinn: So therefore there was no work done on that piece when it was away.
Peters: I got that part. That’s why I put it to you.
Quinn: And that’s why I’m saying—
Peters: There was no work done on the rear part. Was it your conclusion—that you wanted us to reach—that the extended part would have no effect on that rear part?
Quinn: No, not at all.
Peters: What was the point of you telling us that?
Spencer: I’ll answer the question myself, thank you. This is why we’re having a thorough investigation. The board is asking exactly the same question, all right? We’re not experts in this. We have two very, very senior engineers on our board. We have an infrastructure committee that looks at these sorts of things. We’re going through a thorough investigation and will come up with the answer. We don’t know the answer.
Peters: All right. Let me ask this question then. Who floated the idea, straight after the event, that the cargo-only option was available to you where the Aratere was concerned?
Quinn: It is a valid option.
Peters: What—one propeller?
Quinn: One propeller, yeah.
Peters: And you’d run a course on one of the most dangerous straits in the world with one propeller?
Quinn: Mr Peters, there are ships all over the world that only have one propeller.
Peters: I realise that.
Quinn: And just be clear. If you are going to quote me, at least quote the whole thing. What I said was one of the options intellectually is that we could do this, but before we could do that we’d have to be absolutely sure we understood the cause and absolutely sure that that cause did not create a risk on the other shaft. And so we don’t know the answers, so we’re doing nothing about that at this point. We would not do anything that takes a safety risk. It is not what this business does and it was just in response to “What are your options?”. Intellectually, that is an option. Are we going to do it? No, we have no plan yet.
Peters: I’m having difficulty following your explanation being an intellectual one, because what we want is a practical engineering one—and a maritime one at
that. But my point is you’re going to have a replacement ship according to your media announcement in January.

Quinn We are hoping to have one here in January. We are hoping actually now it’ll be there earlier than that. We’re still negotiating, as John said before. We have a board meeting tomorrow. My team are working on what the best options are.

Peters The first statement said end of January.

Quinn Yes, I know, I’m just telling you—

Peters It didn’t say anything about hoping about it. It said “end of January”.

Quinn No, it didn’t say that. My first statement said—I’m sorry, I haven’t got it in front of me—but our intent was to try and explain what we thought the options were. We are hoping to have one here in January. But as we have been saying quite publicly all the way through, we are investigating all the options. Until we’re clear what the best medium and long-term options are, we can’t commit and, as I said to you, they’ve got to come from offshore.

Peters Did you have a contingency plan to cover any ferry breakdown of this type?

Quinn No, we don’t, because the market simply can’t afford you to hold the tonnage just parked up. We’re in New Zealand, unfortunately.

Peters I didn’t ask you that. I said: “Did you have a contingency plan ready to go for an event like this?” I didn’t say: “Did you have a spare ship waiting in the dock?”

Quinn Well, our contingency plan is to analyse the situation and make a plan based on the circumstance, because every event is different, which is what we’ve done in this case.

Peters You’re saying that routine maintenance and inspection would not have detected this?

Quinn Very unlikely you would have found it.

Peters All right.

Genter Bringing it back to the electrification, I’m wondering, at the moment a lot of the maintenance that you’re doing in the metro area in Auckland is saved up for those big shutdowns when you’re working on the electrification. Is that correct?

Quinn No, we’re doing a range of work. The distortion, if you like, over the last 4 years is that we’ve been doing the DART project and the electrification one, which means we know there’s going to be a lot of interruption. So to minimise further interruption, we’ve tried to dovetail all of those as much as we can. Once these two projects—the DART one’s almost done, the power one’s close to done—we’ll get back then to a normal routine of largely nights, the odd weekend, and the odd summer break.

Look, it’s a trade-off in every network in the world between least interference with the punter and the most productive outcome of money and people.
Genter  So there might still be weekend and summer shutdowns after the
electrification and then Project DART?

Quinn  There have always been that. There have always been.

Genter  There’s not in other metro areas. They’re able to do maintenance on lines
that carry more freight and more passengers than Auckland does, without
shutting down—

Quinn  I don’t think it would be anything like the scale you’ve seen, but I would be
lying to you if I said there’ll never be one again, because that’s not going to
occur. There are always jobs you have to do: bridge renewals, which just
simply can’t be done in one night. So there will always be times when
you’ve got to do it, but we do our absolute best with Auckland Transport to
plan them with the minimum disruption. If we can do it at night when
nobody else is around, we’ll do it. But if it’s ripping up a bridge, it’s
probably not going to occur in one night.

Genter  Isn’t it puzzling that other areas have high rail patronage and more people
travelling and more freight travelling on their lines, and yet they don’t have
to shut down?

Spencer  Other areas within New Zealand or in other countries?

Genter  In other countries.

Quinn  Yeah, that’s true. I think it’s somewhat true. Other areas are able to divert
because often the networks are circular and have multi-prongs so they are
able to close one bit and divert trains. We don’t have that. Pretty much the
whole network is singular. I understand the question you’re trying to ask
and I think the perception is driven mostly by the recent 5 years, which has
been extraordinary. If you’re me asking whether we think that’s going to
continue—nah. Will we have some? Of course, you will occasionally, but
it’s not going to be anything like what you have seen.

Genter  Is there, in order to get greater network resilience in our metro areas in
Auckland and Wellington, which obviously have suffered from some
temporary shutdowns due to signal failures due to earthquakes, is that an
argument, perhaps, for greater investment in redundancy, like, for example,
the third line in Auckland. I don’t know what the option would be in
Wellington. Is there any plan to look at improving resilience?

Quinn  We’re always debating those and to me this is a really good societal debate
in the local towns about much you’re prepared to spend, how much
disruption risk are prepared to put up with. And I think the answer isn’t a
binary one. I think it’s a discussion that is being informed. I think the stark
difference to 2013 to, say, 1993 is that everybody continues to invest and
we’ve got the networks up into a much better place. To be clear, ’93 in
Auckland, it was just about switch-off time. So this has come a long way
from those days.

We’re not there yet, but it’s in a vastly better space because of the
investment the Governments have made. It’s nearly $2 billion in Auckland
over the last 5 or 6 years now, well north of $1 billion when you add the
trains to it. So, we’ve just got to be patient and get these things to the level we want and it’s a balance and affordability.

Fenton Just going back to the infrastructure maintenance. You cut 150 jobs last year, infrastructure and engineering jobs, and quite a lot of that work is being replaced by contractors. Can you give the committee an assurance that that is not compromising safety on the network—

Quinn Yes, I can.

Fenton Particularly given the Kaimai Tunnel incident and the appalling report that came out of that.

Quinn Just to be clear, we’ve always used contractors. So there is no change there. I don’t agree with your statement that quite a lot of that work is being done by them. We reduced the work, which is what reduced the staff. So we’ve always used contractors. We always have responsibility to make sure that human beings on our network are trained to be on our network and have the right kit and do the right things. Whether they are employees or contractors in that regard shouldn’t matter a jot, and it’s our job to continue to do that. When people or our processes get it wrong we have to analyse that. We’ve very hard on ourselves and we report openly, and we put in place better steps. So I agree with you—the Kaimai Tunnel report wasn’t one I’m proud of.

Fenton Have you got contractors doing the replacement of the Peruvian sleepers, and wasn’t that being done by in-house staff?

Quinn We have some contractors looking at the inspection and some of our own staff. And that’s more around getting around the wider network and things, and also being productive. But look, we’re working through that. We consult with our union all the time around these things—probably another thing we do good sometimes and not as good sometimes. But the main thing is we are really aware of the standard of them and we’re making the right steps to replace them where they need to be done.

Peters This Aratere was to be extended at a cost of $38 million. It blew up to $52 million. Then you had all sorts of cost fixing the problems. There’s a multitude of problems—there seems to be—attracted to this ship. At what stage do you think KiwiRail’s going to tell the country that they’ve wasted about $150 million?

Quinn Mr Peters, the business case for the extension was justified on a purely commercial view. Yes, it cost more than we planned and that was a mistake on our behalf, which we owned up to. We went back and reviewed the business case and it still stood on the same money, so we would have done it anyway. I don’t agree with you on your statement on the ship. We are very disappointed by this current event. Leaking it without any facts is not
really helpful, because I can’t prove what caused it. When we know the answer to that, we’ll front up and we’ll work that through.

At the end of the day, it’s a ship. It’s the hardest-working ship in the fleet of both companies and we need to understand what’s caused this and put it right. It has been steaming very well this year, and last year, yes, it’s had its issues.

Peters You wouldn’t say it’s working very well. You’ve got the stabilisers not working correctly; ballast tanks take excessive time to be filled up, up to 2 to 3 hours to empty and refill, and this had been throwing the ferry schedule out since it first arrived—no one’s denying that; electronic fuel gauges not working, when we all know that manual measurements should only be a check on modern ships. You’ve got doors not closing properly; they’re actually bending while certain rail wagons are loaded. You’ve got a multitude of problems, which, I might add, when this project was first expressed a number of practical employers with experience in this sort of thing said it would not work—this objective of extending the boat.

Quinn I have no evidence that’s true.

Peters Did you have people who said “this won’t work”? 

Quinn No, I didn’t. Not to me. We went through it. It is not, again, an unheard-of project. There are many stretched ships around the world. It was investigated thoroughly. Yes, we got the budget wrong. Look, I’m happy—as I’ve said to you before and made public through the media—if you want to come and have a look, come and have a look.

Peters You don’t recall Pacifica Shipping CEO Rod Grout telling you way back on 13 October 2011? The CEO, Rod Grout, of Pacifica Shipping pointing out the viability and the safety of the extension, challenging the viability and the safety of the extension, saying that heads should roll, criticising the blowout of the cost from $37 million upwards to a final of $54 million he said—undisputed by you at that time. You don’t recall him saying that?

Quinn I know exactly what Mr Grout has said. I’ve watched his statements with humour over the years because I find most of them reasonably random. He wasn’t the CEO of Pacifica at that time. Mr Grout doesn’t seem to understand the business we are in. The business he’s been in and what we do are quite different, and while I respect he has an opinion, I don’t agree with him.

Peters How much practical experience does KiwiRail have in running a shipping line?

Bennett OK, that’s it. Mr Auchinvole’s got a question.

Quinn Sorry, can I answer that? Because I’ve got 600 folk who have been in the business for a long time. They’re nautical folk. We’re not running this shipping line with rail folk. We’ve been in the business, Mr Peters, for 50 years. They are experienced folk. I’ve got naval architects. I’ve had very good folk involved in this. Do I think everybody who works for me agrees
with everything we do every day of the week? I’d be stunned—I’d be surprised if too many around you would be saying that.

Peters  You’ve got a lemon.

Quinn  No, I don’t agree with you. I’m just explaining to you: we’re running this as a nautical business with people specifically recruited for them. The 600 folk who work for me in this thing sweat blood to make these ships work every day. They’re as disappointed as everybody else about this, and they don’t deserve the disrespect.

Auchinvole  Thank you. Jim, just to reflect, perhaps, away from specific items and to give some continuity between last year’s meeting and this one—has KiwiRail’s internal staff engagement improved during the year and how have you measured it?

Quinn  Yes, it has, and we’re very pleased. We use the Connex model, which is what was the JRA one, and it’s jumped to 71 points, which we’re very pleased with. My experience of engagement is that it takes time for people to engage and to trust the process. When you consider what rail has been through for many years—different owners, all of those things—you can understand the employees being relatively standoffish a bit, just wondering how this is going to go. They’ve been thrilled with the support the business has had customer-wise, investment-wise, and I think the engagement results this year reflect the progress we’ve made culturally, and I’m very proud of my team.

Fenton  Going back to Kaimai tunnel—did you do an internal investigation, and was that ever publicised, and was there a MoBIE investigation?

Quinn  I’m not going to guess. We would always investigate. I don’t know whether it was published, but all the reports are public now so whatever we have is out there.

Fenton  So, one from Impac?

Quinn  They were commissioned by us, yes.

Bennett  Thank you very much. Thank you everyone for your questions. Thank you very much.

conclusion of evidence
2012/13 financial review of Kordia Group Limited

Report of the Commerce Committee

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Kordia Group Limited

Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of Kordia Group Limited, and recommends that the House take note of its report.

Introduction

Kordia Group Limited is a state enterprise operating in New Zealand and Australia, which provides broadcast transmission, operations and maintenance, telecommunications, and internet services. The shareholding ministers are the Minister of Finance and the Minister of State-Owned Enterprises. Kordia Group Limited is the parent company of Kordia New Zealand and Kordia Solutions Australia. In the 2012/13 financial year, it recorded a net profit after tax of $3.669 million. Scott Bartlett is the chief executive of Kordia New Zealand. The chairperson of the board is David Clarke.

Digital system changeover

We asked about the effects on profit and loss of the change from analogue to digital services, and whether Kordia expected any further impairment charges or write-offs. We were told that they were taken into account when the changeover was first announced in the 2011 financial year and there would be no further impairments. Profit and loss figures were affected before the change-over because the analogue system was a high-margin service at the end of its economic life and provided a positive result of $10 million profit on a turnover of $14 million.

Business in Australia

We asked about revenue from the Australian business, especially in view of volatility in the mining sector. We were told that a two-year, $80-million mining project was on track for a successful, if slightly delayed, completion. That project is the extent of Kordia’s exposure in the mining sector, and is considered low risk. There is considerable growth in the telecommunications sector and we heard that Kordia has a healthy order book, but there is also intense competition with a resulting pressure on business margins, which vary between 5 and 7 percent. The market tends to be cyclical and the company is very selective in choosing contracts to bid for. The New Zealand business is more profitable, but around 75 percent of Kordia’s revenue derives from Australia, where 30 percent of its revenue comes from on-going project-based contracts.

Broadcast transmission services

We asked whether Kordia was now in a highly competitive market for broadcast transmission services, especially since the change to digital transmission. We were told that Kordia’s position as a near-monopoly ended with the analogue service. Other digital specialists are now entering the market, and broadcasting companies have a choice of transmission provider.

We heard that the costs of owning and operating a digital transmission service are considerable, but we were assured that where Kordia still maintains a near-monopoly in
regional transmission services, it charges a fair price for these services. Kordia does not envisage any change in its pricing structure. Prices have already come down since the advent of digital transmission, and because there is a choice, provided especially by online services, there has been a rapid growth in the number of channels broadcasting.

Kordia suggested that the regional services need to find a workable commercial model to operate successfully; although Kordia does not comment on funding arrangements for local community broadcasting, it suggested there are effective existing examples of both private and public funding. Where new regional broadcasters can demonstrate that they have a viable proposition for the long term, Kordia can assist with a “soft start”, negotiating a lower-price package for the first two years of operation. We were assured that despite there being no explicit requirement for the company to aid regional broadcasting, Kordia had a strategic intention of ensuring that Freeview remains an attractive proposition for local broadcasters, and thus of providing a successful local broadcasting service.

**Competition with broadband services**

We asked how Kordia expected to maintain its customer base, in view of the expected growth of broadband-based alternatives. We heard that this may become a significant challenge. Statistics indicate that worldwide, although alternative digital services are growing rapidly, television viewing hours have not decreased yet. While this may change, Kordia remains confident that it is not an imminent threat, and its contracts for digital transmission services extend well into the future.

**Maritime operations**

We asked Kordia if it was intending to increase its global footprint in maritime operations. The company covers the roughly 25 percent of the world’s oceans that surround Australia and New Zealand, and said it would investigate possibilities for expansion, but this is not its current strategic focus. We asked about the risk of operational failure, and heard that Kordia has provided a service, recently renewed, to Maritime New Zealand for over twenty years, indicating confidence in its professionalism. The low risk of operational failure is defined in the contract, and will diminish further with the introduction of new digital platforms this year.

**Company strategy for New Zealand**

Since it divested the internet provider Orcon, approximately 75 percent of Kordia’s business is in Australia. We observed that this seemed high for a state enterprise, and asked whether Kordia plans to expand its infrastructure in New Zealand. We were told that the company’s growth strategy is to consolidate rather than continue to expand its business in Australia. It now sought to increase revenue in New Zealand, especially since the change to digital broadcasting.

Kordia remains convinced that a second cable between New Zealand and Australia is essential, but this would require Government investment and, more importantly, support from other telecommunication companies. Kordia had not succeeded in securing this support, so had had to abandon its plans for a second cable. We asked whether New Zealand universities were placed at a disadvantage by a lack of connectivity with the rest of the world. We heard that connectivity is probably not a significant problem for the universities at present; but a second international cable with spare capacity is a fundamental infrastructure need for this country, along with increased competition to reduce the cost of connectivity.
Radio transmission

We asked whether radio content in New Zealand was limited by the cost of transmission services. We were told that the country offers the largest amount of radio content in the world. The availability of radio spectrum and the high cost of spectrum licences pose a risk to purchasers but the cost of transmission is just one factor. Kordia said that in the vibrant radio market in New Zealand consumers are spoilt for choice, and the success of internet radio has provided a genuine alternative to radio transmission.

Debt reduction

We asked how Kordia had reduced its net debt to its lowest level in eight years. Kordia said that proceeds from the sale of Orcon and earnings and profits from investments were the main contributing factors, together with returns from long-term contracts and lower capital expenditure.

Orcon warranty claims

We are aware of certain persisting historical legal issues related to Orcon and asked if there was any risk to the company from a series of warranty challenges. We were told that the claims are being vigorously defended and the company believes they have little substance. A resolution should be achieved by the end of the financial year.

Unused spectrum

We understand that Sky Television returned four blocks of unused spectrum to the Crown, and we asked about progress in deciding on their use. We heard that they remain in the possession of the Crown, which has notified an intention to issue a discussion paper on spectrum use for consultation later this year. Kordia intends to put its views forward in the consultation process.
Appendix A

Approach to this financial review
We met on 6 March and 20 March 2014 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
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Evidence and advice received
Kordia Group Limited, Responses to written questions, received 27 February and 18 March 2014.

Organisation briefing paper, prepared by committee staff, dated 8 January 2014.
Appendix B

Corrected transcript of hearing of evidence 6 March 2014

Members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafou
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Witnesses
Lorraine Witten, Chair
Scott Bartlett, Chief Executive Officer
Shaun Rendell, Chief Financial Officer

Young Welcome, Ms Witten. If you’d like to just introduce your team, that’d be great.

Witten I am aware of time, so we will try to stick to our 5-minute brief introduction. I hope you have our overview paper.

Young Yes, we do.

Witten I’ll just make a few comments, and then I’ll pass to Scott to make some comments about the New Zealand and Australian business, and then follow up with Shaun with a few comments from a financial perspective. Very simply, Kordia is our specialist telecommunications and broadcast network business in New Zealand. In Australia we are also focused in telecoms network but we do design, build, and in that market we have been on a diversification strategy to grow that business, and we’re now a tier 1 player in the telecommunications solutions space for networks. Kordia had a strong year in FY13. The operating after-tax profit from the New Zealand and Australian business was just over $10 million, which was 46 percent up on the prior year. During the year we sold Orcon, and we’ve continued to reduce our debt. It was down to almost, just under $53 million, which is down from a peak in 2008 of $120 million. So that’s been a focus of the board over this period.

Cosgrove Can I suggest you might want to offer some consulting services to Solid Energy—just a thought.

Witten Thank you for that point. Kordia also paid a dividend of $5 million in the last year. So we’ve got two major businesses now in New Zealand and
Australian. With the divestment of Orcon, Australia is actually now the largest revenue portion of our business—almost 75 percent. In both companies Kordia operates in a highly competitive environment. I'll pass over now to Scott to make some points about New Zealand and Australian businesses.

Bartlett Very quickly, for the committee’s benefit, I'll just through what we actually do. So for the New Zealand business, we define it as being a networks organisation. We’ve said that our aspiration is to become one of the country’s leading provider of business critical networks. Specifically what we’re most famous for is free-to-air broadcasting. TVNZ is a good customer of ours—a very good customer of ours actually. They pay every month, which is nice. And we support—

Tremain Who doesn’t pay every month?

Bartlett We’re looking pretty good.

Faafoi I've got a question about that.

Bartlett Yeah, I expected one or two. The FreeView platform, specifically now the digital television distribution in this country—we provide services from the satellite. We have the head lease on that transponder for satellite services, and for the majority of the country we provide terrestrial television services from our towers on top of mountains.

We had a really successful digital switchover in this country. It went really well. From the first of December last year, the analogue television network was switched off. We knew that was coming. It’s been coming for a while, but that has been quite a major impact on our business. We’d been planning for it, and, as the chair mentioned, diversification has been a strategy. But none the less, that is a significant financial impact on our business circa $10 million of profit annualised impact on our business. So it’s a major event for us.

In the television space, we have more and more competition coming as a result of the move to digital. More than half of the country receives their television from Sky, not us, and we’ve seen some really recent announcements from Telecom, or Spark, or whatever they’re called these days—a pack of sparkies—for ShowMe TV. I think we’re just starting to see—and I know, Clare, you had some questions in the previous session around digital television coming—it’s definitely coming. Make no mistake. But we see more and more ways for content to get through to New Zealanders.

Turning the page, in keeping in with content, we provide some really specialised content services that we’re really proud of. One of those is we operate Parliament TV. Some fantastic talent on Parliament TV—thank you. That service is one that we’re particularly proud of. We also facilitate getting content from sports fields through to our customers. So typically when you’re watching a rugby game, it is Kordia that is getting the video feeds from the field back to our customer Sky television. And we’ve been doing that for a number of years.
We’re also really proud of some of the specialised events we do: the Fonterra AGM, connecting the Fonterra board through to their shareholders on live video feeds throughout the country, and that’s a reflection of our national distribution of our network, and also the Hobbit premieres and whenever Air New Zealand buys a new plane, it is great to be able to provide coverage for video feeds anywhere in New Zealand.

Mitchell What’s more popular: the Fonterra AGM or Parliament TV?

Bartlett I couldn’t possibly comment, without—

Faafioi Ratings winners.

Bartlett —discussing the business of our customers. With liberty I accept a rhetorical question. Turning the page, in our maritime operations space, we provide safety of life at sea services for ships in nearly a quarter of the world’s oceans. We do that for the New Zealand and the Australian Governments, and also for the New Zealand Government we track shipping movements in New Zealand waters. So when a ship gets into distress and radios for helps, they speak to our people, who then facilitate that through to Maritime New Zealand for the Rescue Coordination Centre.

Faafioi So that’s you guys at Avalon, is it?

Bartlett It is. And Maritime are at Avalon as well. So we’re really, really proud of that safety of life at sea service, and we’ve been doing that service for over 20 years.

And lastly for the New Zealand business, I talked about transformation and the chair talked about diversification. In the past 5 years we’ve made a move into providing data and voice services for corporate New Zealand. So that’s providing them with their wide area networks, providing them with internet access, managed security, privacy protections, and so on. And you’ll see from some of the logos there on that page—I just took a bit of a handful—that we’re providing this service for some of New Zealand’s largest organisations and most significant economic contributors, including Fonterra, for all of their voice services. So we’re very proud of the progress we’ve had in that business, and our telecommunications business is now a positive economic contributor to our organisation. It was a start-up and we’ve passed through that positive EBIT point, so we’re really proud of that, and the growth is continuing, which is nice.

Moving on to the Australian business, very quickly, as the chair mentioned, we have a team of over 800 skilled engineers, field techs, and riggers operating in both New Zealand and Australia, but most of them in Australia. They are providing design, build, and maintenance services to the telecommunications providers in that country, mostly the mobile operators, but also diversifying into energy and natural resources. Lots of mining investment is going into Australia. Mines need to be connected up with communications networks, and we’re providing those services, and I know that the chair might later on talk about one of those projects.

With that, I will turn over to Shaun to wrap us up before we take your questions.
Rendell Thank you, Scott. While you’re getting there, I’ll just refer to the financial slides right at the end—the group re EBIT and interest. I think Lorraine earlier on talked around last year and how it performed, but sometimes looking at one year in isolation can be misleading to give you a view. I thought it would be useful to show the trend of the business, so it’s going back to 2005 around how Kordia as a group has performed. I think, as you can see there, it shows a long track history of profitable performance for the business. I would highlight that we have normalised 2011. Some of you would have been around would have recalled that was the year that we impaired the analogue asset for the bring-forward date for the digital switchover, which obviously has recently happened, as Scott talked around, so there was a one-off impairment in that year. But I should point out that with freeing up that spectrum for 4G, the Government has yielded a dividend this year of over $200 million, and that is bringing forward that analogue switch-off.

Just flicking over to debt, just covering a little bit more detail of the comments that Lorraine made at the start there, you can see the debt profile of the Kordia Group since 2005 to 2013. Our debt last year was just under $53 million, and you can see when the GFC happened back in 2008 we were quite a highly geared business, and our debt was peaking at around $120 million. The board have taken on quite a significant debt reduction programme over the last 5 to 6 years, and we’ve paid off $60 million of debt since 2008 to 2013. In that time, we’ve managed to fund an Australian business that was $20 million, and is now over $200 million. That business obviously has large projects that do require large working capital, and we’ve had to manage and balance that in terms of growing that business as well as actually reducing our overall group debt. So that’s where we’re at today.

That concludes the presentation, so over to your questions.

Tremain I’ll start. Firstly, that sounds like an impressive result. Well done. I just wanted to pretty much start the conversation with the history of the analogue system and where that’s got, and then perhaps you could take it from there forward. What other impairments do you see that your business would have to make with the old analogue system? Are there any other write-offs or have they all been taken into account?

Bartlett We’ve taken all those into account. The analogue network was turned off at midnight on 1 December, or 30 November. And that was really taken up in that FY11 year, because that’s when we knew it was going to happen, so that’s when the impairment was taken. There’s no further impairments related to analogue.

Tremain You mentioned that there was an impact on your P and L of some circa $10 million bottom line. So what does that relate to in turnover?

Bartlett So the analogue service was a high margin service because it was at the end of its economic life, as it tends things to get more profitable at the end, so in terms of revenue, from memory, it’s around $14 million.

Tremain It’s $14 million. So you’re making a $10 million bottom line off a $14 million—OK, that’s very profitable business. So looking at the Australian
business, I just want to ask a quick couple of questions about the lumpiness of that business. You talked about having, you know, 800 people across New Zealand now. A lot of that mining business—that’s changed quite significantly. There isn’t quite the investment going in there. Are you concerned about the lumpiness of that business? If you can answer that question and also at the same time how much revenue on your Australian businesses is guaranteed income or is there a flow of income there that you can rely upon?

Witten I’ll answer the first part of your question. We have an $80 million project in the mining sector. It’s with APLNG. I think we talked about it at the committee last year. That’s been a 2-year project delivery. It has slipped a little from delivery around June this year to September/October, but that project is on track and is due to deliver, so we don’t feel there is risk in terms of that project is still going ahead. It is a huge mining project. We are doing a discrete mobile network in the mining area. So that’s the extent of, really, our exposure to the mining sector.

Tremain In saying that, I guess if you’re saying you’ve got a $200 million turnover in Australia, I would assume that’s about $40 million per annum—

Witten That’s correct.

Tremain —on your P and L, so is there something that will replace that, or is that a one-off opportunity?

Witten Well, the state of a contracting business is that you do almost have to reinvent your revenues every year. I think we talked about risk in this business last year, and that continues to be the case. There’s always a pipeline and it’s a very robust market. There is lots of growth in the telecommunications sector in Australia still, so we’re still seeing a very healthy pipeline. The big issue for our Australian business is margin, the competition that’s there, and it’s no secret that those businesses are under some margin pressure, as we are in Australia. So we have a healthy pipeline. We’ve got a lot of projects still delivering. We are focused on when the APLNG project closes out. There is a discrete project of people that will need to come and go from the business. As a contracting business, you manage to those peaks and troughs, and we’re not expecting necessarily to automatically replace that revenue, and we have plans for some of those people to exit, some to move to new projects.

Tremain What percentage would be project-based business versus service business? I assume you mentioned that you work with a lot of the other telco providers over there to service towers and that sort of thing. Are they 3 to 5-year contracts or do you have to bid for those every year?

Witten There’s a much smaller proportion of our business, like for example, the maritime business—that’s an ongoing contract. But maybe Shaun you could speak to the percentage.

Rendell Yeah, I mean roughly it would be 30-70 service revenue versus—

Tremain 30-70?
<table>
<thead>
<tr>
<th>Rendell</th>
<th>30 percent would be service revenue, and 70 percent is contractual. We would ebb and flow as contracts come on and come off.</th>
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<tbody>
<tr>
<td>Mitchell</td>
<td>Can I just ask one very quick question. What is the margin that you’re operating currently on in the Australian business?</td>
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<tr>
<td>Witten</td>
<td>The gross margin or the bottom line?</td>
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<tr>
<td>Mitchell</td>
<td>Actually, the bottom line.</td>
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<tr>
<td>Rendell</td>
<td>The industry standard for that—most contracting firms there in the market we’re in operate on a 5 to 7 percent EBIT margin.</td>
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<tr>
<td>Witten</td>
<td>Very tough business.</td>
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<td>Rendell</td>
<td>And we’re in that range. The leading class would be 7. Most of the industry over there has gone through a tough period, particularly with the NBN, and they’ve had significant losses in the last few years. We’ve been fortunate in that case that we’ve mitigated some of those risks and we didn’t do it on the NBN work, but as Lorraine said, there is competitive pressure on margins across the industry there, and like everyone else, we’re in that industry and we have to compete accordingly and evaluate the risks of what we will and won’t bid for.</td>
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<tr>
<td>Witten</td>
<td>And traditionally it goes through periods of very good result and then will go through a couple of years of bad. It’s quite cyclical too.</td>
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<td>Faafoi</td>
<td>I’m aware that your business is changing very quickly. How much of your future performance is actually going to rely on how you do in Australia as opposed to what has traditionally been your market here? I’m sorry, that’s a bit of a crystal ball question.</td>
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<tr>
<td>Witten</td>
<td>Well, yeah, it is a bit of a crystal ball. Well, currently, 75 percent of our revenue is there, but it’s fair to say the New Zealand business is more profitable than the Australian business based on a network business in New Zealand. So if you’re talking profit, I think it is more than 25 percent is in New Zealand, so it’s not like for like with the revenues. What sort of numbers are we forecasting? I think probably just under 50 percent through New Zealand and profitability going forward, I think is around about 40.</td>
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<td>Faafoi</td>
<td>Can I turn to the New Zealand network then. Traditionally you’ve been broadcast transmission. You’re moving away from that to a degree. You also said in some of your opening comments that you’re in a highly competitive market. Are you really in a highly competitive market in terms of what you’re still doing in the broadcast transmission?</td>
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| Bartlett | Well, I think we’re entering into a more competitive space than we’ve traditionally had. I know there’ve been questions from the committee directed at Kordia in the past of “Are you in a monopoly?”.

Curran Straight to the point.

Bartlett I think that you could say that in the past Kordia has had a natural monopoly in New Zealand on analogue broadcast, and that monopoly really came to an end—jagged edges have staggered off over a few years, but it
ended on 1 December. In terms of the broadcasting space now, we’ve seen more competition than we’ve ever had.

Faafoi So who is it, then?

Bartlett Well, recent examples of that would be the New Zealand Racing Board electing to cease transmission on FreeView and move to Sky, solely for transmission. So that for us is competition. Another example would be to see that there is more competition coming into the online space. Telecom are making what will presumably be a big investment in telly, but not doing it in the traditional way. They’re doing it in a different way. So we’re not getting any of that money; someone else is getting that money. Where Kordia used to be the one-stop shop for broadcast in this country, that is now no longer the case.

Faafoi Can I ask you a similar question in relation to regional broadcasters, where to a certain extent you’re still a one-stop shop, because there isn’t a hell of a lot of competition around the country. They’ve got an issue about the cost of transmission that they’re bearing at the moment. The blunt question is: are you really charging them a fair price for what they’re after?

Bartlett I guess the blunt answer is yes, we think we are. The cost of owning and distributing a digital television network is substantial. We’ve got multiple numbers of big towers—130-metre high towers at the top of mountains—that all need to be maintained, they all need to have links going to them, and we’re continuously reinvesting in our network to everything from roads to access them, all the way through to replacing transmission equipment as it gets replaced. The New Zealand business, as we said, is going through a major transition, and that transition is away from analogue broadcast, and if you look at the journey we’re on with the New Zealand business, while, yes, it does produce more than its proportionate revenue share of profits for the group, its return on equity is not to the extent that we feel currently satisfied. We think that the New Zealand business in terms of its financial performance needs to get better. The management and board are not currently satisfied with its current level of return on equity.

Young Just with ultra-fast broadband rolling out and some of these radio stations and things like that—I don’t know whether they’re trust ones or community ones or whatever—probably going to online, internet radio as opposed to, say broadcasting, how are you going to maintain your customer base with that sort of technology becoming available?

Bartlett Yeah, for us that is the big challenge—at what point does digital start to really have a significantly negative impact on our traditional lines of transmission, including not just television but, as you say, radio is another one. So for us we’re looking at some global stats. I know (inaudible) was talking about them as well. Globally, yes, digital is going like that. It is absolutely booming. The growth rate is enormous. If you look at, for instance, Netflix in the United States, something like 90 million homes in the US have Netflix. However, the amount of hours watched consuming just normal telly hasn’t really been negatively impacted. They seem to so far be complementary. Will that change? Possibly it will. Maybe you should say
probably it will. But we can’t see it yet. We can’t see the point where people consuming television over a broadband service will replace them tuning into Sky or Freeview.

Young

It won’t take you by surprise will it?

Bartlett

Say again? Sorry?

Young

We’ve just had Solid Energy here this morning. It won’t take you by surprise?

Bartlett

No, absolutely not. Actually, it’s an important point to recognise that a significant number of our television transmission contracts are contracted out for a substantial period of time in the future.

Young

Right. OK.

Faafoi

I’m trying to refine my question here, sorry. I guess my concern is that I think there are a lot of regional broadcasters out there who do see themselves having in the future some kind of online digital television future, but there are also some who would like to but because of survival in the current environment, it’s difficult, they may not be able to make it there. I guess the answer is probably no because the price isn’t going to change by the sounds of things. How do we try and support those guys who want to stay alive in this world—try and get to the next world of digital TV?

Bartlett

If I can answer the question in two ways. One is how are regional or community-based services funded in New Zealand. There is both the commercial funding and other funding, some of it public, some of it private—a lot of it private. So there are some good examples of where we’ve got broadcasters in both categories. Māori television is an example of that, where both their main channel in the form of Māori Television and also now Te Reo broadcasts on the free-to-air platform. That is publicly funded as to how that is a public service broadcast in this country. Another example where we’ve got community-based broadcasting happening on the Kordia platform is examples such as Channel 33 for the Chinese market, and I hope that this year we will see the entrance of an Indian language-based channel as well. They still need to find a commercial model to be able to afford to broadcast their services. There is a wider debate which we do not participate in, as an infrastructure provider, as to how funding should be arranged for community and regional broadcasters.

Curran

But as that infrastructure provider, you’re able to demand prices that unless there’s leverage for those providers to jostle amongst themselves or whatever, there is no other alternative that regional broadcasters have other than to do the deal that you say that they need to do. And if they can’t afford to, then they’re falling over, and that’s what’s happening out there in our community.

Bartlett

Sorry, I don’t—Again, a couple of things—

Curran

So there’s nowhere else they can go to get that provider—
Bartlett I disagree—

Curran So they can’t go and seek a cheaper option. So we go to the monopoly issue. You’ve got the monopoly power to demand the terms, to set the terms of how they engage.

Bartlett I disagree for a couple of reasons. One is that there is choice for people that wish to broadcast their content. This committee hearing today is being broadcast online, and it is a terrific vehicle for reaching the masses. We’re a really well-connected society. We actually have pretty good broadband irrespective of the UFB not being completed, and that option is being taken up by a number of parties today. If you can see that actually one of the largest corporations in the country is putting their television future not on the online market who can afford it, but rather doing it online, speaks volumes as to the viability of an online play.

Secondly, the cost of transmission has come down substantially with the advent of digital technology. It used to cost millions of dollars per annum to transmit a television channel under the analogue platform because you had to provide a tower network of 400 sites. Every single one needed to have a big expensive transmitter on it, and that was definitely, as we saw from the number of channels in this country, the purview of the major broadcasters only.

Today we’re seeing more and more channels come into New Zealand. Again, for a country of 4.5 million people we have a substantial number of digital television channels broadcasting now, and there’s more adding all the time. So just in the past few months, we’ve seen Te Reo now broadcasting on the digital television channel. We’ve seen a Korean shopping channel launch which has come in probably over the past 4 or 5 months, and we’ve also seen Al Jazeera start to broadcast a 24-hour news service on the FreeView platform. So we’re seeing more channels come to market now than we ever had.

Faafoi I guess my response to that would be if we look at Te Reo and Māori Television, you either have to have quite a lot of money or have some kind of State backing to get into the digital space, and that’s why I’m asking about regional TV because, as you say, the personality of regional television stations is varied. Some are community access and some are purely commercial, but, still, I think they’re finding it very tough operating in the environment that they are because they still face what they think are very high transmissions charges. And my concern is that some of them may survive; some of them may not. That’s up to how they manage their own TV stations. But I would hate to think that it’s a transmission charge that prevents them getting into the next world of digital television which I think we’ll get to eventually and they want to make sure that they do have some form of long-term survival. I was just wondering is there some kind of middle ground to get people there?

Bartlett We are a commercial operator. We have to provide a return to our shareholder and that is our focus. As I said before, our return off our assets
in New Zealand is not satisfactory for us. We think we can do better. In fact, we feel we need to do better off our return.

Faafoi So you’re saying you want to charge more.

Bartlett No, no. It’s not what I’m saying at all.

Witten Or invest less.

Bartlett What I am saying is that we have diversified our business into areas such as telecommunications to leverage our network platforms to get other revenues. So that’s the likes of Fonterra and Deloitte and Simpson Grierson and others. We don’t see any change in our price for digital television transmission. As I said, it’s come down substantially and it is fair and equitable across all of our customers. So we do provide in some commercial situations—I can’t name who, but they have been regional players—soft starts so that they can get in with a low cost for the first couple of years to build their commercial platform. But, at the end of the day, we need to recover the costs of providing the service and we need to make a profit.

Young Is a soft start, is that a negotiated one-off?

Bartlett Negotiated one-offs on a case by case basis.

Young What would be the basis on which you would negotiate for a soft start?

Bartlett Where parties can demonstrate that they have a viable proposition for the long term, and that is one of negotiation, discussion, dialogue. It’s a practice we’ve used, and I think it goes possibly to the question as to what are the things that we have done to help these regional broadcasters get into this space.

Witten And you’re investing, I’m guessing, in a long-term revenue that you’re going to get by discounting up front.

Mitchell Just a couple of things because the last time you were here we talked about your maritime operations, which I thought were pretty cool, actually, to get into. There’s quite a bit of tension on that sort of stuff really, too. You were trying to increase your global footprint. Have you had much luck in that space? And the other thing is that what risks do you carry in terms of if there is an incident with a ship and it needs to report that through you guys—so if there’s a failure somewhere in that, do you carry any risk or liability around that at all?

Bartlett Our liability is defined in our contract with Maritime New Zealand, and having provided the service—so I recognise there are two questions there.

Mitchell Yeah, there are, sorry.

Bartlett So having provided the service for 20 years, and the contract last year was renewed for another 11 years, we take that as support from our customer that we’re doing a pretty good job. In terms of technical risk of, say, missing a call or equipment failure, we’re currently in the process of upgrading our maritime operation services in both countries to the new digital platforms. So the old platforms were the good old RF transmitters. They’re big and
bulky and, yep, there are spares, and so on and so forth, but the digital environment just gives us so much more flexibility.

We’re expecting that service to go live in the middle of this year. It’s in trials now for both countries. In terms of global reach and footprint, we cover 25 percent of the world’s oceans. It would be nice if we could do more and I’d be lying if I said that we don’t harbour some ambitions to extend that capability, but our patch is New Zealand and Australia and it’s unlikely that we would be in a position, for instance, to take over the next set of zones which extend up into Hawaii. That’s really the domain of the Americans.

Mitchell Because I thought that little port at (inaudible) there could be quite lucrative, couldn’t it?

Bartlett Well, if the weather’s blowing the right way, we can hear Hawaii, but that’s not our strategic focus.

Mitchell Yeah, OK. Excellent, thank you.

Curran Thanks. By my reckoning, since you sold Orcon last year, close to 80 percent of your business is in Australia and around just over 20 percent is in New Zealand. That would seem, on the face of it, to be pretty extraordinary for an SOE to be focused on mainly another country, even if it is our nearest neighbour, and for its growth strategy to be directed in that area. Where are the, I guess, plans or the ideas that you’re putting before us today around your expansion in New Zealand?

A couple of years—I mean, I have sat on this committee for 5 years now, so I’ve seen you come and go in various forms. You came before us a few years ago and spoke really, really strongly about the need for more external infrastructure, in terms of a second overseas international cable. You were working on a business case for which you believed you had the strength behind. Obviously, things have moved on since then. Why is it that you’re not coming before us and talking about those sorts of issues—the infrastructure issues—that are lacking in New Zealand? You’re the SOE that could be providing the advice and the—I guess, rather than looking at what’s going on in Australia and about building more profits to give more dividends back to the Government, where is the infrastructure plan that Kordia could be putting before the select committee today?

Witten Let me answer—there were a couple of points in there. Our growth strategy is not to continue to expand the business in Australia. It’s actually grown sufficiently at the moment. We’re actually in a consolidation position there. So the growth in the next couple of years we are planning to come out of New Zealand. Part of the change, of course, as you know, has been the decrease in revenues in New Zealand from the analog. So we’ve been in the position of trying to replace that as an overall company, and while the New Zealand business declined, the Australian business has risen. Now it’s time for the New Zealand business to grow, and Scott could speak more about what those particular growth items are on our agenda.

We were very passionate about getting a cable between New Zealand and Australia, and I think we remain of that view, that it should be done. The
reality is that we’re a lot smaller player than we need to be to be the major player in that sort of investment. We did try to get investment through parts of Government and with other telecommunications—

Curran? And failed.

Witten —and failed—through other telecommunications players. To get an investment like that off the ground you need big telecommunications players to buy capacity on the cable. You can’t get investors to come on board until you have that signed up.

We’re in competition with those other really large players, so at the end of the day we were not able to get that off the ground. It doesn’t mean that that isn’t actually a good investment.

Curran Have you given up on that? Have you given up on the—

Witten At the moment we have—yes, we have.

Curran Is that because of the strong signal or basically a command by Government to butt out of that area and let the market work it out?

Witten No, I don’t think that was the only—I think there was a factor that we didn’t pick up Government money, but that was only a minor part of it. The big piece of it is actually getting the other telecommunications providers to come in as parties to it. As I said, they’re competitors to us. So what’s happened is Telecom actually has picked up, itself, progress towards that.

Curran Well, as we’ve seen for the last 5 years, there’ve been various ideas come and go. The big gap appears to be the lack of Government commitment, as a cornerstone investor. Were you told by Government to drop your plans?

Witten No, we weren’t. It was a board decision. We’d spent over 2 years working on trying to get the deal together, trying to get the funding, trying to get the support of the other telcos, and at the end of the day you have to call a point when enough is enough. We got to the point where we weren’t going to get that across.

Yang This is just a technical question. I was talking to (World) TV and Chinese Voice, and all these radio programmes and TV programmes, it appears that it is very difficult or very expensive to own a radio channel. I’m just wondering whether it’s because there’s a frequency limit. You can’t have more channels simply because it’s difficult or for some other reasons—costs for operating the channels is expensive.

Bartlett In New Zealand, some of our markets have the most number of radio channels in the world. I forget the exact number of how many channels, radio services there are in Auckland, but I know it’s world-leading in terms of the number of services. The availability of spectrum is an issue, but the cost of transmission is not the only cost. The cost of spectrum licences is also a factor.

But we see that there is a very vibrant radio market. Consumers are kind of spoilt for choice in this country for the number of radio services. And,
actually, internet radio is an example of where the internet really has provided an alternative today, right now, in the form of tens of thousands of radio services that people can stream for free.

So radio is not going anywhere. There are some markets overseas. There’s been a move to digital radio. That doesn’t seem to be happening in this market. So we think that consumers are pretty well served by the radio market here.

Tremain I just have one last one in the financial area. You made the comment with your balance sheet that you’d dropped debt by $120 million down to about, I think, $53 million. So, quite a significant fall. I note that your profits have been this year a reported $3.669 million. So, clearly, the reduction in debt hasn’t come from—I’ve heard you talking about it—hasn’t come from profits. The sale of Orcon was probably part of it. Can you just explain to me where the cash has come from to enable the level of debt reduction that you’ve achieved?

Rendell Well, it’s come from a number of areas, like you just said. One, we divested a business last year—Orcon—so obviously the proceeds of that business (inaudible) the debt, and obviously as part of our banking arrangement it’s required to be repaid as debt. So that’s one factor.

Two is earnings. Earnings have been variable, and remember that’s the consequence of the analog switch-off coming on and investing in new revenue streams. So we still had ongoing profits to help draw down debt. Really, that comes down to free cash flow. So looking at our EBITDAs, we’ve had a lot of historical capital in the business, so our EBITDAs, and that’s EBIT on our chart, have been strong. Also, as we’ve invested in assets, and Scott gave an example where we will spend money in year 1 on the maritime upgrade for a 10-year contract. We obviously have a lot of negative cash overflows in the early years of investments, which then reap rewards with lower capital ongoing. So our CAPEX has actually dropped over the similar periods, as well as we’ve tightly managed our assets.

Tremain So some of that’s quite short-term debt to cover—

Rendell Yeah, short-term.

Tremain —big contracts like the $80 million one.

Rendell Yeah, and our return on equity is still quite low and we’re trying to get that up because we’ve got a big asset base, and relative to performance we still need to improve that. That’s fundamentally how we improved our cash position to actually help us pay down that debt over the last 6 or 7 years.

Tremain Is there any risk? I see with the Orcon example there were legal issues that the company or the organisation still faces. Can you just talk me through some of the warranties in question here that are being challenged, and what you’re thinking, particularly as a board, are the risks that are present?

Witten We can’t talk, obviously, specifically about what the warranty claims are. There are warranty claims. We’re vigorously defending those. We don’t believe that there’s much substance. You can never say it’s all right or all
wrong, but we are confident that they will come to a resolution and that we are in a very strong position there.

Tremain What’s the time frame around the resolution? Do you have an approximate?

Witten Well, we would hope that they were done by the end of the financial year. But, again, it is about negotiation and how long they want to make it—whether it’s quicker or slow.

Faafoi Two very quick questions. The one is: Sky Television handed back a packet spectrum, I think, at some stage last year—

Witten Around December, I think.

Faafoi Where is that spectrum? I don’t quite know if it’s gone back to the Crown. Are you guys expecting to get it back to do something with it? And the second one is, going back to the regional broadcasters, I know that you’ve got a commercial imperative, but is there any onus on you guys to support the local industry in terms of broadcasters out there?

Bartlett I’ll take the last question first. Is there a written onus on us? No, there isn’t. But is there, really, an onus in terms of us ensuring that there is a vibrant, dynamic, free-to-air broadcasting market in this country? Yes, there is. We want to support having as many channels on FreeView as we can possibly do. Most recently we’ve done that by investing substantially in more digital television equipment to support another 10 channels on the free-to-air platform. Looks like half of those slots will be taken up when it launches later this month, and we’ll put out a press release on that matter. So for us there absolutely is a desire and a strategic intent to see that FreeView remains a compelling proposition for New Zealanders. If it is not, we lose as the infrastructure provider. And your first question, sorry?

Faafoi Was about the Sky TV spectrum. I don’t know where that’s gone.

Bartlett There were four lots of spectrum—I think, from memory—that Sky returned to the Crown. They are in the Crown’s possession. As I understand it, they are not currently being used. My understanding is also that the Crown will be putting out a discussion paper for consultation on uses of spectrum, later in the year. So we will definitely be engaged in that process and putting forward our views.

Curran I’ve got one more little one, which is actually just an observation that you may or may or not want to make. There has just been an announcement today about the rankings of New Zealand’s and the top 100 universities, and New Zealand universities don’t feature in that. Do you have a view on whether or not the ability of our tertiary sector to connect with the rest of the world through overseas campuses, through connectivity, as many universities are doing nowadays—creating campuses in other countries and connecting and using fibre, ultra-fast broadband, essentially, and through international cabling, to connect with each other. Do you think the fact that we don’t have that capacity right now, really, in New Zealand, in our universities, is a key to the detriment of New Zealand’s ability to really rank up there with other universities?
Bartlett I think I have to say I’m just simply not qualified to give an opinion on that.

Curran I know that, and I realise that you may not. But I know that there are debates that go on in these areas—for example, through REANNZ etc.—and our ability to compete at that level. As an infrastructure provider who has an interest in our international connectivity, which is presumably around our ability to compete in world markets—of which the tertiary sector is one—is that a factor, the fact that we don’t have a second cable and we don’t have more competition in that area?

Bartlett I think for us, the view is very much that we would like to see more international cables. We would like to see the cost of international connectivity come down. We would like to see more competition in that space. We know from our own experiences the chair was describing just how difficult it is to get a commercial proposition going for building another cable, and Pacific Fibre knows even better than we do about the difficulties of that. I personally have hope that we’ve already got one additional cable announced as going ahead, and that is the one across the Tasman. I also hope that Hawaiki Cable are successful in their endeavour to build a second cable up to Hawaii.

Curran But is it impacting—that is my question. Is it impacting on our ability to compete in the world market place—the fact that we don’t have another international cable. It’s a simple question: yes or no?

Bartlett I don’t know.

Witten I would say that right now, probably not, but it’s got to be on our planning horizon. The redundancy that we need, to have spare capacity, what we’ve seen going forward in terms of the data—the size of the data transmissions—I think it’s a fundamental piece of infrastructure that New Zealand needs.

Bartlett There is a data tsunami coming.

Young Well, thank you very much for your appearance today. All the best for the year coming up.

CONCLUSION OF EVIDENCE
2012/13 financial review of the Lakes District Health Board

Report of the Health Committee

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Lakes District Health Board

**Recommendation**

The Health Committee has conducted the financial review of the 2012/13 performance and current operations of the Lakes District Health Board and recommends that the House take note of its report.

**Introduction**

Lakes District Health Board is one of the smaller DHBs, with around a third of its population living in the Taupo region and two thirds in the Rotorua region. The population includes a high percentage of Māori, and a small but growing Pacific population. It exhibits the greatest health inequality of all DHBs, with a low average health status, and many disadvantaged people.

**Financial and service performance management**

In 2012/13 the DHB had a total income of $316.162 million and its total expenditure was $317.982 million, resulting in a deficit of $1.78 million. The DHB’s budgeted income and expenditure for 2012/13 were $313.392 million and $314.194 million respectively, with a budgeted deficit of $802,000. It is forecast to break even in the 2013/14 financial year.

The Office of the Auditor-General issued a modified audit report, with an unmodified opinion on the financial statements and a qualified opinion on the performance information of the DHB. The office gave a “good” rating to its financial information systems and control, the same as last year. It downgraded its ratings for the DHB’s management control environment, and its service performance information and associated systems and controls, however, from “good” to “needs improvement”.

The service performance information rating was downgraded because of the qualified audit opinion, which related to emergency department target information and third-party performance information. We note that the Office of the Auditor-General gave qualified opinions to all the DHBs reflecting the fact that the DHBs have limited control over information provided to them by third-parties and were, as a result, unable to satisfactorily demonstrate that they could rely on the quality of third-party performance information.

The DHB’s management control environment rating was downgraded following an internal audit which determined that two staff members had colluded to obtain fictitious invoices from suppliers to preserve a department’s unspent budget. We were surprised to learn that the staff members in question retained their positions, although we note that disciplinary action was taken. We were pleased that the DHB intends to send letters to its suppliers reminding them that they should prepare invoices only for goods supplied and services rendered. We consider that transparency in reporting to be vitally important to ensure the integrity of an organisation.

**Population-based funding**

The population-based funding formula determines the share of funding allocated to each district health board according to its population. Funding can also be adjusted to recognise differences between DHBs in the cost of providing certain health and disability support.
services. The DHB said that, while this type of funding is always a challenge for small districts, in general it considered that the formula works, but we were interested to hear that, if the DHB were in a position to change the formula, it would review the funding adjusters as it believes they could be more sensitive. It particularly noted that the tertiary adjuster (for specialised consultative health care) uses a one-size-fits-all approach.

**Vulnerable children**

Under the Children’s Action Plan the first cross-agency Children’s Team was established in Rotorua in July 2013, to work with vulnerable children and their families. We heard that as a “green fields” programme it took six months to develop a framework, which will need adjustment as the team takes on more children. While the team has had about 25 vulnerable children referred to it, it is working with a larger number of people, including the siblings of the children referred.

We heard that a particular challenge has been the cultural differences between the health sector and the Ministry for Social Development, one of the five administering agencies, as the health sector tends to favour a more autonomous approach. The DHB said clarity regarding information sharing and privacy requirements had been lacking.

**Children’s services**

The DHB achieved its target of 80 percent of the eligible population completing their Before School Checks—free health and development checks for all four year olds nationwide. Asked about improving the number of “hard to reach” children completing the checks, the DHB said that a Before Schools team within the public nurse team does a lot of outreach work. Because “hard to reach” children and “vulnerable” children overlap, some of this work may be done by the Children’s Action Plans Children’s Team.

We were pleased to hear that the DHB is expecting better results regarding the national newborn hearing screening programme, which encountered some issues with registration. The DHB is due to be audited on the programme in the 2013/14 financial year. We look forward to the results.

**Mental health and addiction services**

During the 2012/13 financial year one of the DHBs key strategic priorities was mental health and addiction services. It did not, however, achieve many of the targets intended to improve the health status of people with severe mental illness. While we applaud the DHB for instigating a number of programmes to improve its reach into difficult populations, there is some concern that its plan to improve child mental health waiting times involves diverting money from other mental health services.

**Queen Elizabeth Health Centre**

The primary role of the privately owned Queen Elizabeth Health Centre in Rotorua is providing rehabilitation services for patients with severe arthritis and other chronic disorders. A national referral centre, it receives patients from other DHBs including Lakes. We are aware that some post-polio-syndrome patients feel their access to the facility has been reduced. The DHB explained that it does not administer the national contract for these services; it also said that treatment for post-polio syndrome has changed radically and that DHBs are now in a better position to treat patients locally.
Appendix

Approach to this financial review
We met on 12 February and 5 March 2014 to consider the financial review of the Lakes District Health Board. We heard evidence from the Lakes District Health Board and received advice from the Office of the Auditor-General.

Committee members
Dr Paul Hutchison (Chairperson)
Shane Ardern
Paul Foster-Bell
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Moana Mackey
Scott Simpson
Barbara Stewart
Dr Jian Yang

Evidence and advice received
Lakes District Health Board, Responses to written questions, received 7 and 27 February 2014.
Office of the Auditor-General, Briefing on the Lakes District Health Board, dated 12 February 2014.
Organisation briefing paper, prepared by committee staff, dated 28 January 2014.
# 2012/13 financial review of Landcorp Farming Limited

Report of the Primary Production Committee

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Recommendation

The Primary Production Committee has conducted the financial review of the 2012/13 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 Steve Carden, 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. A joint venture with Shanghai Pengxin took effect when Landcorp took over the farm dairy stock on 1 June 2013.

Financial performance

In 2012/13, Landcorp’s total revenue was $203.117 million, and its total expenditure $179.357 million, resulting in a surplus, after costs, of $12.959 million.

Strategic review

We heard that Landcorp is undergoing an internal strategic review, coinciding with a Treasury-instigated external strategic review. The two reviews are proceeding in tandem, and their reports should be finalised towards the end of April 2014.

Future direction of Landcorp

We asked about the future direction of Landcorp, and especially its conservative stance on debt levels. We were told that Landcorp understands clearly that it is not in the Crown’s interest for the size of its balance sheet to grow, and that it needs to operate within existing capital. Wherever possible a return should be made on capital, and if a need for cash arose, a different approach would be required. The strategic review will seek to determine where the balance should lie.

We asked about the framework of the concurrent reviews and the guidelines for the reviewers. We were told that the two reviews are not significantly different. Their terms of reference do not relate to ownership issues, and are confined to operations and structure. The Treasury review will look at alternative capital structures, but it does not conflict with the internal review, and we understand that any proposal to allow the acquisition of external capital is not under consideration.

Chinese investment

We asked about Landcorp’s relationship with Shanghai Pengxin and heard that it is working well and that the operating results are well ahead of projections. Landcorp is continually monitoring the progress of agreed capital expenditure, and progress is reported...
regularly to the Overseas Investment Office. The next major item of expenditure will be
the launch of a dairy academy. Its exact nature is still being decided.

We were told that there are no contractual obligations on either party for further
expansion, but any opportunities for expansion would be carefully investigated.

The meat industry

We asked for information on the use of taxpayer-funded Primary Growth Partnership
money on plans to improve returns in the meat industry, and for Landcorp’s view on Meat
Industry Excellence’s proposed changes in the meat sector. We heard that Landcorp has
received no money directly, but that FarmIQ, owned by Silver Fern Farms and Landcorp
and established to create a demand-driven integrated value chain for New Zealand red
meat, is the main driver of the reform process. An “on-farm management system” has
been designed to help benchmark reporting, and will aid in the capture of information
further down the supply chain. The system has taken several years to produce and is now
in use by about 130 farms. Landcorp will commence operating the system in May 2014. No
calculations have been made to determine the value to Landcorp that this system will add,
but it is expected to help Landcorp manage its portfolio of properties much more
effectively at both farm and corporate level. The value of the new system to Landcorp and
the meat farming industry would be assessed once the system is fully implemented.

Many farmers have expressed the view that the structure of the meat industry needs to be
reformed. We heard that Landcorp supported changes to help rationalise overcapacity,
which is a huge cost to the industry, and to improve the industry’s performance in other
areas. Landcorp suggested it can exert an influence by improving its own productivity and
marketing, and helping other red meat farmers do likewise.

FarmIQ and technology transfer

A big challenge in pastoral farming is effective technology and knowledge transfer. We
asked if Landcorp, and specifically FarmIQ, might take a lead in the dissemination of
knowledge. We heard that Landcorp is placing a new emphasis on farm management
groups, and increasing its supervision role. Landcorp will also invite farmers to visit
Landcorp farms and observe how the new farm management system is being used.

We asked if this transfer of knowledge and intellectual property had a value. We heard that
Landcorp’s accumulated IP and farming expertise is regarded as the most valuable
component of the organisation. This value is being utilised increasingly as Landcorp seeks
partners who can contribute capital and land. However, Landcorp is uncertain how to deal
with requests from the farming community for information derived from its expertise and
farming systems, which have been developed at a cost.

The current review will consider whether to commercialise its corporate IP to help the
wider farming industry, and if so how. Landcorp is aware of the conflicting pressures, but
has not yet been able to decide on a response. Shareholders’ interests also need to be taken
into account. We expressed concern at this uncertainty, and strongly urged Landcorp to
find a way to determine what can be disseminated, and how it can be done so as to benefit
both Landcorp and the wider interests of New Zealand farming.

Employment

With some ten percent of Landcorp farm workers, particularly on dairy farms, classed as
migrants (that is, on work permits), we expressed concern that while Landcorp was
improving its recruitment and retention of New Zealand staff, many farms were unable to compete without using migrant labour. We asked whether Landcorp had any lessons for other farms in recruiting New Zealand staff. We heard that while attracting and retaining dairy staff is still a major problem for Landcorp, the company has improved its reputation as an employer in the regions and is seeing improvement in recruitment. The company offers programmes to young staff members that could accelerate their progress towards management positions. Engagement with students at Telford Rural Polytechnic was an important recruitment tool, with the brightest students offered insights into careers in the primary production sector. This process often resulted in offers of employment. Landcorp recognised that, while it operates on a sound commercial basis, it has an advantage over other commercial operations because of its scale, and access to public money.

**Forestry operations**

We asked whether the Landcorp forestry operations were carbon neutral, and whether it planned to increase the amount of forest held. We were told that the exact figures regarding carbon exchange were not available, but a mixture of New Zealand units and overseas units were used as carbon offsets. About 14 percent of Landcorp’s land area is under forestry covenant, and it is striving to increase this figure with an aggressive programme with the QEII Trust. Half of the planned 11,000-hectare increase in plantation forestry has been completed, using marginal land for expansion. The committee intends to monitor progress on this as they are behind with their stated aspirations.

**Organic farming**

We asked about Landcorp’s views on trialling different farming models, including organic methods. Although we were told that Landcorp’s size and scale of operations allowed it to experiment it has decided at this point not to become involved in organic farming.

**The St James Conservation Area**

We asked if Landcorp had been in discussions about managing the St James Conservation Area in the same way as the successful Molesworth Station. Landcorp said it had looked carefully at options, but found that too many limitations were imposed on the area for farming purposes, and it could not take it on as a commercial venture. An alternative might be for Landcorp to make a charge for managing the property.
Appendix

Approach to this financial review
We met on 13 February 2014 and 6 March 2014 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
Landcorp Farming Limited, Response to questions, received 21 February 2014.
Organisation briefing paper, prepared by committee staff, dated 24 October 2014.
# 2012/13 financial review of the Law Commission

Report of the Justice and Electoral Committee

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Recommendation

The Justice and Electoral Committee has conducted the financial review of the 2012/13 performance and current operations of the Law Commission, and recommends that the House take note of its report.

Introduction

The Law Commission is an independent Crown entity, established to review, reform, and develop the law of New Zealand. The commission is funded through Vote Justice. It provides advice on law reform, reviews the quality of legislation and advises the Legislative Advisory Committee and the Legislative Design Committee, and helps government departments to implement its recommendations.

Financial and service performance management

In 2012/13, the total revenue of the commission was $4.101 million, and its total expenditure was $4.256 million, resulting in a deficit of $154,000 (in 2011/12 the commission reported a small surplus of $64,000). The commission is working towards achieving a balanced budget by June 2016.

The Office of the Auditor-General gave the commission a “needs improvement” rating for its service performance information and associated systems and controls. The Auditor-General considers that the commission needs better measures, indicators, and targets to help it report on its performance in improving the quality, relevance, and effectiveness of New Zealand law.

Staffing

We asked about the commission’s capacity, and heard that the commission is being asked to do more with less; budget constraints have meant the number of commissioners has been reduced from five to three-and-a-half, and over five years the number of legal and policy advisors has decreased from 24 to 15. The commission told us that its position is unique in the public sector, and its staff resources have a strong bearing on what it can do.

We asked about the use of contractors, and heard that occasionally the commission engages outside expertise. For example Emeritus Professor John Burrows was contracted to supervise the completion of the commission’s report The News Media Meets ‘New Media’: Rights, Responsibilities and Regulation in the Digital Age. We heard that at present the nature of the issues the commission is exploring require extensive cooperation and consultation.

Advocacy and promotion

We wanted to know whether the commission has a role of promoting its own work on Parliament’s legislative agenda. We heard that while the commission’s president considers the organisation could do more to make its work better known, the independent Crown entity’s focus is on producing reports, and the president would be concerned if the commission were seen to have an advocacy or lobbying role. The commission operates
independently as an advisory body, and the president told us he is happy to discuss the commission’s work with Members of Parliament.

**Acceptance of recommendations**

The commission considers that the ultimate test of its work is whether Parliament adopts legislative changes on the basis of its reports. We heard that between 75 and 80 percent of the recommendations in the commission’s reports are accepted, which is among the highest rates of the 64 law reform agencies in the Commonwealth countries. We asked what a reasonable acceptance rate would be, and heard that the commission would be concerned if the rate fell below 50 percent, but also if it were much higher than it is at present, as this could mean Parliament was not being sufficiently rigorous. The president said that the commission wants to achieve change, and he admitted that some disappointment, when the commission’s recommendations are not accepted, comes with the job.

**Parliamentary time**

We were interested to hear that the Law Commission considers the biggest constraint on its work to be the availability of parliamentary time to advance legislation. The president gave as an example the Inquiries Bill; the commission completed its report on public inquiries in 2008 (which included a draft bill), the Inquiries Bill was introduced to the House in September 2008, the Government Administration Committee reported to the House on the bill in November 2009, and after sitting on the Order Paper for nearly four more years the Inquiries Act was finally given the Royal assent on 26 August 2013. The commission considers drawn-out timeframes to be inefficient, as work gets out-of-date and has to be revisited.

The commission accepts that the planning of parliamentary time is something over which it has no control. It observed that, although New Zealand’s timeliness compares well with other Commonwealth countries, some important legislation in this country is not progressing as fast as it would like.
Appendix

Approach to this financial review

We met on 6 March and 26 March 2014 to consider the financial review of the Law Commission. We heard evidence from the Law Commission and received advice from the Office of the Auditor-General.

Committee members
Scott Simpson (Chairperson)
Paul Foster-Bell
Joanne Hayes
Raymond Huo
Alfred Ngaro
Denis O’Rourke
Hon Maryan Street
Holly Walker
Hon Kate Wilkinson

Evidence and advice received
Organisation briefing paper, prepared by committee staff, dated 10 February 2014.
Law Commission responses to committee questions, dated 7 March and 21 March 2014.
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Meridian Energy Limited and Petition 2011/45 of Eric Roy

Recommendation
The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of Meridian Energy Limited, and considered Petition 2011/45 of Eric Roy. The committee recommends that the House take note of its report.

Introduction
For the 2012/13 financial year Meridian Energy Limited was a state enterprise. After a 49-percent public stake in the company was floated on the New Zealand Exchange on 29 October 2013, it became a mixed-ownership company under the Public Finance Act 1989. The Crown is Meridian's major shareholder. On 4 December 2013 a government notice of motion was lodged to declare Meridian Energy a public organisation for the purposes of the Standing Orders.

Meridian Energy is an energy developer, generator, and retailer. It generates energy entirely from renewable resources and supplies approximately 30 percent of New Zealand’s electricity. Meridian operates seven hydro stations and five wind farms. It retails power through the Meridian and Powershop brands to approximately 272,000 customers. The chief executive of Meridian Energy is Mark Binns; Chris Moller is chairperson of the board.

Financial and service performance
In the 2012/13 financial year, Meridian generated total revenue of $2.71 billion, and reported a net profit after tax of $295.1 million. Profit was up $220.5 million on the previous year, mainly because of the sale of the Macarthur Wind Farm in Australia and better hydro in-flow following record low rainfall in 2011/12. The Office of the Auditor-General rates Meridian’s management control environment, and financial information systems and controls as “very good”.

Tīwai Point agreement
We asked Meridian about their negotiations with Rio Tinto to continue the electricity contract. The aluminium smelter at Tīwai Point uses approximately 40 percent of Meridian’s electricity generation; Rio Tinto is the majority shareholder of Pacific Aluminium which owns the smelter. Meridian told us that an agreement with Rio Tinto was reached after 13 months of commercial negotiations. This agreement sets out an electricity price discount for Pacific Aluminium from the rate negotiated in 2007. Meridian retains the right to adjust the electricity price to reflect inflation; price increases are also possible if the global price of aluminium increases or the New Zealand dollar falls against the US dollar. The agreement also allows Pacific Aluminium to give Meridian notice to reduce their electricity usage to no less than 400MW and to exit the contract from January 2017.

We asked to what extent Government intervention influenced Meridian’s negotiations. Meridian said although they were aware Rio Tinto had approached the Government during
the negotiation process, the Government had responded by encouraging Rio Tinto to negotiate commercial terms with Meridian. Mr Binns told us that it was only after Meridian had reached a final agreement with Rio Tinto that the Government agreed to a one-off payment of $30 million for continuation of the contract; Meridian was not consulted about the amount. Meridian considers that Rio Tinto approaching the Government after completing the commercial negotiation was inevitable in the light of international experience.

We asked whether Meridian’s negotiating capability had been hampered by the impending share float. Meridian said that it would be viable without the aluminium power contract, and its public listing did not factor into negotiations. It refused to speculate as to whether the Government payout would impede future negotiations with Rio Tinto.

**Labour Party minority view**

Labour members noted that the agreement the Government concluded with Rio Tinto included not only a $30 million payment, but also a reduction in the price of electricity purchased by Rio Tinto, and a halving of the notice period to terminate the contract. It was further noted that despite claims by the Government that jobs would be preserved at the aluminium smelter, the Minister of Finance who led the negotiations did not receive any guarantee to preserve jobs, and further he has admitted publicly that he did not ask Rio Tinto for a jobs guarantee.

**Petition 2011/45 of Eric Roy**

The petition from Eric Roy requests

> That the House encourage the Government to see Meridian and Rio Tinto renegotiate a viable power supply contract to save Tīwai Point aluminium smelter, and note that 3,110 people have signed postcards supporting this request.

We considered this petition alongside the 2012/13 financial review of Meridian Energy Limited. We have no other matters to bring to the attention of the House relating to this petition.

**Transparency**

We asked Meridian for comment on the Prime Minister’s statement that mixed-ownership companies would become more transparent as a result of being subject to the NZX’s continuous disclosure regime. Meridian said it considers that its disclosure about operations has remained consistent with previous years. However, they conceded that, while transparency remains of utmost importance, they are mindful of the effect of announcements on the share price. Mr Moller said he hoped the company would be able to demonstrate more transparency over time, within the bounds of commercial sensitivity.

**Responses to written questions**

We asked Meridian why a number of our written questions went unanswered. Meridian argued that the questions were answered to the same level of detail as those in 2011/12, and answers were constrained only by the amount of time and work required to gather the information. Labour members were concerned that Meridian did not fully answer 25 written questions relating to communications, and a host of other matters pertinent to the financial review, and asked whether its management considered the information requested to be commercially sensitive. Its chairperson assured us that no NZX rules impeded their answering the written questions; we were told Meridian would provide us with the
requested information, and give full responses to questions in future. We will continue to monitor this area with interest.

Investment in renewable generation

Meridian currently owns seven hydro stations; we asked if there were further opportunities for investment in hydro generation in New Zealand. We heard that any remaining hydro opportunities were limited and no large investment was expected in the medium term. Meridian said that hydro involves high start-up costs and gaining consent often takes many years. As most hydro opportunities are in the South Island, wind farms are more attractive alternatives, as they can be placed in strategic locations around New Zealand and require less capital investment.

Wind farm updates

We heard the Mill Creek Wind Farm project is currently on budget and on time; its completion is planned for early 2015, with initial generation in May 2014. We asked about Meridian’s sale of the Macarthur Wind Farm in Australia, a joint venture with Australian Gas Light. Upon its completion in January 2013, Meridian decided to sell the farm because of the limited risk involved in a sale and prevailing low interest rates. It resulted in a pre-tax profit of $101.4 million.

Solar energy

Meridian is not developing solar energy opportunities at present, and is in the process of selling its solar farm in California. It considers that wind generation is more viable from a financial viewpoint. We asked about potential long-term savings per household from using solar panels. Taking into account the capital cost, and the solar technology currently available in New Zealand, Meridian does not believe that consumers would benefit financially from installing solar panels. However, advances in battery technology overseas, allowing solar energy to be stored for later use, may make this a viable option in future.

Energy-buying agency—New Zealand Power

We asked Meridian if the policy of a single wholesale energy-buying agency would affect investment in renewable generation. Mr Binns said the policy proposal was difficult to analyse at this stage as the details of New Zealand Power remained unknown. However, he thought the presence of a central buyer might make investment in renewable energy less attractive. Generation from fossil fuel, such as coal, can be developed quickly and at a lower cost than generation from renewable energy sources.

Initial public offering

Meridian’s listing on the NZX in 2013 was a major undertaking; it considers the initial public offering very successful, and it had been achieved with minimal disruption to normal operations. National members congratulated Meridian on their result. We asked whether the announcement of the single central electricity-buyer policy had affected the share price. Its chief executive said he was not an investment expert; but some investment analysts had commented that the proposal had created “uncertainty” in the market. Meridian also refused to speculate on whether it would have been inappropriate for political parties to announce the policy proposal after the share float.

We asked whether Meridian’s new status as a mixed-model ownership company had caused shareholders’ interests to be prioritised over those of consumers. Meridian asserted that the
balance had not changed; consumers’ expectations of good service, reliability, and competitive pricing had to be met in order to make profits for shareholders.

**Labour Party minority view**

We noted that Meridian was very comfortable in hypothesising about opposition parties’ power policies, even though they admitted they had not conducted any analysis of the policies.

**Retail electricity pricing**

We noted a significant increase in Meridian’s reported profit and asked whether it would result in discounts for consumers. Meridian explained that although the profit increases looked large, they were coming off a low-profit base because of record-low rainfall in 2011/12. It also has to factor in capital costs and risks when calculating retail electricity prices. We heard that Meridian has not increased the energy component of consumer power bills since December 2012; up to 40 percent of power bills are composed of transmission and network charges, which are out of retailers’ control. Meridian will continue to pass on any increases (or decreases) in transmission charges to consumers, but does not expect the energy component to increase for at least 18 months because of low demand.
Appendix A

Approach to this financial review
We met on 13 February and 13 March 2014 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
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Evidence and advice received
Meridian Energy Limited, Responses to written questions, received 30 January and 10 March 2014.

Meridian Energy Limited, slideshow presentation, received 13 February 2014.


Organisation briefing paper, prepared by committee staff, dated 8 January 2014.
Appendix B

Corrected transcript of hearing of evidence 13 February 2014

Members
Jonathan Young
Kanwaljit Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Gareth Hughes
Mark Mitchell
Hon Chris Tremain
Jian Yang

Witnesses
Chris Moller, chair of Meridian Energy board
Mark Binns, chief executive of Meridian Energy

Young Welcome, Mr Moller and Mr Binns. Good to see you again. Sorry that we just needed to take a 5-minute break, and thanks for your patience. I wonder if you could just introduce any of your team that are with us, apart from yourself, of course.

Cosgrove Contractors, spin doctors, anybody else.

Young Don’t listen to him.

Moller Perhaps you could do that, Mark.

Binns Yes, we have Jason Stein, our company secretary; Paul Chambers, our CFO. We have Guy Waipara, our external relations manager. We have Claire Shaw, communications; we have Tess Bridgman, our regulatory manager; and Michelle, also in communications.

Young Great. Thanks very much indeed. Well, you’ve got a PowerPoint to take us through, so if we could just allocate about 10 minutes to you, that would be great. Thank you.

Moller Thank you, Mr Chairman. I’ll make an opening statement and then we can talk to the PowerPoint if necessary. Thank you, Mr Chairman, and good morning, ladies and gentlemen. A lot has happened since we met with you last year. The two biggest things were the reaching of a commercial agreement with the owners of the Tiwai Point aluminium smelter and the company’s IPO. We also posted a strong financial result for the year ended 30 June 2013, and Meridian became the major sponsor of KidsCan as part of our commitment to sustainability and communities.
Generating electricity from 100 percent renewable resources through our seven hydro stations and five wind farms is the cornerstone of our business. It signifies our commitment to being a truly sustainable business, which is something that the company, the board, management, and staff all take great pride in. Supporting communities where our generation assets are located is also a core part of our approach to being a sustainable company. Our community funds programme enables us to work closely with communities and fund dozens of community-led projects and initiatives. In the year to 30 June 2013 we granted over $687,000 to community projects throughout the country.

We also became the principal partner of KidsCan, an initiative that provides food and clothing to children in low-decile schools across the country. The sponsorship is our largest, and we are delighted that this support has enabled KidsCan to bring more than 60 additional schools into its programme.

In terms of financial performance during the 2012-13 year, Meridian’s underlying net profit after tax was 53 percent up on the previous year, at $163 million. This result was significantly influenced by much-improved hydro inflows compared with the record low inflows in our South Island catchments the previous year, and also operational performance enhancements. The $163 million underlying profit was also achieved despite heightened retail competition and continued market disruptions, including 42 days of HVDC outages to support the commissioning of Pole 3. This is a testament to Meridian’s ability to manage operations in challenging circumstances.

In addition the result included a handsome pre-tax profit of $101 million from the sale of the Macarthur Wind Farm in Victoria, Australia, proving the company’s capability to successfully operate overseas as well as in New Zealand. As a result of these factors Meridian’s operating cash flow improved by 29 percent on the prior year and enabled the payment of $156 million in dividends.

However, transmission costs remain a contentious issue for Meridian, as HVDC charges increased 33 percent from the previous year—charges that are only paid by the South Island generators. We will continue to support and consult with the Electricity Authority, which is reassessing the system of charging for transporting electricity across the transmission network.

The last time we met with you the board was pessimistic about the chances of concluding a satisfactory commercial arrangement with the owners of the Tiwai Point aluminium smelter. We are pleased that that pessimism ultimately proved to be incorrect, but it was not without some tortuous negotiations very ably led by Mark Binns, the chief executive, and his team. The agreement was commercially acceptable to Meridian in that it was a better outcome than the alternative options and provided a greater level of certainty for the company.

The biggest piece of work for Meridian last year was its listing on the New Zealand Stock Exchange as part of the Government’s share offer.
programme. The IPO involved months of preparation and was successfully achieved with minimal disruption to the ongoing operational business of the company. Now that we are a listed company we are, of course, subject to the continuous disclosure regime that governs companies whose shares are traded on the NZX. This means we cannot during this meeting divulge market-sensitive information that is not already in the public domain. We would ask the committee to respect that constraint but we will, of course, do our best to answer your questions as comprehensively as we can. Thank you.

Young

Thanks very much indeed, Mr Moller, and I appreciate that it’s been such a very big, big year for Meridian. And congratulations on the results that you’ve been able to furnish to the committee and, of course, to the Government and the new shareholders.

Moller

Thank you.

Young

So, well done.

Moller

I think we’re happy to leave the presentation to lie on the table, and you use it for any questions you might wish—

Young

Sure. Yeah, we could use that as our own resource.

Cosgrove

I’m interested in your last comment—that you’ll endeavour to answer the questions as best you can. Do you share the Prime Minister’s statement when he said of your company and the other mixed-ownership model companies that they will end being better, stronger companies for the rigour and transparency that being listed on the sharemarket brings? Do you share that view?

Moller

I hope that’s going to be true. We’ll have to demonstrate that over time.

Cosgrove

And do you think that now that you’re a listed company, you are more transparent and more accountable with information than you had been when we saw you, say, last year, when you weren’t a listed company?

Moller

No, I’m sure Mr Binns would say that we don’t feel that way. We’ve always tried to run ourselves as a publicly listed company. But every day I receive an email from the NZX, twice, that tells me the share price, and that focuses, certainly, my mind, and results in a number of emails to Mr Binns on a regular basis, particularly when the share price goes down.

Cosgrove

So do you feel you’ve been as upfront as you can be with this committee in answering its written questions?

Moller

Yes. I reviewed those questions. They were given to me, and my immediate question of management, one of the management who’s here today, was is this because we’re a listed company that some of the questions aren’t answered as fully as I might have expected? And the answer came back very strongly, no, it is very similar in content to what we have provided you in previous years. The biggest constraint around the questions is the amount of manual work that would need to go into assembling the data to answer many of the questions. So I absolutely assure you, based on the assurances I
have from management, that it is not because we are now a publicly listed company.

Cosgrove  So you’re not constrained because of stock exchange rules? OK.

Moller  Not for answering those questions, because none of them were market sensitive.

Cosgrove  Excellent. Well, could I point you to a couple of things. We asked you a question in regard to—and this may seem peripheral to some, but it’s not to others—question 16. We asked you a simple question, and part of that question was in relation to the name of the public relations company that you use. You declined to answer that—fees, I understand, being confidential. You declined to answer, to even give us the name of the public relations entity that you use. Why is that?

Binns  I can’t answer that.

Cosgrove  Why not?

Binns  Because I don’t know. But I can tell you that we deal with most of our public relations issues internally, and most of our PR—

Cosgrove  With respect, Mr Binns, I’m not querying the nature of the work. That’s not my question. If you don’t know the answer, that’s fine.

Young  Sorry, can we just also hear the answer from Mr Binns?

Cosgrove  I’m querying why the company couldn’t be named?

Binns  Can we research that and come back to you?

Cosgrove  Well, could I assist you? You might want to have a look at the website of Business New Zealand, where Tracey Chambers of Chambers PR lists you as a client on here as of 2 days ago. There’s no great conspiracy in this; I have nothing against Ms Chambers nor her firm. I just wonder why, when it took us 2 seconds to find that, you could not provide us with that information. But you’ve said you don’t know. I’d appreciate a written explanation when you do know.

Binns  We can provide you with that. I’m not even aware of what the name of Ms Chambers’ firm is.

Cosgrove  I’m happy to furnish you with the document if that helps.

Moller  That name doesn’t ring a bell to me.

Cosgrove  You might want to take that up with her, because it’s listed here.

Binns  Well, we’ll check it out first.

Young  Can I just come back? So, Mr Binns, you were explaining that you do most of the PR within Meridian.

Cosgrove  With respect, I’m asking the questions. I’m not querying the PR they do; I wanted to know the names. So, with respect, I’d like to move on to the next question. I’ve got an adequate answer. Could I ask you why, in question 13, quote, you say “it is impractical to break down and detail”—and this is question 13 being around public relations and advertising campaigns etc.,
and again I’m talking about detail here—“it is impractical to break down and detail this ‘business as usual’ expenditure, as it is spread across a number of directorates and budgets.” I put it to you that that’s an inadequate answer, given that other SOEs we have heard from and will hear from today have provided that information. They are big SOEs; they are small SOEs. So why can’t you provide that information?

Binns: What would you like, Mr Cosgrove? Would you like to know what the PR budget was spent on, the categories?

Cosgrove: I won’t waste your time, but I’ll point you to the question we asked, which was question 13.

Question 14, if I can move on, again you say—and this is a question that relates again to advertising and expenditure—that it would be impractical to provide details that were requested. You further go on when we ask you were there any PR campaigns; you say there were no PR campaigns. I’d be interested to see what you term the IPO as, but, again, no information. I’ll give you a third example: question 15, which was a question to break down—we asked you, for instance, salary bands of your PR division. You have 10 staff. You say that because they’re too small it would be inappropriate to give that information. Can I tell you that an SOE who was in here just beforehand, who has a smaller PR division than you, provided us that information.

Binns: It’s not a PR division. It’s a communications function, including internal.

Cosgrove: Again, I’m not criticising the function. I’m wondering why you couldn’t answer the question. We also asked you a question—I think it was question 55—where we asked you if you could break down, as we normally do, into salary bands of $10,000. You came back and said that this information is available in the annual report for salaries above $100,000, as required by legislation. Again, we have two SOEs before us today, and I asked Transpower, just before they came in, did they have any difficulty answering these questions? No difficulty at all. And I could go on. So my question is really, given that your chairman, thankfully, has said that—because we did ask the audit office for advice—that you aren’t constrained by stock exchange rules, why is it that this entity can’t provide us with detailed answers to basic questions when others can?

Moller: I just reiterate my comment. I asked management whether or not this was consistent with previous years, and it is consistent, as I understand it. I have not gone back and checked, but we take the message on board, and we’ll appear before you next year. We’ll have a discussion in-house about these matters, and we’ll come back to you with the information you’ve covered in terms of those questions.

Cosgrove: With respect, Mr Chairman, that’s not good enough, coming back to us next year. I’m formally requesting that you actually answer those questions as they were submitted to you, given that you’ve told us you have no external constraints.
Moller  
No, Mr Chairman, that was the second part of what I said: that we will come back to you and answer the questions that you’ve raised. That was on the general point of being more fulsome about answering these questions. You have raised some specifics, which we would look at and revert to you as soon as we can.

Mitchell  
I just wanted to point, actually—looking at these, there has been some detail provided, and there have been some answers made, maybe not to the satisfaction of my colleague. There are 144 questions. I’m just interested to know whereabouts in terms of the priority for the CEO would be a question around a PR company?

Binns  
Look, I understand that Mr Cosgrove might have a different take on PR and have a different reason for asking the question, but from our point of view, as I said, we handle just about all PR inside the company. I mean, yes, obviously, associated with the advertising of the IPO there were costs, but those costs have been fully disclosed. From my perspective it is an issue of de minimis, but I accept that for Mr Cosgrove it might be important, and if we can expand on the answer, give him some detail, give the committee some detail, we will do so.

Cosgrove  
Can I make very clear that I haven’t at any stage criticised the public relations communication function. So don’t reinterpret what I say. If other members aren’t interested in that, that’s their problem. What I’m concerned about—and I’ve given you a range of questions, not just about public relations—is that we asked some specific questions, we’ve asked them of other entities with smaller units than yourself, and they’ve been able to come up with it. They haven’t worked to rule and you have. You’re a large organisation. Yes, we do ask a lot of detailed questions, which I acknowledge, Mr Moller, take a lot of time. But other entities have been able to answer those. Now, we were told that we were going to get a greater degree of transparency—this was the new world order—when you guys were listed. We’ve been told there’s no constraint in the stock exchange rules, so that’s the point I’m making. So please don’t define it as some sort of criticism of communications.

Tremain  
I’d like to change the line of inquiry here, and look more to the future of the business. You’ve got seven hydro power stations now and five wind farms—looking to grow the wind farms. What’s the future of hydro? Are there opportunities in New Zealand around hydro, or do you think that’s been limited?

Binns  
There are opportunities around hydro, but our view is that they are limited. The costs of building hydro are very, very high. They always, as they involve water, involve complex consenting issues, and in the current environment we would think it would be highly unlikely that a major hydro will go ahead inside the medium term. That being said, we do have Gate 18 in the South Island, a potential small hydro opportunity, but the difficulties were probably reflected in the fact that we walked away from the North Bank Tunnel opportunity in Waitaki, because it was probably too far out and too expensive. So we would see the future for us more being around wind,
where we can make smaller capital investments in locations that are, from a network position, more advantageous than being in the South Island.

Tremain I’m interested in pursuing that wind farm growth. You’ve said that that’s where you see the future. Wind, from my experience, at a marginal pricing level comes in at the top end of marginal pricing. I’m really interested in your comments on policies that have been put into the market in terms of changing the electricity market price round, there’s one, the single electricity market that’s on the table. What do you think that market, or if there was a change to that market, would have on the likes of wind farms that have a high marginal price?

Binns Wind farms are at a high marginal price, but so is also the geothermal options that are probably next off the order of merit. So, sort of by definition, when you’re moving up the price curve—

Geothermal and then wind.

— and wind is up there, but we think there are wind options that are priced very competitively with geothermal. The demand situation is such that it’s probably some time away before they will be needed.

Your question around NZ Power—I don’t want to get into the political aspects of that. I mean, the detail—Labour and the Greens have not provided us any detail since the initial announcement as to how it might work, but our view is that it could potentially impact on renewables, because it could make thermals—particularly gas plants, which are easier to consent and easier to put in place quickly—more viable in that environment. The problem is that if we have a central buyer, you don’t know—I mean, if you have a central buyer, the Crown then has responsibility for delivering the next wind farm or other power plant that is required, and wind farms take between 5 and 10 years to consent, so the question we have is why would we keep investing in developing the renewable options given the uncertainty around a central buyer.

Tremain I think you made the comment that this is political, and I don’t think this actually is. It’s a proposal that’s in the market place that could potentially be a market within which you, as a key generator of energy, have to work within. So what you’re saying to me, and I just want to be clear about this, is that the single electricity market model could have a significant impact on both geothermal and wind energy from a sustainability point of view for this country.

Binns That’s our view. I re-emphasise the “could” because we don’t know exactly how the proposals are going to come forward from Labour and the Greens.

Hughes Thanks for the presentation. Is that realistic, given there’s 3,500 megawatts of consented renewables already consented? What you’re saying is that we’re likely to see more fossil fuel generation, despite having all these consented renewables on the books.

Binns Well, you’ve got to remember that that 3,000—sorry, 300 megawatts, was it?
Hughes  No, it was 3,500.

Binns  Three thousand, five hundred megawatts—I don’t know how much of that is still around. Remember that we have already walked away from a number of opportunities. What I’m talking about is the longer term—which I think you have to look at—if we see a significant change in the energy market. And it will just raise for us an issue around what investment we are prepared to make, given they are such long lead times, to get renewable projects up and running.

Cosgrove  In regard to your comments about the Opposition’s proposals—and based on the information you have received, if it is in the public domain—have you done any analysis or modelling?

Binns  It’s very difficult for us to do a lot of analysis or modelling when we don’t know the detail of how it will work.

Cosgrove  So your comments are based on what?

Binns  Our comment is based on the relative attractiveness of a thermal plant in the future, or renewables, because the reality is that it’s far easier for somebody like Todd Energy to basically get a piece of land with the gas to the front door and strap a jet engine to a lump of concrete and generate electricity, which could be put in place in a relatively short period of time, as opposed to—it takes us, who might be very inefficient at getting them, but it takes us between 5 and 10 years to complete consenting landowner arrangements in terms of wind farms. So you basically have alternatives that are far easier to put in place than we do in the renewable sphere.

Yang  Yes, the wind farm, the Mill Creek is on a budget of $169 million. Does that include land, the purchase of land—or you not own land?

Binns  We don’t own land.

Yang  OK. Is it still within budget, for the farm?

Binns  Yes. We are marginally under budget at the moment.

Yang  OK, so what time is it going to finish?

Binns  First power will be in May, and completion date is early 2015.

Tremain  Thanks for those answers around renewable energy, because I know that’s certainly a big future for this country. I think we are about 78 percent renewable at the moment and we’ve got (inaudible) lift that goal. So it seems to me that (inaudible) doing everything possible to grow renewable energy.

I just want to come back to the IPO, which has obviously created a lot of market noise some months ago, and also come back to the announcements that were made in the market around that point in time, in terms of the impact of those announcements on share prices. One of the announcements that was made was again from political parties, around the single electricity market. Do you believe that that announcement had a material impact on the share price in the market?
Binns: Well, all I would say is that neither the chairman nor I are investment experts, so—

Tremain: I’m not asking you as investors, I’m asking you: did that announcement have an impact on your share price?

Binns: Whether it did or it didn’t—we don’t know. But all I can say is that the commentary from market analysts has been that the uncertainty that has been created by the Labour-Greens proposals has been a drag on the share price.

Tremain: So what percentage did that reduce the share price, do you believe?

Binns: Impossible to tell—I wouldn’t even guess.

Cosgrove: Well, since we are in the area of sort of speculation do you believe that it would have been appropriate for a political party to announce policy after the shares had floated, therefore doing over shares—well, you’re prepared to speculate about certain propositions that are put to you, even though you are not an investment analyst. Do you think that would have been appropriate, or would it have been slightly underhanded to shareholders?

Moller? No, I don’t think we did speculate. We just answered—

Cosgrove: I’m asking a question. Do you think that would be—

Moller: I will answer the question, Mr Cosgrove, in a moment, if I may. We answered the question of Mr Tremain by saying that from what we were told by investment analysts and, I’d add, institutions around the world, it created uncertainty. As to whether or not it should have been done at that point in time is not a matter for us to judge.

Cosgrove: No, no. I’m not asking for a judgment on timing. Would it have been underhanded and detrimental to shareholders had an announcement been made after the float than before the float, when potential shareholders can make an informed judgment?

Moller: I don’t think it’s appropriate for us to make a comment on that, either before or after.

Young: Yes, thank you—you’re probably right on that one. Can I ask a question—coming to your Australian strategy, you have mentioned that you’ve sold one of the—

Binns: Macarthur.

Young: Yes, that’s right—over in Australia. What was the reason behind that?

Moller: I was just going to say: a profit.

Young: Profit—that’s not a bad reason.

Moller: I like profits, particularly when they are Australian profits.

Cosgrove: Thank God you’re not a supermarket.

Binns: No, we’re not a supermarket. We just—

Young: Mount Millar, was it?
Binns  Macarthur. Millar’s our other investment in Australia—our current one—and we’re building one more. Look, we did that project in joint venture with AGL, and AGL had entered into a power purchase agreement. So, effectively, we have completed the project. We had to review it. All the risks had been taken out of it. We could have sat there for 20 or 25 years of the PPA, and got a bomb-like return, or we could capitalise on a development profit. As all the members know, interest rates are very low both in New Zealand and Australia, so discounts were low, and we thought we should test the market. We got very good prices, and we thought it was in the best interests of the company to realise that and get around about half a billion dollars back, including, as my chairman said, a very handsome profit.

Young  Great. OK, thanks very much. That’s a very good reason. In regard to the solar energy farm in Tonga that you’ve been involved in, can you give us a little bit of background behind that, and where things are at at the moment with that?

Binns  Well that was completed nearly 18 months to 2 years ago. It was done in conjunction with the New Zealand Government aid to Tonga and Tonga Power. It was a very successful project from both our perspective and Tonga Power’s perspective. While we have maintenance obligations, that is the extent of our obligations there at the moment and all the communication we have from Tonga Power is that the investment has been very successful because it obviates the need, obviously, to burn diesel in that country.

Young  Right. Thanks very much.

Hughes  My question relates to your net after-tax profit, which is $290 million, up $220 million. Obviously $120 million of that was the wind farm sale. Do you think that’s justified, and what do you tell your customers who are struggling with power bills, and who have seen power bills rise 3 percent in the last year, despite demand across the country falling about 2 percent?

Binns  I’ll make two points to that. First of all, it comes off an exceptionally low base in the year before, because we had a drought—the worst inflows in our catchments in 83 years of records. So you’re coming off a very, very low base. The issue around pricing for customers is determined by the market, and our positioning in the market, which we’ve currently looked at is, in most networks, in the lower half of the pricing range, and—just to pre-empt a probable question—we have not put our power prices up since December 2012. So in real terms our, when I say power prices, the energy component has not been increased since December 2012. We did that in 6 out of 29 networks.

So, as I reiterate, the energy component in real terms has gone backwards. What everybody fails to realise is that 40 percent of most people’s bills are composed of transmission and network charges, which have continued to rise, because people like Transpower, who you’ve recently just seen, have had to reinvest in the network, and under the current arrangements that is recovered from consumers eventually. So our view is that it is unlikely that the energy component of power is going to increase over the next year to
18 months, but we will be passing on any increases in transmission in network charges—or decreases. I would point out that when Vector decreased their network charges last year, we were, I think, the only major retailer that actually passed that through to consumers.

Hughes So can you explain to the committee where this approximately $100 million plus of operating revenue has come from, given your transmission charges have increased 33 percent from the HVDC? The IPO and related costs are up 8 percent. So a lot of operational costs increases—where has all the operating revenue come from?

Moller Water.

Binns I mean, you’ve got to remember that we have generation of X number of gigawatt/hours, and in terms of risk management, we need to cover that. So we’ve 40 percent of that load covered by Rio Tinto, and of course we’ve had a change in the Rio Tinto arrangements, and the balance is through residential and commercial customers, and we have a balance, because we don’t cover, right up to our total amount of generation we believe we will deliver. So then if we have excess water, like we have had recently, it allows us to sell more into the wholesale market.

Hughes I just like the one word “water” answer. Would you call it money for jam? You know, it costs around 1 cent per kilowatt/hour to produce, yet you’re selling it at a much larger rate, because of the average long-run marginal pricing.

Binns Yeah, but you’re looking at the short-run marginal cost and not the capital cost of putting it in place—the major infrastructure like dams. I mean, as I said before, one of the reasons that we—

Young Supplementary?

Cosgrove Sorry, had you finished your answer? I don’t know if you had.

Young Yeah, I think so.

Binns I’m waiting for the chairman.

Young The previous year—2011-2012—was the driest year in the last 81 years, I understand.

Binns That’s right.

Moller Correct.

Young So that’s where your water flow through the dams was constrained considerably.

Binns Exactly.

Young So seeing an increase in this last period of time is comparative to quite a dry year.

Binns This business is all around managing risk, and in that previous year—That’s all retail prices are about. I mean, retail prices are about giving customers some insurance, if you like, that they’re paying X. Our costs go up and down like a yo-yo and in that period where we didn’t have sufficient water
to cover our obligations in the retail market, we had to take cover, which came at a high cost, so our profit position was down. Mr Hughes is pointing out that we had a significant increase in profit. Yes, that is right, but it is off a low base, because we had a better hydrology situation in the following year.

Young Right, so, yeah, the previous year obviously your costs were there but your income levels coming in were a lot lower.

Faafoi Slightly related to the balance you try to make between the customer and whatever (inaudible) manage as well. Since the share float, who has become more important to you: the customer or the shareholder?

Binns Well, I mean, since the share float—that’s, I think, an artificial way to look at it. I mean, since the share float, I’d say neither. I would say it has not changed. To make money for the shareholder, you need to satisfy the customer, so you’ve got to give the customer obviously a price and a service that he perceives as being good value in the market place relative to your competitors. Our focus is ensuring that we get better at that.

Faafoi But you also have a balance of either ratcheting up the prices for the consumer or (inaudible) dividend for the shareholder? Who wins in that tension?

Binns If you want to talk about since the IPO, as I said, we haven’t increased our energy prices since December 2012, and that was in 6 of the 29 networks. So we have not increased prices since the IPO. We’ve been very limited in our ability to increase prices because, as everybody knows, we’re in a position where aggregate demand is relatively low and we have excess supply.

Young Sorry, just a supplementary on that—Powershop, your retail arm, continues to do very well in the annual energy excellence awards and I believe is increasing the number of people subscribing to Powershop. So can you give us a little bit of background in terms of its success just in a word or two?

Binns Sure. Well, Powershop is all about trying to provide transparency to customers in terms of power price, so they basically are working it on the technology platforms that deliver better and better information to customers. I mean, you can have an app on your iPhone—which I have; I’m a Powershop customer—which allows me to monitor my daily usage and compare month on month, month versus last year, and it provides information which is just a number of cents per kilowatt/hour, which enables very easy comparison. That’s what’s been driving, basically, the business model and its success, and it’s a model that is very unique, particularly unique in Australia, where, believe it or not, retailers are criticised often by consumer groups in terms of legal transparency and information they provide. We believe we have something that is of potential value and we have started rolling out the Powershop model in Victoria.

Tremain I’m slightly confused with some other information that’s been given to us in one of the briefings, where it talks about customer connections, which fell by 15,000 over the 2011-2012 year, and that being due to Mighty River
Binns: Power’s power prepay system and Energy Direct. Just to confirm that that’s correct?

Binns: Yes, well, Energy Direct had 15,000 customers. They were the electricity and gas retailer in Wanganui area, and we supplied them and they decided that they were going to go elsewhere, and so we lost those 15,000 customers.

Tremain: Oh, so that was a one-off transfer—

Binns: A one-off drop. The ICP numbers will be out in the next few days, and over the last little while we’ve been doing reasonably well and marginally increased our numbers, but it is very, very competitive, and I think our churn rate over the last 6 months was still around about 19 percent, which is less than the industry average, but still high.

Faafoi: Can I return to my earlier question? I acknowledge the IPO is recent, and that you may not have changed your pricing, but since the IPO you’ve gone from 100 percent State-owned, where you may have had some social responsibility to keep the prices at a decent level now to where you’re a mixed model. Does that change the way you’ll behave and the long-term attitude and tension between consumer and shareholder?

Binns: No, I don’t think it has. Since I’ve been on board, which is 2 years, my chairman has been very clear in terms of our obligations under the State-Owned Enterprises Act, which is to provide a very efficient and profitable business, which are our obligations under the Act. So I mean in my tenure, the focus has been on trying to achieve that.

Moller: Can I try answering it by saying that the IPO contained, of course, a 2-year forecast, and a key assumption stated in that forecast is no change to the energy component—I keep on stressing that: not the overall price to the consumer, because that’s out of our control, but no change to the energy component in those forecasts.

Yang: Yeah, you talked quite a bit about wind farms but not much on solar energy. So I am just wondering how much you have invested in solar energy and the prospects for solar energy in New Zealand, and also your strategy towards solar energy?

Binns: We’re in the process of selling our solar farm in California. At this stage, we are not developing any more solar opportunities. We have the IP because we have owned the US facility and built the Tonga facility to complete solar, but where the economics stand at the moment, we think wind is still significantly more viable than solar. So we’ve only got X amount of dollars that we can invest in options, and at this stage that’s going into wind.

Moller: So that answers the generation side of it. Our retail arm, however, does involve itself with customers with solar installations for household use.

Hughes: What’s the latest figure for the amount of grid-connected, small-scale solar panels on people’s roofs, and how has that increased in the last year?

Binns: Can’t give you the number. I’ll just ask if any of my people have got that. Have we got that number? No, we can’t answer that number. All I would
say is that we are getting—and this is anecdotal—we continue to get probably three or four inquiries, I think, a day around solar. I believe our solar offering, in terms of feed-in tariffs, is still very market competitive, but I would say I can’t follow the economics that are put forward by proponents of household solar in terms of return as an investment, on our numbers, on our analysis. It is still probably not viable if you went to an accountant.

Hughes

It’s still cheaper than buying it from a retail provider, though, isn’t it, over the lifetime of the solar panel?

Binns

No. The thing that people don’t realise is you invest in a solar facility, you get nothing back at the end of 20 or 25 years. It’s not like investing in a Government bond or a bank bond, where at the end of the period you get your capital back. You don’t with solar; it’s written off. So our view is that the answer is no, it’s not currently economic if you are hard-nosed about it. If you want to have it for reasons of independence, etc., etc., that’s fine, but probably your accountant would say “OK, that’s great, but I’m not signing off on it.”

Tremain

Are there short-term technologies that will see us advance to a position quickly where the capital and operating cost together is a feasible prospect?

Binns

I think the biggest thing that is probably out there, but it’s talked about constantly, is battery technology, and just at what rate that is going to improve. That tends to be the Holy Grail, so that you store your wind energy and your solar energy, which might be at points in the day that aren’t beneficial. You can actually store the energy and use it later. And if you get on the internet and look at some of the articles around battery energy, there appear to be some quite promising advances in places like Germany.

Cosgrove

What’s the impediment—storage capacity, or size, or both?

Binns

I think it is storage capacity, which comes down to size.

Tremain

Isn’t it cost, the capital cost of it at the moment?

Binns

That’s right, which comes down to cost.

Cosgrove

Could I just go back to Tīwai. Would you be able to just outline in some detail for us the exact nature of the company’s involvement in the ultimate deal that was reached with Tīwai. Our understanding was you guys were the initial negotiators, obviously—it’s your deal—and then certain interventions happened. Could you take us through that, because we’ve never really been able to get to the bottom of it.

Binns

OK. I think everybody knows that it took about 13 months to renegotiate this with Rio Tinto. It got to a point where at the time of last year’s select committee, I think the morning before, we had to announce that we thought it would be unlikely we’d get a deal with Rio Tinto, who were very hard-nosed in their negotiations. We finally got to an arrangement, the nature of which is that they got a price discount from the arrangements that had been negotiated in 2007.
But there were certain quid pro quos to that, the first being that we got an inflation-adjuster to the price. So every year we get a CPI increase and we have some leverage to the upside if the aluminium price increases and/or the New Zealand dollar goes down—because the issue is the New Zealand dollar against the US dollar. So if things improve, then we have some upside in the pricing. We have an arrangement where, as at 1 January this year, Rio Tinto could give us notice that they wanted to reduce their usage from 572 megawatts to 400 megawatts, and they have the right under the agreement to give us—don’t hang me on this, because I’m—15 months’ notice that they want to leave in January 2017.

Cosgrove

In 12 months after 2017, is that correct?

Binns

No, no, I think the first date they can actually go.

Cosgrove

Yeah, no, but then it’s a 12-month notice period post-2017. Is that correct, or am I wrong?

Binns

No, I think you’re wrong there. [Interruption] Yep, OK, 12 months. Sorry, 12 months after the notice?

Cosgrove

Indeed.

Binns

Yes. That’s the essential nature of the arrangement. I can say that we have heard nothing from Rio Tinto that would indicate that they are considering downgrading their usage at Tiwai Point, and the relationship is going ahead as it always has.

Cosgrove

At what point did the Government advise you that they’d intervened in the negotiations?

Moller

Can I just say I think it’s important to note that they had one negotiator based in Brisbane. We interfaced with that negotiator, and that negotiator was also discussing matters with the Government. So it was essentially them, as they’ve done in all parts of the world, trying to get the best out of the company concerned and then getting the best out of the Government of the day. So I’ll let Mark—because he’s closer to the whole—

Binns

I know you won’t want to hear this, but the Government were actually very good in pushing Rio Tinto back—because, of course, they go around this quite regularly—and pushing them back to us to say “This is a commercial negotiation. It has to be sorted out with Meridian.” But we knew that at the end of the day, no matter what the deal we did with Rio Tinto, there would probably be an approach to the Government at some point, because no matter what we probably put on the table from a negotiating point of view, they probably thought they should approach the Government as well.

Cosgrove

I accept that. My question was at what point did the Government notify you that they were intervening—because our records show that they made a unilateral decision; they’re the Government. At what stage did they—because you were the lead guys.

Binns

Yes.
They were out of it, or they were in the background. In fact, Mr Ryall was at great pains to say you were the guys in control. I think you made that point at the select committee last year. And then suddenly the Government intervenes, it appears to us unilaterally. At what point did they advise you that they were now actively negotiating?

They advised us when they had the approach from the Brisbane negotiators on behalf of Rio Tinto.

Which was around the time of the select committee last year, and by my memory it was not the day of the approach to the Government or the engagement, but it was around the time of the select committee, which was the Thursday before Easter.

And were you consulted on the $30 million cheque that was written as part of the deal?

No.

You weren’t consulted?

No.

But we were kept in the loop.

We were kept in the loop.

But because of this—and that’s why I pointed out at the start there’s dual negotiation that as soon as they’d talked to us, they’d want to go and talk to either the Treasury officials or to Mr English and Mr Ryall—

You weren’t asked for a view on the deal, on the value of the deal?

No, because we had reached a position that was it, as far we were concerned as a commercial organisation—as far as we could go—and it was up to the Government to make its own decisions with regard to other issues.

As an SOE, what would be your expectations of the Government as your major shareholder? Will they come on board to help you out in such situations? What is your expectation?

You mean in terms of those negotiations?

Yeah, yeah, the Government of the day.

I mean, as I said before, our expectation was that the Government would not intervene directly with the commercial negotiations. As I said, they forced Rio Tinto back to the table with us, because they wouldn’t deal with them indirectly. But, as I said, we were of the view that once we’d finally cut a deal, even if it had been at zero it probably wouldn’t have been enough for Rio Tinto, so they were always going to make a play at the end of the day to the shareholders.

I think, if I can just add, I mean, when we announced that—and we sincerely meant this—the day before we met with you last time, we thought it was unlikely there would be a deal. I’m quite certain that put the pressure back on them to come and negotiate, and I have no doubt that the
assistance of the Government to them, not to Meridian per se, was valuable in the whole exercise. But it was basically kept all separate.

Cosgrove  Do you feel you were in the strongest possible negotiating position to leverage the best possible deal for your entity, and thereby the taxpayer, when the Government had nailed down a strict time frame for your float, thereby, I put to you, giving Rio a nice little time frame to work to turn the screw, because, of course, floating with the difficulty and uncertainty of the deal not being done would have had a detrimental effect on the share price. So do you think that you were in the strongest negotiating position you could be, given you were nailed to a deadline not of your choosing but by the Government?

Binns  I think we were, because our attitude was with Rio Tinto that we couldn’t strike a deal. We were prepared to walk away and they could close. That was made clear to them very early on. They may not have believed first up, but, remember, this went over 13 months so it was a significant period of time. They may have thought they had some leverage, but I think they came to realise that really they didn’t.

Moller  As I said in my opening remarks, I mean, we as a company—irrespective of the IPO—needed certainty. With a major customer of this nature, having absolutely beaten each other up over the intervening period, I mean, it had to come to a conclusion. Either they went or they stayed.

Cosgrove  I suppose that’s my point, because a number of commentators, and to the casual observer, I’d put it to you that you were placed in the worst possible positions because Rio Tinto knew the Government was committed to a time frame for the float—that was public. All they had to do was sit there and hold out to a point where it became—you’re dealing with the commercial relationship. You said: “Hey, we can’t do a deal”. It’s the commercial imperative, we accept that, where Government had to intervene, halve the notice period, reduce the cost, and then throw in $30 million on the guise of a guarantee of job retention, which we know the Minister of Finance never even asked for a guarantee and didn’t get one. So I would have thought you were put in an extremely difficult position to try and get the best possible deal for the taxpayer.

Binns  Well, all I can say is that it most certainly didn’t feature in our thinking in terms of pricing. I mean, we got the best deal that we thought we could get, and we didn’t take a suboptimal deal just to get a deal with them.

Cosgrove  But the $30 million doesn’t come out of the—

Binns  The $30 million is a political decision, not a commercial one.

Cosgrove  That’s my point.

Hughes  You said you were aware there was likely an independent Government negotiating track and possible public taxpayer subsidy. Were you aware, or did you or any of your staff talk to any Ministers or Government officials around an approximate figure? For all we know from the Official Information Act, John Key literally picked up the phone and offered $30 million.
Binns No. I can tell you that, personally, for myself, and I also believe none of my staff would have spoken to any of the officials or politicians about a number. Those negotiations, we were aware that they were going on. They were last minute, after we’d concluded our deal, and the amount was not advised to us.

Moller Just to be clear, after we concluded as far as we were willing to go, and then they had the discussions, and we were kept informed after the event.

Mitchell Can I just clarify a couple of things? I think, Mr Chair, you stated that actually it was Rio Tinto’s negotiator in Brisbane that reached out to the Government in terms of continuing to try to open negotiations with the New Zealand Government?

Moller Yes, that’s absolutely right.

Cosgrove Sorry, how would you know that, given you’ve told us you weren’t advised of the negotiation when the intervention happened? How would you know that?

Moller Put it around another way: we didn’t do it. I assume, given the only other interested party directly involved in the money flows, it must have come from Brisbane. We were informed after the event.

Mitchell The other question I have is—obviously, when the Government is negotiating they have a whole range of factors that they take into account that the chair and CEO don’t take into account in terms of running the energy company. In terms of Meridian as an energy company, I’m sure that you are doing some modelling around—you’d decided that maybe you couldn’t deal, you weren’t going to get across the line. Was Meridian Energy going to continue to be a viable energy company even with the loss of a contract like Rio Tinto?

Moller Absolutely. We would have been a viable operation. But there was a point of when Rio leaving was a better deal for us than Rio staying. And that’s the commercial imperative. We had to look at the point of indifference. And that’s what we did.

Mitchell So you were in a strong position in terms of leverage. You were far stronger than what Rio—

Moller I think, round the world they have managed to use their clout to get some very good subsidies out of the equivalent of us and/or Governments, and I think they came here expecting that the same response would be provided. I think they were quite surprised that they found that Mr Binns was a fairly commercial man, notwithstanding he was working for 100 percent Government owned company, and furthermore they were very surprised the Minister said: “Go back and see Mr Binns and Meridian”.

Cosgrove With respect—and I agree with you with Rio Tinto, having dealt with them myself in a past life—how surprised would they be now that they achieved—I mean, you guys played hard ball, and how surprised would they be now, looking back, when the Government lobbed in 30 million bucks and intervened, because they won in the end. There’s no jobs guarantee,
none was sought, $30 million of taxpayer subsidy went in. I think they achieved—no disrespect to you guys, because you weren’t in control—I think they achieved their goal.

Moller I think that’s a question for the Government, not for us. I mean, we drove a normal commercial deal.

Cosgrove Could I ask you though, do you find it unusual from a Government’s point of view, given the statements that Ministers made as you were negotiating—“This is your deal, hands off, over to you, not intervening.”—that suddenly there’s an inconsistency when the Government does intervene unilaterally? It doesn’t advise you, but it intervenes unilaterally. Whether the reach-out, or the sucker punch, came across the Tasman from Australia—it certainly wasn’t returned in kind—is immaterial. But don’t you think it’s unusual for a shareholder of an SOE to act in this inconsistent way?

? Not around the world.

Cosgrove I’m talking about New Zealand.

Binns No, I don’t think it is at all. I mean, we knew that one way or another, at the end of the day, after we’d done a deal that we thought was the bottom end of what was commercially viable for us, it was basically the tipping point, once we’d achieved that, we knew just from a negotiating position they were going to approach the Government.

Moller Yes, I think that we should make that clear. Right through the whole thing, Pacific Aluminium, the sort of in-substance, subsidiary, made it very clear that once we’d finished with the deal they were going to be talking to the Government.

Binns To be fair, right through the negotiations they were very open in saying “Look, we don’t like this, we’re going to see the Government.” So they were very open about—

Cosgrove So the question is if we go forward and this replays out again—and why wouldn’t it given the halving of notice should they decide to pull the pin—doesn’t that put you even in a worse position? Because at the end of the day the Government’s bent over once, why wouldn’t they bend over again?

Moller That’s a matter for the Government of the day.

Binns We’ve got our bottom line position, and we’ll be sticking to it.

Moller And we’ve got certainty.

Young And well done on that too, and I think we got that sense at last year’s hearing that you guys were standing pretty firm. Congratulations on a really good return that you’ve produced. All the best for the future, and thank you very much for appearing today.

Cosgrove Just one point before you go—I take it we resubmit questions to you, you’re willing to answer those, and there will be additional questions?

Binns Yes.

**Conclusion of Evidence**
# 2012/13 Financial Review of the MidCentral District Health Board and the Whanganui District Health Board

Report of the Health Committee

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MidCentral District Health Board and Whanganui District Health Board

Recommendation

The Health Committee has conducted the financial review of the 2012/13 performance and current operations of the MidCentral District Health Board and the Whanganui District Health Board, and recommends that the House take note of its report.

Introduction

The MidCentral DHB is medium-sized, with a population of about 160,000. The Whanganui DHB serves a population of 62,000, and has above average percentages of Māori (about 23 percent) and people aged under 15 years (22 percent). The centralAlliance, which has been operating since 2009, is a collaborative arrangement between the two DHBs to enable them to develop joint clinically-led health services and shared support services. Because of the DHBs' close working relationship resulting from the centralAlliance, we resolved to hold a joint hearing of evidence.

Financial management

In 2012/13 the Whanganui DHB’s total income was $222.733 million and its total expenditure was $224.602 million, resulting in a deficit of $1.869 million. The DHB had budgeted $220.891 million income and expenditure of $223.839 million for 2012/13, with a budgeted deficit of $2.948 million. We note that it is forecasting a deficit of $1.5 million in 2013/14 and hopes to then break even in 2014/15.

In 2012/13 the MidCentral DHB’s income of $582.912 million and expenditure of $576.509 million resulted in a surplus of $6.403 million. The DHB expects to achieve surpluses in the future and to use them to future-proof assets such as technology and real estate. The accumulated surplus is currently at $60 million, and we heard that it will fund new service plans.

Service performance management

The Office of the Auditor-General issued a modified audit report on the DHBs, with a qualified opinion on the performance information of both of them. The qualified opinion, issued to all the DHBs this financial year, relates to their limited control over third-party performance information.

The Office of the Auditor-General gave the MidCentral DHB “good” ratings for its management control environment, and its service performance information and associated systems and controls, the same as last year. We were pleased to note the improvement in its rating for financial information systems and controls from “needs improvement” to “good”.

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The Office of the Auditor-General gave the Whanganui DHB “good” ratings to its management control environment and financial information systems and control, the same as last year. We were pleased to note that the DHB’s service performance information and associated systems and controls rating improved from “needs improvement” to “good”.

**Collaboration**

While the DHBs’ different financial situations may affect the extent to which they can collaborate, we heard that they are making good progress, mainly through the centralAlliance. At the specialist level, it was noted that the doctors decide the collaborative model to adopt, according to what works best between services.

We were interested to hear that the MidCentral DHB is extending collaborative practices to pharmacies, building relationships between hospital and clinical pharmacies, and is working to bring pharmacists into its health team.

**Integrated services**

We support attempts to provide integrated services. We heard that the Whanganui DHB’s primary care strategy is working well, but is yet to be fully realised. The MidCentral DHB said that an integrated management structure helps rapid decision-making. We note that it is also using flexible, integrated primary care services to identify high-risk and high-needs children.

**Staffing**

The MidCentral DHB reported in information provided to us that the number of medical, nursing, and allied health staff was 1,615; but they also reported that the number of front-line staff had increased to a total of 1,848. When we queried the difference, we heard that applying different criteria can cause an apparent discrepancy. There is concern that staff have been reclassified from back office to front-line. While the MidCentral DHB has taken measures to retain its nurses including student placements and holding some positions for the newly qualified, we were interested to hear that the Whanganui DHB has a low nursing turnover, and would actually like to see it raised.

**Orthopaedic services**

We raised the fact that the MidCentral DHB’s thresholds for elective and orthopaedic surgery are 90 points (one of the highest), and queried whether this resulted in surgery being limited to people with the greatest need and thus greater pain. The DHB recognises that, in the long term, it needs to increase its surgical capacity. We heard that, of the extra $10 million in nationwide funding for elective surgeries announced in January 2014, the DHB received $270,000 which it intends to spread evenly with orthopaedics and ophthalmology receiving the greatest proportion of the funding. We will watch progress.

**Emergency department services**

While the Whanganui DHB exceeded the national target for shorter stays in the emergency department, the MidCentral DHB did not. MidCentral DHB has identified issues with patient flow, and we were pleased to learn that it is doing work to improve patient flow. It also agreed that a shortage of general practitioners, and other issues with access to primary care, could contribute to longer waiting times in the emergency department. The Whanganui DHB noted that emergency department triage can be helpful in identifying frequent attendees and directing them to primary care providers.
Appendix

Approach to this financial review

We met on 5 March and 9 April 2014 to consider the financial reviews of the MidCentral District Health Board and of the Whanganui District Health Board. We heard evidence from the MidCentral District Health Board and the Whanganui District Health Board, and received advice from the Office of the Auditor-General.

Committee members

Dr Paul Hutchison (Chairperson)
Shane Ardern
Paul Foster-Bell
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Scott Simpson
Barbara Stewart
Poto Williams
Dr Jian Yang

Evidence and advice received

MidCentral District Health Board, Responses to written questions, received 27 February and 1 April 2014.

Whanganui District Health Board, Responses to written questions, received 28 February and 4 April 2014.

Office of the Auditor-General, Briefing on the MidCentral and Whanganui District Health Boards, dated 5 March 2014.

Organisation briefing papers, prepared by committee staff, dated 28 January 2014.
2012/13 financial review of Mighty River Power Limited

Report of the Commerce Committee

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Mighty River Power Limited

Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 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 mixed-ownership-model company bound by the requirements of the Public Finance Act 1989, and a public organisation for the purposes of the Standing Orders. A 49 percent stake in Mighty River Power was floated on the New Zealand Exchange on 10 May 2013.

Mighty River Power generates over 90 percent of its electricity from renewable sources. It has nine hydro stations and five geothermal stations, and operates a gas-fired co-generation plant in Auckland. Mighty River Power retails electricity to over 400,000 customers through several retail brands: Mercury Energy, Glo-Bug, Tiny Mighty Power, and Bosco Connect. It has interests in the United States, Chile, and Germany. Doug Heffernan is the chief executive of Mighty River Power until 31 August 2014; we thank him for his service. Joan Withers is chairperson of the board.

In 2012/13 Mighty River Power generated revenue (exclusive of line charges) of $1.382 billion and its expenditure amounted to $991.95 million. This resulted in a net profit after tax of $114.76 million (compared with $67.7 million in 2011/12).

Share price

Ms Withers commented that the timing of the announcement of the single energy buyer proposal had adversely affected Mighty River Power’s share price. We heard that a number of factors were likely to have contributed to the decrease in share price, including transmission pricing, and the Tīwai Point smelter negotiations. However, Ms Withers argued that the timing of the single buyer proposal’s announcement was a “major factor”, because it created uncertainty for investors, and analysts did not have time to calculate the proposal’s potential impact (if any) on power companies. Ms Withers said she did not think the timing of the proposal was intentional.

It was suggested by a Labour member that the Crown could halt the sale in order to stop the valuation of the share price in light of the Labour-Green announcement. Ms Withers acknowledged that the Crown set both the share price and time for the float; however, she said she was unable to comment further. Mr Heffernan argued that the result for the taxpayer was a “good deal” because the share valuation reflected Mighty River Power’s value before the announcement was made.

Glo-Bug

We asked about Glo-Bug, Mighty River Power’s pay-as-you-go electricity system. Mr Heffernan said it was developed in consultation with budgeting and social agencies to help consumers to manage their weekly budgets whilst paying down outstanding electricity bills.
Mighty River Power told us Glo-Bug has over 17,000 customers, who each save on average $250 a year relative to what they would be paying on monthly billing plans.

We questioned how Glo-Bug customers could save when pay-as-you-go electricity rates were higher than the cheapest monthly billing rate. Mr Heffernan said that for consumers to qualify for cheaper monthly plans they were required to pay promptly, receive electronic bills, and make payments online or by direct debit. However, many of the customers on Glo-Bug would not be able to meet these requirements and average savings needed to be calculated against the plans they were on before switching to Glo-Bug, rather than the cheapest. We heard that Mighty River Power’s profit margin on Glo-Bug is less than that on an average monthly billing customer because of higher set-up and service costs. Mr Heffernan expressed an opinion that consumers should pay for electricity up-front, as it is an essential commodity, rather than after their usage.

We noted that Glo-Bug customers whose accounts were “deactivated” when credit ran out were not recorded as being disconnected, and asked for the figures. Mighty River Power told us that 44 percent of Glo-Bug customers were deactivated in the 2013 calendar year. Deactivation occurs when a customer runs out of credit; accounts are automatically reactivated by topping up. More than 93 percent of deactivated customers topped up their accounts within eight hours; whereas 79 percent of Glo-Bug customers were disconnected at least twice the year prior to switching, and would have incurred disconnection costs and a wait to be reconnected.

Electricity pricing

We asked about the contributing factors in electricity price increases. We were told that many factors are taken into account when calculating retail pricing, including energy prices, taxes, transmission, and lines charges (which can vary from one region to another). Distribution charges are split into fixed and variable components, which can be confusing for consumers.

Mr Heffernan suggested the best way to make pricing transparent is to legislate for the separation of the components of bills, so the energy component could be shown separately from the lines or transmission charges.

We asked Mighty River Power if it agreed with the assessment that power prices would increase by 2.4 percent in the next 6 months. Mighty River Power has committed to freezing prices at its standard open tariff until 1 April 2015.

Renewable energy

We asked Mighty River Power about its generation profile. We heard that almost all of Mighty River Power’s generation is from renewable sources, with 40 percent from geothermal sources, and almost 60 percent from hydro sources. Thermal generation makes up less than 5 percent of the total. Mr Heffernan said that New Zealand ranks third internationally in its use of renewable energy, generating over 80 percent of electricity from geothermal, wind, and hydro sources. Mr Heffernan said that New Zealand will face less upward price pressure, compared with other countries in the developed world, because of the high level of unsubsidised renewable generation.

We asked whether the proposal of a single central energy buyer would affect generation from renewable sources. Mr Heffernan said that he would require more detail about the proposal to analyse its implications. However, he believes that it could encourage more
thermal generation, because it is faster to set up and requires less investment than renewable sources.

**World Energy Council ranking**

We noted New Zealand’s ranking on the Energy Sustainability Index, which measures a country’s stability regarding three indicators: energy security, energy equity, and environmental sustainability. New Zealand has been ranked eighth out of 129 countries by the World Energy Council.

**Medically dependent consumers**

We heard that Mighty River Power was found in a recent audit to be fully compliant with the Electricity Authority’s guidelines on providing electricity to medically dependent consumers. Mr Heffernan said that the guidelines were “embedded” in the company’s culture and he was not aware of any medically dependent consumers being disconnected by Mighty River Power since the unfortunate death of Mrs Muliaga in May 2007. Mr Heffernan said he could not comment on whether he believed the Electricity Authority’s guidelines on this matter were fit for purpose or sufficiently enforced.

**Operating costs**

We observed that Mighty River Power’s operating costs had decreased significantly from the previous year. We heard that management had had more time to introduce efficiencies since the share float and the completion of the geothermal development programme. Mighty River Power has taken direct control of its offshore geothermal interests, and reduced its spending on legal, tax, and consultancy fees.
Appendix A

Approach to this financial review
We met on 13 March and 17 April 2014 to consider the financial review of Mighty River Power Limited. We heard evidence from Mighty River Power and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Gareth Hughes replaced Julie Anne Genter for this item of business.

Evidence and advice received
Mighty River Power Limited, Attachments 1 and 5, received 13 March 2014.
Mighty River Power Limited, presentation for hearing, received 12 March 2014
Mighty River Power Limited, Responses to written questions, received 5 March and 8 April 2014.
Organisation briefing paper, prepared by committee staff, dated 26 February 2014.
Corrected transcript of hearing of evidence 13 March 2014

Members
Jonathan Young
Hon Chris Tremain
Kanwaljit Bakshi
Mark Mitchell
Jian Yang
Hon Clayton Cosgrove
David Shearer
Kris Faafoi
Gareth Hughes

Witnesses
Joan Withers, Chair
Doug Heffernan, Chief Executive Officer
William Meek, Chief Financial Officer

Welcome Mr Heffernan and Ms Withers—it’s great to have you here again. Am I right, Mr Heffernan, that this is perhaps your last appearance before our committee?

That’s probably in your hands.

Just as long as we get full answers to full questions—

We’ll do our best.

—that would be nice. It would make a change.

I certainly hope not.

If you’d like to just introduce members of your team that would be great, thank you.

Thank you, chairman, and thank you to the committee. I am assuming that you all have the PowerPoint presentation that we’re going through available to you. That’s good. The structure that we’re proposing again is just for Doug and I to go through just a few slides quite quickly and then, obviously, we look forward to questions from the committee, which we will answer as fully and frankly as we possibly can. We don’t have the same caveats around us this year that we did last year as we were going into the IPO. So that’s good. And the timing for this presentation is actually quite good because, although we are charged with reporting on the full 2013 financial year, we have, in the last couple of weeks, just announced our results for the half-year ending 31 December 2013. So we’ll give you a quick update on the performance for that half as well.
It really goes without saying that it’s been a very big year for Mighty River Power, but we are delighted to be presenting to the committee for the first time as a listed entity. Just to give you a quick overview of who we are and what we do—our consumer brands, of course, are very well known, particularly Mercury, which has a major presence nationally. But we’ve also got niche products and services, which meet the needs of a very diverse range of consumers, including the GLO-BUG product, which provides a unique pay-as-you-go capability, which allows customers who have in the past struggled to pay their household bills to have more control of their electricity spend.

In aggregate we serve and sell electricity to just under 20 percent of New Zealand homes and businesses. Our metering business Metrix provides enhanced information solutions for Mighty River Power retail brands, but also for other electricity retailers and their customers. This is a really exciting space now, and Doug’s going to provide a bit more information shortly about the functionality and the benefits that this smart meter technology can provide for customers. In particular, he’s going to talk about GLO-BUG, which I’ve just mentioned, and also GEM, which is the Good Energy Monitor.

As you all know, Mighty River Power is very strongly oriented towards renewable generation. In fact, the proportion of our geothermal production has increased during the period to 31 December to about 40 percent now of our total generation, and that’s as a result of the recent commissioning of the Ngātamariki plant in September last year. That geothermal growth has really been enabled by the commercial relationships that we have created and nurtured with our Māori partners. The unique competency and the knowledge that we have in geothermal exploration, development, and operation is being used also in our investments in Chile and through our Energy Source shareholding in the United States.

Turning now to slide 3, of course the major milestone for the company during the financial year was our listing on the NZX and ASX 10 months ago. We have more than 100,000 shareholders and the composition of our register has changed slightly during that period. In fact, our percentage of retail investors has increased, with institutions—both domestic and international institutions—just going down slightly as a percentage of the total.

As you will also be well aware, the Mighty River Power share price has dropped almost 20 percent in that period since listing. While there are, of course, a range of factors at play, there is no doubt that the dominant impact by far has been the uncertainty around the NZ Power proposal, which was announced by the Opposition parties in April—in fact, just weeks before our float. So in the short space of time between the NZ Power announcement and the IPO, there was not a lot of time for analysts to conduct the appropriate level of analysis needed, or for the market to gain a really comprehensive understanding of the potential value impact of that policy.
Over the following months, as those analysts then interrogated more deeply the implications of the proposed policy, and the likelihood of its implementation, a more consistent consensus view developed. This potential impact has then, obviously, been factored in to market pricing, as has been represented through our share price. This can also be evidenced by the fact that the two other listed companies at the time of our float also suffered share price declines in the subsequent period. It also, of course, resulted in lower valuation metrics for the Meridian float.

You’ll see on the slide there the comparisons in terms of share price decline, and if you’re asking the question as to why Contact’s share price, which is down 6.6 percent, decreased less than either Mighty River Power or Trustpower, which went down about 14 percent, we believe that that reflects Contact’s lower proportion of hydro generation.

Moving now to slide 4, which is the full-year 2013 versus the year prior—although, of course, the company is not able to control the share price, we are, of course, accountable for strategy and we are accountable for our operational and financial performance, and we have continued to deliver on the performance that we projected in the offer document last year. The operational and financial performance of the company has been strong. In the full year to 30 June 2013, energy margin, EBITDAF, NPAT, and underlying earnings all exceeded our IPO forecasts.

You’ll see on the graph there the comparison with that year and the year prior. Energy margin, which is a key measure of operating performance, held up remarkably well given the Waikato drought in the second half of the financial year, and was in fact just $6 million year on year down. As anticipated at the time of the IPO, our EBITDAF was down $71 million, or 15 percent on the prior year. That reflected one-off costs that were associated with our offshore interests, and some listing costs were included in that. Our net profit after tax and our underlying earnings both improved year on year.

Turning now to the half year, which ended on 31 December 2013, which, as I said we announced a couple of weeks ago—so those poor hydro conditions in the North Island that we experienced in the early part of the 2013 calendar have actually continued right through until today. We are hoping for wet weather this weekend. However, during that half year to December we managed to increase our operating earnings year on year by around 4 percent to $270 million in spite of the hydro inflows being down 25 percent on the previous corresponding period. Our underlying earnings decreased by 21 percent, and that was due to a payment from our US investment in the prior period.

Turning to slide 6—as I said at the outset, partnerships have been a critical success factor in our history to date. When you look at our business today, you can see the value that we derive from having a large component of reliable, renewable geothermal production. That didn’t exist for the company or for New Zealand’s benefit when Doug joined Mighty River Power at the time of our formation back in 1998. We had then only hydro-
fuel in our portfolio. Under Doug’s leadership, the company has forged strong, deep, and mutually beneficial partnerships that are grounded in our core beliefs about harnessing natural resources in a sustainable way to build value.

A key foundation of our geothermal growth has been our commercial partnerships with Māori land trusts. That business model ensures direct and aligned economic participation and generates value to the land trust for them to invest in their people. These trusts own land over the geothermal reservoirs and are distinct entities from iwi. Our 25 percent interest in the Tuarōpaki Power Company, Mokai, came about following their invitation to us to invest equity to help double the size of their original station. Our joint venture with Tauhara North No. 2 Trust on Rotokawa was formed when we were invited by them to provide equity capital and to jointly expand the power production from their lands. Partnerships are a marriage of capabilities. Māori land owners bring access to geothermal resource and a set of values based on kaitiakitanga. We bring informed capital and a skill-base to sustainability develop opportunities.

One other point that I should make is that the additional clean energy supply that the geothermal projects have delivered is enough to power more than 330,000 New Zealand homes. Those three stations alone are taking about 2.3 million tonnes of carbon out of the atmosphere. It means that that’s fossil fuel that is not being burnt. Doug’s going to expand on that shortly and talk about how our renewables are a great platform for a much broader New Zealand green energy advantage.

Turning to dividends—I don’t know if I need to cover that in detail. We are on track to deliver 13c per share. The interim dividend is being paid at the end of this month. We have reiterated in the half-year result that we are on track, as long as we get normal inflow hydro between now and the end of the financial year. Forecast operating earnings are $498 million, which will be a 27 percent increase on last year.

Just talking briefly about governance and management—we have successfully transitioned from being a State-owned enterprise into the listed environment. We have added Patrick Strange to the board. He assumed his directorship in February. We have one other director to appoint very shortly, which will bring our complement back to eight. But the major task for the board at the moment is, of course, finding and securing Doug’s successor as chief executive, and these are very big shoes to fill. I have to say, he’s been an exemplary leader for not only Mighty River Power, but for the industry as a whole. The board is well down the track in that process and the good news, both for us as a company and from “New Zealand Inc.”, is that there are very high calibre applicants coming forward. Doug leaves us at the end of August. He has a fixed-term contract in place to that point in time, but we anticipate being able to make an announcement on his successor in the April-June period. On that fitting note I will now hand over to Doug.
Young
Doug, if we could, we’ll come to your comments through some questions that I know that you’re going to be speaking on in particular areas, if that’s all right. It’s just that we did have an allocated period of time for presentations, which we have gone over. We want to get to questions if that’s all right with you. We’ll certainly come back and you’ll have ample time to make some comments. We’ll now go to questions.

Cosgrove
Ms Withers, you’ve made some rather interesting political comments and I’d caution you to understand the boundaries of those comments—especially in an election year—in respect of Opposition power policies. You neglected to mention a couple of other factors that I would have thought contributed to the tanking of your share price. That was simply, first, you could term it as Government greed. A number of analysts have said that the initial price of $2.50 was way over the odds. It’s now, I think, $2.25, I am advised. Secondly, the outstanding major issue at the time of Rio Tinto as to whether their contracts would be terminated or not. And, thirdly, the fact that the timing of the sale was completely in the hands of the shareholder. They could have halted the sale, stalled the sale, terminated the sale, but they proceeded on. Have you taken those factors into account in preparing this statement today, and why were they omitted?

Withers
As I said, I prefaced the comment by saying that there was a raft of issues around that but the major factor in our view—in my view—was the timing of the Labour-Greens announcement. You’re absolutely right—there were significant other issues in play, not least of which May 10, I think, represented the high tide in terms of where yield stocks were and obviously at that stage the US Federal Reserve was making announcements in terms of quantitative easing being tapered. Tīwai Point, obviously, was at large. There were some statements that were made after our initial public offering, which, one might have assumed, would benefit us but in fact did not. Transmission pricing is another area where there is regulatory uncertainty, which I know that Doug is going to cover. So I did not say that it was the only factor, but in my view it was a major factor.

Yes, the Crown did have control over the timing and the pricing. We had no responsibility whatsoever for the price that was set at the time of the initial public offering. We received a letter from Mr Shearer at the time of the announcement, suggesting that we should look at a supplementary disclosure, which we did put into the market place before the initial public offering. So we have conducted ourselves prudently. You are absolutely right; there are other factors at large. It’s probably been a perfect storm for Mighty River Power, but, in our view—in my view, particularly—the Labour-Greens announcement created a huge amount of uncertainty. All of the analysts whom we communicate with were trying to work out what it would mean. Some of that was based on the question of what the probably is of Labour getting into power. And, if it does get into power, what, then, is the probability that it will implement that policy? So there was a huge amount of concern and angst about how this would actually impact, and what the likelihood was of it happening. Any uncertainty, as you know, in the market normally results in people taking a very conservative position. So
what happened is that more information was worked through, more analysis was done, the share price continued to go down to the levels that it is at now.

Cosgrove: So how much—

Heffernan: And that was reflected in the other listed companies.

Cosgrove: I’m not here to talk about the other listed companies. How much analysis, or what analysis, did Mighty River Power conduct, if any, on the policy proposal?

Withers: Do you mean before the initial public offering?

Cosgrove: No, no. As a basis for your comments today.

Withers: We’re still working through that. Obviously, there is a lot of detail still to come out.

Cosgrove: What analysis have you done?

Withers: We’ve done a lot of analysis in terms of potential impact, but obviously all we know is the bare bones of the policy at this stage. How it’s going to impact, what sort of valuations you’re going to put on existing hydro assets that are 70 years old—I don’t know the answer to that, but Doug might.

Cosgrove: Could you—

Withers: Let Doug—can Doug make his point?

Cosgrove: No, no. I’d like to ask a question, please. You have been a business person.

Withers: I think that’s a compliment.

Cosgrove: Indeed. I didn’t mean—I meant in your professional capacity, not an age one. Forgive me if I was misinterpreted. I wouldn’t presume—

Shearer: Leave it at that. You’re digging a hole and you’re going to fall in it.

Cosgrove: On a more serious note, given your experience, would you have considered it ethical or appropriate for such a policy announcement to have been made after the float had occurred, thereby giving investors no choice as to whether they were in or out? Or would it have been more ethical to have made that announcement prior to that?

Withers: I’m not criticising the timing of your announcement—

Cosgrove: Well, you have done actually.

Withers: No, I’m saying that’s what happened—I’m not saying that the timing was intended. I would have made a direct statement if I believed that. What I’m saying is that the impact of the timing on Mighty River Power, and the fact that within a couple of weeks there was not enough time for the market to fully comprehend all the implications of it.

Cosgrove: Therefore, the point you make is that you—the Government, I suppose, was offered the ability to make a statement, which you did in your documents. You would also agree that the Government had the ability, if
they wanted to maximise the return for the taxpayer, to have halted the sale. It could have halted it at any time, could it not?

Withers That is not my decision and I’m not—

Cosgrove I didn’t ask you; I’m just saying—

Withers Well, I’m not going to comment on that.

Cosgrove No, I’m asking you for a technical response. The shareholder—a shareholder—

Withers Any shareholder times the sale of assets if that is the strategy they’re embarking upon for a raft of reasons. And, you know, the timing was up to them. We had absolutely no control over it.

Cosgrove Indeed, and I accept that. The Government could have, at any point, pulled the pin or delayed, had it wanted to. It chose to proceed. I would have thought that Rio Tinto—all the debate and the ongoing negotiation and the machinations around that—was a massive uncertainty. Other State-owned enterprises have advised us—

Heffernan Actually Rio Tinto is not a big issue for Mighty River Power. Look, I’ve talked with David Parker about this, about the timing, and he has represented—as you are—the sort of moral dilemma that led to the announcement being made when it was. In an ideal world, a much earlier announcement would have been much better because there would have been a much greater opportunity for analysts to be able to work out what it might mean, as we saw in the elapsed time between our float and that of Meridian Energy. By that time, analysts had actually worked it out and you saw the dramatic impact on the relative valuation of Meridian Energy to Mighty River Power.

If you look at it from a taxpayer point of view, the taxpayer actually got a very good deal out of the Mighty River Power float because the valuation of the float was very similar to the pre-NZ Power announcements of Mighty River Power’s value. That’s not true in regard to the Meridian Energy float. And that just shows the benefit of time, which allowed people to analyse—

Cosgrove So that benefit of time could have also occurred had the Government said: “OK, the Opposition has made an announcement. We’re going to pull the pin.”

Young Clayton, these are statements, not questions, about the Government, all right? They can’t answer these questions.

Cosgrove Well, with respect, they’ve made a lot of statements about party political policy. I’m coming to a question. Your issue in terms of timing—if the announcement had been made earlier, yep, OK. But also, if the shareholder had said they were going to taihoa, that they were going to give analysts more time, that was also within the gift of the Government to give.

Heffernan It could have been done and it would have led to a much lower valuation at the time—
Shearer In the number of floats that have occurred—yourselves, Meridian Energy, and now Genesis Energy, which is even lower—with bonuses being offered, split payments being proposed, that has nothing to do with the saturation of the market to buy products that have been let in and people investing, is that right? There’s no issue around that, either? That led to that tapering off of interest in energy companies?

Young These are shareholder decisions that—

Cosgrove Hang on, hang on. They answer the questions, not you.

Heffernan Look, all we know is that there were over 400,000 registrations prior to the announcement of NZ Power, and less than a quarter of those followed through to buy shares. That’s all we know.

Shearer That was the same pattern that occurred, say, in Brisbane with the railway system in Brisbane, where they had far less proportionately than that. Can I just move on to another area?

Young David, excuse me, are you going to do a line of questions, because you’ve done 10 minutes, and it’s this side 10 and then we’ll come back to you.

Tremain I just wanted to focus on a couple of the slides that you didn’t quite get to, which is your green energy advantage slide on page 11. You mentioned geothermal as being responsible for 40 percent of your production at the moment. Could you just fill out that gap to 100 percent? What is the rest of the profile to 100 percent of production?

Heffernan Virtually all of it is hydro.

Tremain Is there any thermal? There’s no thermal?

Heffernan Yeah, there’s a small amount of thermal out of our gas-fired plant in Southdown, but it’s been less than 5 percent in recent times.

Tremain You make a point in here that New Zealand is ranked No. 8 globally by the World Energy Council. What does that specifically mean? How is that ranking established?

Heffernan They have a trilemma system, where they evaluate the three pieces of the triangle, and the argument for doing that is if any one of those is too strong or too weak, it causes consequences on the others. So you want stability across all three, being energy security and reliability, energy access and affordability, and sustainable energy production. And we rank No. 8 in the world.

Tremain Is it fair to say we’re world leading in terms of renewable energy?

Heffernan Absolutely.

Tremain Just in terms of total production of renewable energy, I understand that as a percentage of our total production we’re in the low 70s—I guess it depends on the climate during the year and that. Can you just give me a sense of that and also comparison to other countries, such as, say, where we sit internationally in terms of total quantity of energy produced renewably?
Heffernan I think in the developed world we’re probably No. 3. No. 1 is Iceland, which is just hydro and geothermal. And our percentage of renewable has been increasing in recent times because geothermal and a little bit of wind has effectively been displacing coal and gas. I think we’re 80 percent over the last half.

Tremain Eighty percent—

Heffernan Over the last 6 months of calendar 2013, New Zealand was 80 percent renewable.

Tremain Crikey. So there’s a target there of getting to 90 percent, so it’s certainly heading in the right direction.

Heffernan Yeah, exactly.

Tremain Just in terms of projects that can take us towards that 90 percent of renewable energy, you mentioned in terms of your portfolio there’s no big projects on the horizon. Long-term, what are the possible projects? I mean, you’ve talked a short and medium where there’s no big projects. What would be the next, out of, say—

Heffernan Well, the big thing in the last few years has been coal has been just shut out of the market, which, you know, in a global sense, we’re almost unique in doing that. You do have gas, which is a really important complement to something like wind or solar.

So if I took a 10-year view, I would see geothermal, wind, and solar being the technologies that will displace completely any residual coal. I think it would be really difficult to get away from any gas at all unless you want to sacrifice the environment and build bigger lake storage. And I think the right balance would be a little bit of peaking gas to be able to complement the unpredictability of wind and solar.

Tremain Two last questions there. So is the current market providing a platform for us to move towards the renewable goals for the country?

Heffernan It is, because New Zealand has very large-scale, very high-quality renewables in wind and geothermal. It is the unique place in the world where renewables have been the investment of choice without subsidy. There’s nowhere else in the world you’ll find renewables being invested in to the scale that has happened in New Zealand without subsidy.

Tremain Nowhere else in the world?

Heffernan Exactly.

Tremain That’s incredible. So we talked about the Labour-Greens policy that was put forward. You’ve talked about that previously. Have you had a look at what that policy could do in terms of our aspirations to get to the type of future that the current policy is delivering for us?

Heffernan Well, I think, just like Mr Cosgrove’s analysis, all analysis is based on assumptions. Assumptions are the mother of all evil, but, you know, if I look at a range of analysis that’s been done by other parties—other people, I should say, rather than of the political spectrum—their view is that the
single buyer policy, as it was described, would lead to more thermal generation.

If I can just describe that from a geothermal perspective, the investments we’ve made take about 10 years in the planning of geothermal. You actually have to spend about $100 million of risk capital before you know whether you can proceed with a half-billion-dollar investment. Under the single buyer policy there’s no reward mechanism, there’s no contractual mechanism, by which that would occur. So what it tends to do is favours fast-start alternatives—things that can be implemented very quickly. And I see David shaking his head. I’m just repeating what other people have said.

Heffernan Right? And so that’s one of the issues. And I’ve been public about we don’t know exactly how that policy would work. No one knows the detail, and my view is it’s unfair to actually expect that detail, because Opposition parties do not have the wherewithal of the bureaucracy to help put the detail around a policy. So I would be keen if I was still here—which I won’t be—to actually engage between business and Government, because, again, world best practice is if you do get that engagement you get sound policy development.

So if those issues are problems, how would you address those in such a policy? What would you change in order to prevent that undesirable outcome, because, ultimately, you have to secure that trilemma. If you do not secure that trilemma, consumers will pay either through higher prices or poorer security or dirtier environment.

Young In terms of your social responsibility through commercial innovations like page 14, in terms of the GLO-BUG device, I think you reported to our committee last year, and perhaps even the year before, on the uptake of this. Can you just give us an update on that and also what you see as the benefits for the community? And who are the people who are utilising this technology?

Heffernan Actually, I think I’ve reported on this probably in each of the last 7 years. So it goes right back to the time of the Labour Government, which was when we first devised the pay-as-you-go product through consultation with the Government of the day and then subsequently with the current Government and with social agencies right through that period and with MPs in the local community in Auckland, which is where we developed it.

The fundamental benefit is that people who are on the GLO-BUG pay-as-you-go product are people who previously got behind in paying their power bills, ran up debt, and, ultimately, got disconnected because they were unable to pay their power bills. Now, you could just carry on doing that if you were blind to actually having a regard to dealing with good outcomes for the consumers.

We spent a lot of time. I employed two people who worked full-time in the community working with budget agencies and social agencies to try and understand what would work better for the people who end up in that
situation. And what they saw was a tool that would actually help people
better budget. And when we say “budget”, we’re not talking about an
annual budget; we’re talking about budget week by week. And what they
needed was something that they could effectively pay for their power every
week, because that’s the cycle by which they manage the cash available to
them.

Young So how do they make the payment?

Heffernan There are 3,000, I think it is, places across Auckland where people can go
and top up—petrol stations, dairies—and that facility, it’s not costless, but
that facility was a key design feature that the budget agencies advised us to
put in place. So what we have seen with the 17,000 customers that we have
on GLO-BUG now is that if you analyse their history and their
performance on GLO-BUG, their annual savings, on average, exceeds $300
a year compared with what they were previously playing out for electricity.
So it’s a significant benefit for that targeted piece of the community who
really struggle to pay bills and basically manage to a budget.

Young And so you make the comment here that pay-as-you-go prices are
comparable with post-pay.

Heffernan Correct.

Young And so that’s where you’re talking about the potential savings they can
have.

Heffernan Yeah.

Young In fact they’re less—

Shearer Can I ask a supplementary on that, because I saw your comments reported
earlier about that, and so I went back to the consumer institute data that we
based our figures on. And based on that, in 2014 your figures were 30
percent above a standard cheapest model. So today what I did was to then
check with our Parliamentary Library, because I thought, well, you’re
coming in; I’ll get them to run a second check on that. They came up with
the same conclusion that if you want to take a family of one or two that are
only in a house for a small amount of time and have very low power bills,
then there’s a possibility that it’s comparable. But you take an average family
that’s using about 8,000 kilowatt hours—

Heffernan In Auckland.

Shearer —then it is more expensive. Then I rang today a budgeting service and said:
“What do you think about GLO-BUG ?”. They said: “We get people off
GLO-BUG as soon as we can, because we all know it’s more expensive. So
everybody’s information that I’m receiving is completely contradictory.

Heffernan I’ve got a meeting with you after this meeting, I think, David, and I’ve
already supplied you with some information to take you through why those
comparisons are fallacious. Some of those comparisons—which, ultimately,
when you get them off websites—go to the problem of confusion, which
we’re also trying to address in the industry. Some of those lowest price
plans you talk about, people have to pay regularly, continuously, in advance
to get those low-price plans—the competitors’ plans, the ones you’re talking about with 30 percent difference. They have to pay online, on time, direct debit, online bills. So when you’re comparing plans, they’ve got to be compared with what they would otherwise be on. Unfortunately, these are people who can’t do that. They haven’t been able to be on those plans because they can’t meet the terms and conditions that those plans require. So when I’m working through the numbers, I’m comparing it with what they would otherwise have been on. That’s where they end up—as I say, I can give you the data. They save $300 a year, every one of them—well, 85 percent of them save more than $300 a year compared with what they were previously paying on electricity. There are a number of reasons for that, but at the end of the day that’s about a 15 percent saving on average.

Shearer Wouldn’t you expect somebody who was paying in advance, so that you have your money in your pocket before you even start, to be comparable to one of the cheapest plans, as opposed to one of the other plans that they may have come off?

Heffernan Absolutely, but that’s a different product. If someone wants to prepay, online, on time, ahead of consumption, and do that consistently every month—every month—they’ll get a cheaper plan. That’s not what pay as you go is. Pay as you go actually requires significant technology to enable them to pay at any different outlet and just to top up with $20 a time.

Shearer But they’re paying in advance.

Heffernan A week in advance.

Shearer But they’re paying in advance.

Heffernan Yes, and they’re getting the benefit of that. Absolutely. But look, I’ve invested several million dollars in technology to enable that to happen. Without that investment, which someone has to pay for, they would be on the same prepay plans—so-called—that our competitors are offering, which are significantly higher than GLO-BUG.

Yang I have a few questions but I’m aware of the time. First of all, a very quick question—in your presentation you said more than 95 percent of Mighty River Power electricity production is from renewable resources, while on your website it says over 90 percent. I’m just wondering whether that is because the new geothermal plant Ngātamariki came into operation recently, so the website has not been updated. Is that the case?

Heffernan I think the 90 percent is a long-run number. It has been around for a long time. It was always a safe number, because if you’re in the middle of a drought, which we are now, your hydro production can fall quite a lot. But what we’re seeing is that because the geothermal’s now running, as you quite rightly point out, our expectation is it’s probably going to be more like more than 95 percent rather than more than 90 percent.

Yang All right. My second question is in the first half of this financial year your net profit climbed 64 percent to $123.7 million on the lower operating costs and one-off gains in the value of financial instruments. So your operating costs fell 24 percent to $107.8 million. My question is how did you achieve
the reduction of operating costs and whether this kind of operating costs reduction is sustainable?

Withers  Part of that was a one-off, wasn’t it, from a prior period?

Meek  Yes, so on an adjusted basis we did have operating costs for the first half of this year down $8 million. I think having IPO’d 10 months ago and the completion of our geothermal development programme in New Zealand has certainly freed up management time in terms of looking deeper inside the organisation about how effective, how efficient we are running. There is no silver bullet. It’s a broad and wide programme. The internalisation of the offshore geothermal interests we have—we’ve brought that back onshore. That also was a significant contributor to that $8 million saving. Looking forward, we’ve confirmed prospectus guidance of EBITDAF of $498 million. The drought has continued in the North Island, so the energy margin is lower as a consequence of lower hydro volumes. That is being made up through ongoing cost efficiencies inside the Mighty River Power group.

Yang  A final one about the carbon credit. You purchase carbon credit units at a higher price than what it is now. So are you not concerned about the price and cost and whether they will compare in the future?

Meek  Yes, so the annual report does disclose the company has entered into a number of long-term agreements with New Zealand forestry owners. So, again, the carbon prices globally have collapsed, largely due to falling demand in Europe and overallocation there. Again, it’s a long-term game. Certainly we’d prefer if those prices for carbon credits were lower, but, again, those are domestically sourced carbon credits and will be used over the 15-year period that those contracts exist for.

Yang  So you’re not worried any more, basically?

Meek  We’re happy with those contracts.

Hughes  Mr Heffernan, I’d like to thank you for your service to this SOE over a number of years and wish you the best of luck. My question, though, is around power prices. I was looking at the weighted average retail electricity price for Mercury between November 2008 and November 2013. Your prices have gone up 23.5 percent, which is larger than the national average. Why are your customers paying so much for your power?

Heffernan  Look, I haven’t had prior notice of the detail of your question, so I obviously can’t analyse that on the spot. As you know, retail energy prices are a combination of a range of factors. You’ve got energy prices, you’ve got local lines company distribution, you’ve got transmission, and you’ve got Government taxes. Government taxes have gone up in that period, as you know. I’ll look at the detail and break it down for you, but you do get regional differences in New Zealand because of those—not because of the energy pieces, so much, or the tax, but because of changes in the local distribution and the national grid. They do have geographical differences. I’ve got some graphs, but obviously we don’t have time, that show why there is confusion around price changes at a local level. It’s complicated by
the structure of distribution charges. It’s got two parts, fixed and variable. If the fixed and variable are changed at different rates, then it is almost impossible to tell what the impact is on an individual customer with clarity. My proposal, which is very similar to that proposed by David Shearer, is to go for separation. We have voluntarily separated on our bills in Auckland for Mercury Energy customers for 15 years, so you can see—always have been able to see—the difference between line and energy, but it hasn’t made a scrap of difference in removing the confusion in the industry. So our view is David Shearer’s bill needs to go further, and it should require complete bill separation.

Young Separate in bills?

Heffernan Separate invoices between the lines component and the energy component. That would remove this confusion. You would have a very simple—very simple—energy price. You would be able to see exactly what was happening between 2008 and 2013. I would be able to answer you on the spot. But with the two integrated, I’ve got to go back and I’ve got to analyse what the heck was going on with distribution charges and transmission charges, over which I have no control. Separate them. Be done with it.

Withers Gareth, just to answer you, going forward you will know that we’ve announced that we have a price freeze on energy until at least April 2015, so that’s effectively a 2-year freeze.

Hughes But you’re also inviting your customers—well, some of them—to switch to a 3-year fixed-term rate that is, I understand from media reports, around 9 percent above the existing tariff.

Heffernan Incorrect—I think you might be picking on Genesis numbers.

Hughes This was in relation to yours, a press release from a company called Switchme and also information provided by—

Heffernan I think that’s outdated.

Hughes What price increase—

Heffernan I think we were looking at extending fixed-term offers at the moment. They’re absolutely locked in at current rates, because we’ve made and announced our energy prices. Obviously, when we make that offer we are taking the risk of what might happen with transmission and distribution costs. In Auckland, where the majority of our customers are, we know transmission costs are going up and we know distribution costs are going to be probably relatively flat.

Hughes Do you acknowledge that consumers are getting a bit sick of you passing the buck when it comes to responsibility, because in the latest MED quarterly price survey it shows that only around a quarter of the price increase in the last year was from transmission and distribution?

Heffernan Look, I am heartedly sick of it. I am absolutely up to the gills in it, which is why I’m saying—

Young Are you tired of being blamed?
Heffernan: Separate the bloody bills. I can’t cause that to happen. Only policy can do that. Separate the bills and be done with it—quickly.

Young: We’ll expunge your expletives from the record.

Shearer: Could I ask a question?

Heffernan: I’m trying to get in before the 15 years is over, you see. It’s my last shot.

Shearer: Can I just pick up on a couple of points on price increase—the Government has recently come out and estimated that in the next 6 months the price is going to go up by 2.4 percent. Could I just get your views on whether you think that is accurate, and where you think those price increases will come from?

Heffernan: They won’t come from Mercury Energy. We’ve already made our—

Shearer: What about Mighty River Power?

Heffernan: Mighty River, in terms of its retail brands—all of its retail brands—as Joan has said, we last increased our energy prices by, I think it was, 2 percent in April 2013. We have committed not to increase those prices until at least 1 April 2015. So in terms of the year ahead, they’re not coming from our energy prices. We know in Auckland the lines component has gone up. So in central Auckland most customers will be facing a 1.2 percent increase in their bill in the next year, starting 1 April. That is entirely coming from the transmission costs because Vector, the local lines company, is decreasing its charges slightly under direction from the regulator, the Commerce Commission. So the 1.2 percent in Auckland is entirely driven by transmission charges, again determined by a regulator.

Shearer: I’m getting bills from people—I’ve been asking people to send me their bills—that are showing that their prices are going up considerably. They have no way of knowing—and obviously this is a conversation that we’ve had before—where those increases in price are coming from. So I just want to be 100 percent clear: you are not raising—and I’m not talking about fixing prices for the next 2 years—

Heffernan: A standard open tariff, yes.

Shearer: Your standard open tariff. You will not increase energy prices at all?

Heffernan: You heard right. Exactly.

Shearer: You mentioned Vector, and it was instructed to decrease its price by 8.4 percent of its lines charges. As far as I’m aware, only Meridian passed those savings on to their customers.

Heffernan: Incorrect. Vector has announced, and has repeatedly said, that Meridian and Mighty River Power passed on those savings.

Shearer: So you passed on those savings as well?

Heffernan: Correct. Yes.

Shearer: So they must be correcting themselves from their earlier statements that you didn’t—
Heffernan: No, Meridian made those statements. Vector has corrected them. The chief executive has corrected them at least twice.

Shearer: OK. Can I just take another look at what you were talking about with GLO-BUG. You’re out there promoting GLO-BUG at the moment. I saw you at Pasifika Festival, for example, and obviously you’re targeting that area of the market in order to be able to—

Heffernan: It’s not a target. It’s responding to where we see, historically, that disconnection rates have been high.

Shearer: Is that not targeting?

Heffernan: Well, I—

Shearer: It just seems to me—

Heffernan: No, look, what we’re saying is the disconnection is—I would say that’s an antiquated solution to a credit problem. The problem for this industry is that it’s based on 50-year-old technology. We only recover payments for our product more than 20 days after it is used. You don’t do that with petrol; why do you do it electricity? Oh, because of our metering technology—look, I can do metering today where you can pay in advance. The problem is, say, Sky TV—you can’t turn your Sky TV on unless you pay for it.

What’s happening in some communities—South Auckland is one—is that people are struggling to deal with how they manage limited income. They’ve got this range of bills. If you don’t pay the Sky TV it’s not on, so the first amount is on Sky TV. Electricity—“Well, I can put that off, because companies don’t demand that I pay that until later.”

Our industry has run a credit card system, where customers have been able to put electricity on tick and had to pay these other things in order to get the service. We’re at the bottom end of the food chain for payment. That is really bad. I think it’s irresponsible from a societal point of view. We want to actually move to a position where electricity is rightly considered a more important thing to have than Sky TV.

Faafoi: Is there a different rate of return on someone who’s on GLO-BUG to what you would call a standard customer?

Heffernan: I make less money off a GLO-BUG customer than a normal customer.

Curran: It was almost 7 years ago that there was a very unfortunate event—

Heffernan: This is Mrs Muliaga, yes?

Curran: Yes. And as a result of that there was a whole range of measures put in place for all of the electricity companies to ensure that medically dependent and vulnerable customers were not falling through the cracks and ending up dying because their electricity had been disconnected, or being unduly disadvantaged because their electricity was disconnected. It appears, in 2014, that there are still cases emerging of this. Now, I guess that you’re an outgoing CEO and I’m interested to know—it appears to me, because you responded to the financial review of this committee the year after that saying that the measures that you’d put in place and that you were fully
compliant with the then Electricity Commission’s guidelines—whether you consider that (a) you’re still fully compliant; (b), how do you know that you’re still fully compliant, because who is ensuring compliance? There is nobody, as we understand it in this committee, actually ensuring compliance any more. And, (c), are those guidelines still fit for purpose, and is there still a problem in this area?

Heffernan I can only answer to the best of my knowledge. As far as I am aware, absolutely we are compliant. There is an audit process that the Electricity Authority runs and we have been recently audited and we are fully compliant.

Curran But it has told us that it has got no mandate—or, it appears, interest—in actually ensuring compliance.

Heffernan Look, I can’t answer for it. All I know is that it has audited us and we’re compliant.

Curran You mean that it surveyed you?

Heffernan No, audit. Are the guidelines fit for purpose? I think that was one of your other questions—

Shearer So, you say that yes, it audited you—I mean, its description of its audit is that it sends a sheet out to electricity companies and they send it back to us.

Heffernan Yeah, but we have to warrant that.

Shearer And some of them have sent it back and some of them haven’t. Maybe it’s different for you, but I mean that’s what they told us.

Heffernan Well, I’ll tell you that it is bloody different for me. Sorry, it is very different for me. The reason it is very different for me is that I was there. I was there in the Muliaga household. I made a commitment to Mr Muliaga that my vision for this company is never to have a disconnection. But I need to have products like GLO-BUG—

Curran Are they fit for purpose? Are those guidelines fit for purpose across the industry?

Heffernan Look, it’s not just for the electricity industry, as you will know, Clare. It’s also about the health sector. So if you read the coroner’s report on Mrs Muliaga, one of the biggest issues was the lack of information that was flowing from the health industry to the electricity industry to help inform.

Curran Well I need, I’m asking for, I guess, a view from you as to whether or not compliance—because the public scrutiny has gone off it, are people no longer bothering?

Heffernan Look, I can’t talk for everyone else; I can just talk for my company—

Curran Is it a concern?

Heffernan Not for my company. It is deeply embedded in our culture that we don’t want ever to have such a thing happen to us again. Never. But I can’t speak for other organisations.
Curran So can you say to this committee that as a result of that there aren’t disconnections happening through Mighty River Power that are happening to vulnerable and medically dependent customers?

Heffernan I’m not aware of any incident in the last however many years it is—

Curran Seven.

Heffernan —where that has happened with a medically dependent customer. Absolutely.

Young And so you’d put that down to the fact that this GLO-BUG technology—

Heffernan No, that’s a separate issue.

Young A separate issue. No, sorry—I’m talking about your disconnection rates, and that you’ve been able to reduce those down substantially.

Heffernan Medically dependents do not get disconnected, but we needed to have a tool that was better than the sledgehammer of disconnection.

Young Can I just go back to a statement—

Shearer Just a supp on that; it’s just interesting. Your disconnections have actually been falling as a comparison with other companies.

Heffernan Radically.

Shearer What I’d like to know is—you don’t define a disconnection if you’re on GLO-BUG or on a prepaid system as a disconnection; it’s just a voluntary disengagement or whatever it is, which is a nice term about it, but ultimately it is the same thing. People can’t afford to put money in the meter and they disconnect. Are you keeping a track of those, and what’s happening with those?

Heffernan Yes, we monitor those. Part of what we learn from that is that people actually learn when they first go on to GLO-BUG. The early disconnection rate is higher than it is once they’ve learnt how to use it or adapted to it and realised, you know, that it’s actually easy to just top up and keep in credit. But, you know, the powerful thing in these households is—

Shearer Have you got the numbers for that in terms of—

Heffernan Yes. Yes, I’m happy to—

Curran Could the committee have those numbers?

Young So just joining this to your smart technology, GLO-BUG uses—that’s a device. Are they connected to any smart technology that might help them around tariffs?

Heffernan The reasoning you can deploy GLO-BUG is because you have AMI technology already in field. So we can’t run GLO-BUG in those network areas where there is not smart metering. But that’s becoming a very small part of New Zealand.

Young So I just want to come back to a question that, actually, David asked in terms of the increase of energy costs. If you could just reiterate your answer
Heffernan: Just to make sure it is on the record, we have made a commitment that our energy prices—and I said Mercury, but I was corrected; it is Mighty River Power that has said that its energy prices will not increase before at least 1 April 2015. But my wider view on New Zealand is we need to get a perspective in this country. If you’re an outsider looking, New Zealand is in a much, much better place than nearly everywhere else in the world. If I look forward in the next 10 years, because of the fundamental quality of renewables in New Zealand, because of the security we already have, this country will face far less upward price pressure on electricity than almost every country in the developed world.

Shearer: You want to tell the people who just got 21 percent increases on their—

Young: David, sorry, I’ve still got a question, thanks. So the concerns that people had around the fact that Mighty River Power became partially listed and there is going to be just an increase in power charges has not been evidenced.

Withers: We said last year that our pricing has absolutely nothing to do with our ownership structure.

Young: Right, so people can be confident that stability is in this structure, in this company, regarding forward-looking pricing?

Withers: We’ve made that commitment that we will not increase our energy prices before at least 1 April 2015.

Heffernan: That’s for energy. We can’t make commitments about lines and distribution.

Young: I understand.

Shearer: And that’s including retail charges, energy charges—it’s everything? I just want to make 100 percent sure, because people out there have a very, very different view.

Heffernan: Yes, but, David, if you go into Auckland, you will not see those—was it a 24 percent number that’s been quoted here? I think the Greens have it on their website. The Meridian number—that’s not Mighty River. It doesn’t exist.

Young: Right. Any further questions from any member of the committee? Any closing comments you’d like to make?

Withers: Thank you very much for your attention and for your questioning.

Young: And thank you, Mr Heffernan. Look, if we see you again, we’ll be thrilled, but if we don’t, all the best for your future, and thank you to your team for attending today. Thank you.

Conclusion of evidence
2012/13 financial review of the Nelson Marlborough District Health Board, the Northland District Health Board, the Tairāwhiti District Health Board, the Taranaki District Health Board, the Waikato District Health Board, the Wairarapa District Health Board, the Waitematā District Health Board, and the West Coast District Health Board

Report of the Health Committee

The Health Committee has considered the financial review of the 2012/13 performance and current operations of the Nelson Marlborough District Health Board, the Northland District Health Board, the Tairāwhiti District Health Board, the Taranaki District Health Board, the Waikato District Health Board, the Wairarapa District Health Board, the Waitematā District Health Board, and the West Coast District Health Board. With Crown entities and district health boards we resolved to undertake formal hearings of evidence on a rotational basis. This year no hearings of evidence were held for the above district health boards.

The committee has no matters to bring to the attention of the House, and recommends that the House take note of its report.

Dr Paul Hutchison
Chairperson
2012/13 financial review of the New Zealand Antarctic Institute

Report of the Foreign Affairs, Defence and Trade Committee

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2012/13 financial review of the New Zealand Antarctic Institute

Recommendation
The Foreign Affairs, Defence and Trade Committee has conducted the financial review of the 2012/13 performance and current operations of the New Zealand Antarctic Institute and recommends that the House take note of its report.

Introduction and context
In signing the Antarctic Treaty in 1959, New Zealand undertook to ensure that the Antarctic continent remained devoted to peace and science. Accordingly, New Zealand needs to remain committed to influencing outcomes in the region in a way consistent with the terms of the Antarctic Treaty system. To maintain a positive influence in the region, New Zealand will need not only to maintain, but to increase, its level of commitment, particularly to scientific projects. The New Zealand Antarctic Institute was established as a Crown agent under the New Zealand Antarctic Institute Act 1996. It is responsible for New Zealand’s activities in Antarctica and the Southern Ocean. The institute is based in Christchurch and manages Scott Base, New Zealand’s research station in Antarctica. Its total revenue for the year under review was $16.3 million, a $300,000 decrease from the previous year. The institute receives 94 percent of its funding from the Crown. It had a net surplus of $1.1 million, 42 percent less than the previous year, reflecting higher operating expenses.

New Zealand Antarctic Research Institute
In August 2012 the Prime Minister launched the New Zealand Antarctic Research Institute, a charitable trust which aims to promote the national Antarctic Research programme, and to bring new private-sector funding into Antarctic research. The institute recognised that it was unlikely to achieve its research goals without further funding, and that overseas donors were a possible source. It opted to be a charitable trust because it was more likely to attract donors than a government agent. The trust has begun to generate interest from foreign foundations and philanthropists.

The institute will provide logistical support to the trust, as it already does for universities and Crown research institutes. The institute and the trust are expected to work closely together toward their common goals. The trust board was appointed by Antarctica New Zealand, and the two organisations share a chairperson.

In response to some concern that the model could result in foreign funders determining priorities for research rather than New Zealand scientists and the New Zealand Government, we were told that funders would not be able to determine the direction of research. The trust’s terms of reference on science priorities are dictated by the New Zealand science strategy.

Christchurch hub
The New Zealand Antarctic Institute is liaising with the Christchurch City Council, Christchurch Airport, the University of Canterbury, and the Christchurch Development
Corporation towards establishing Christchurch as the natural logistics hub for countries conducting research in Antarctica. The Republic of Korea has already chosen Christchurch as its base for operations in Antarctica; the institute is discussing a similar agreement with China.

The institute told us it intends to establish an internationally recognised education, science, conference, tourism, and logistics support centre in Christchurch.

The Council of Managers of National Antarctic Programmes is an international association of members of the national Antarctic programmes of multiple countries. The council’s secretariat is located at the University of Canterbury. Its purpose is to develop and promote best practice in managing the support of scientific research in Antarctica. Every country that is a signatory to the Antarctic Treaty 1959 normally sets up a national Antarctic programme to manage its support of scientific research in the Antarctic Treaty Research Area.

**Science programme**

The New Zealand Antarctic Institute is involved in a number of collaborative efforts with scientists from other countries. The main focus for research is the impact of climate change. This research is regarded as fundamental to our understanding of climate change. We were told that the fate of Antarctica will determine the future of the oceans, and of what lives in the oceans, and so continued research on the continent is critical. We heard that the Ross Sea region is recognised as a part of the continent that provides real scientific value, and new research opportunities continue to arise in the area. We heard that New Zealand must continue to ensure that it is at the leading edge of science in Antarctica to ensure New Zealand retains its position of influence in scientific decision-making on the continent.

We were told that New Zealand is recognised as the leader in sustainable environmental practices in Antarctica. Every year Scott Base’s footprint is measured for, among other things, energy use, waste disposal, water use, and vehicle use. During the year under review the base received the highest available rating. The institute also provides guidance to other research groups when new bases are being built. It expects to provide guidance to America when it redevelops its base at McMurdo.

**Andrill**

Antarctic Geological Drilling (Andrill) was a multilateral collaboration of more than 200 scientists, students, and educators. The programme sought to understand glacial and interglacial changes in the Antarctic region. This project was described as the best example of significant science New Zealand has led in Antarctica. The results of the project were published internationally, and New Zealand’s leadership was highlighted. This programme was wound down, however, because of a lack of committed funding. New Zealand has expressed interest in a proposed Andrill 2. The United States has not yet determined whether it will participate in the proposed programme, which may affect whether it goes ahead.

**Policy support in Wellington**

We raised the possibility of the institute strengthening its voice in the Wellington policy environment of the Ministry of Foreign Affairs and Trade and the Ministry of Defence to
ensure a comprehensive Antarctic New Zealand perspective was taken into account on issues such as whether a new military tanker should be ice-strengthened.

We consider it important that an auditor from the Office of the Controller and Auditor-General involved in assessing Antarctica New Zealand and representatives of relevant select committees should visit Antarctica periodically.

**Logistical support**

The Pegasus ice runway, the main runway in Antarctica, suffered considerable melting during the year under review, resulting from a combination of warmer temperatures and oil and dust contamination. Its deterioration caused much disruption to flight scheduling. Wheeled New Zealand aircraft were able to land early and late in the season; American aircraft with skis were used at other times. While we were pleased to hear that this has not strained the institute’s relationship with its American counterparts, we consider that it is very important that sufficient resources and funding be made available to the New Zealand Antarctic Institute to ensure that New Zealand is seen to be pulling its weight. We heard that the contamination affecting the Pegasus runway will eventually necessitate its replacement, although no firm decision has been made. The existing runway will be used in the interim.
Appendix

Approach to this financial review
We met on 13 March and 16 April 2014 to consider the financial review of the New Zealand Antarctic Institute. We heard evidence from the New Zealand Antarctic Institute and 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
David Shearer
Lindsay Tisch

Evidence and advice received
New Zealand Antarctic Institute, response to written questions 1 to 145, and 146 to 169, received 5 March and 8 April 2014.
Office of the Auditor-General, Briefing on the New Zealand Antarctic Institute, dated 11 March 2014.
The Social Services Committee has conducted the financial review of the 2012/13 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.

Melissa Lee
Chairperson
The Government Administration Committee has conducted the financial review of the 2012/13 performance and current operations of the New Zealand Film 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
2012/13 financial review of the New Zealand Fire Service Commission

Report of the Government Administration Committee

The Government Administration Committee has conducted the financial review of the 2012/13 performance and current operations of 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
2012/13 financial review of the New Zealand Forest Research Institute Limited

Report of the Education and Science Committee

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Recommendation

The Education and Science Committee has conducted the financial review of the 2012/13 performance and current operations of the New Zealand Forest Research Institute Limited and recommends that the House take note of its report.

Introduction

The New Zealand Forest Research Institute Limited, which trades as Scion, is a Crown research institute. Its purpose is to drive innovation and growth from New Zealand’s forestry, wood products and wood-derived materials, and other biomaterials. Scion described its focus as growing better trees quicker, making wood processing more competitive, and using timber to produce other products. Scion also does research into pest-control and fire-reduction. Its total revenue during the year under review was $45.489 million, and it made $1.655 million in profit after tax.

Operating environment

Scion seeks to maximise the value and profitability of commercial forests so the sector can increase export earnings to $12 billion by 2022. The outlook for the sector is positive, with global trends, such as an increase in the demand for raw wood in China and deforestation of tropical forest in other countries, indicating that the $12 billion goal is realistic. In order to ensure the goal is achieved, the sector is seeking to increase the quantity and value of the logs exported. Scion has been working with Solid Wood Innovation, a research consortium, and wood processors to improve log processing yields. We heard that New Zealand processors have room for improvement; they are recovering 50 to 55 percent of a log, whereas Chinese processors are recovering 70 percent. However, the quantity of logs being processed in New Zealand is dependent on the price of unprocessed logs on the global market; over 55 percent of logs are exported raw, rather than processed in New Zealand. Without security of supply, some processors could be reluctant to invest in facilities that might not be fully utilised.

Scion has also worked on exploiting the by-products of wood processing, particularly to generate energy. Scion told us it has secured a $4.7 million Waste Minimisation Fund grant jointly with the Rotorua District Council, to build a commercial-scale demonstration plant for Terax technology, which converts organics waste into energy and useful chemical products. Scion and the Rotorua District Council have formed a limited partnership to commercialise the technology. Scion is also seeking to increase the number of products made from wood waste, such as a biodegradable kiwifruit “spife” (spoon/knife) and biodegradable foam for transporting fish.

Facilities

Scion has a large campus and innovation park in Rotorua, which it shares with 27 forestry companies. Scion began a 10-year campus maintenance and development plan in 2011, and during the year under review it commissioned a refurbished laboratory wing, which won an international award.
Biosecurity threats

We heard that the primary concern of the forestry industry is the health of the trees. Scion has managed to mitigate some of the biosecurity threats to trees. It identified the cause of red needle cast disease, helped the Ministry for Primary Industries to eradicate the eucalyptus leaf beetle, and is helping to develop alternatives to the methyl bromide treatment of export logs, which is thought to be hazardous to human health. Scion also has a dedicated team of forest protection scientists at its Forest Protection Diagnostic Laboratory, where it conducts genomic research to rapidly breed trees that are tolerant to diseases.

Genetic engineering

Scion told us that it intends to invest $500,000 over the next two years to upgrade and extend its containment area for field trials of genetically-modified plants, to the highest reasonable standard of security. The larger trial area will allow the continuation of the planned programme of research for which Hazardous Substances and New Organisms ACT 1996 (HSNO Act) approval was obtained. The programme is to continue for the next 23 years.

Some of us expressed concern that Scion is spending $1.6 million on genetically modified trees, and that the intellectual property rights to these trees are owned by an overseas company.

National Science Challenges

Scion told us it is involved in the preparations for responding to four of the National Science Challenges: resilience to nature’s challenges, which concerns coping with natural disasters; New Zealand’s biological heritage, which concerns biodiversity, biosecurity, and resilience to harmful organisms; land and water, which covers primary-sector production and productivity and land and water quality; and science and technological innovation, which is about our capacity to use physical and engineering sciences for economic growth. We heard that an “eleventh challenge”—better homes, towns, and cities—is particularly relevant to Scion, and important for ensuring New Zealand overcomes challenges such as affordable heating and exposure to natural hazards. Scion told us it is seeking to increase the use of wood in building houses and low-rise buildings. Wooden structures are fire-tolerant, respond well in earthquakes, and store carbon. Wood also lends itself to prefabrication of frames off site, to be assembled very quickly on site.

Commodity levy

We are aware that the forest industry is undergoing structural change. In March 2013, forest growers voted for the introduction of a commodity levy, which was introduced on 1 January 2014. We were told that the levy is raised against unprocessed logs, and should raise an estimated $6.5 million per annum. The Forest Growers Levy Trust was formed to determine how proceeds from the levy will be spent. The trust’s board includes representatives from the Forest Owners Association and the Farm Forestry Association, with an independent chair. Half of the revenue from the levy is likely to be spent on research and development, the rest on industry-good activities. Scion suggested that the Forest Growers Levy Trust has the potential to lead a nationally-coordinated effort to drive innovation in the forest sector.

The Wood Processors Association and the Pine Manufacturers Association are planning to merge, to help position the forest products industry more effectively. Scion’s board and
staff are involved in these developments, helping the industry plan for sustainable growth and better returns.

Legal challenges

We are aware that Scion is challenging the Bay of Plenty Regional Council on its precautionary principle regarding genetic engineering. Scion told us that it considers the Bay of Plenty Regional Council is writing a district plan that overrides the HSNO Act and the decisions of the Environmental Protection Authority (EPA). Scion expressed the view that the council’s plan would also involve the duplication of inspection and approval, with consequent costs. Scion told us its appeal has been strongly supported by Federated Farmers, the New Zealand Forest Owners’ Association, and Timberlands Limited among others.

Scion also requested that the EPA rule on the classification of two technologies, which elsewhere in the world are not classified as genetic modification, under the HSNO Act. The EPA ruled that the two technologies are not genetic modification, and therefore their products are not new organisms for the purposes of the Act.

Forest growth

Scion is working on harvesting trees on steep land and growing and harvesting trees more efficiently, in an effort to ensure that the industry’s export targets are met. We heard that the average New Zealand forest grows at about 18 tonnes of dry matter per hectare per year, compared with 40 tonnes in Brazil. Scion is trying to double the annual growth rate of radiata in central North Island forests. Scion told us it is also researching alternative species, such as Eucalypts, that may grow faster in New Zealand conditions.

Wilding pines

There is much concern about conifer wildings, especially on the part of forest growers in the South Island, where the risk of wilding spread from managed plantations is affecting growers’ freedom to operate and could generate liabilities. We heard that Scion is working with the Ministry for Primary Industries, the Department of Conservation, and regional councils to address the problem. Scion is continuing research on methods to reduce the cost of controlling wildings; for example, it is developing “sterile conifers” using genetic modification and other technology, as a best long-term solution to this problem.
Appendix

Approach to this financial review
We met on 20 November 2013 and 12 February 2014 to consider the financial review of the New Zealand Forest Research Institute Limited. We heard evidence from New Zealand Forest Research Institute 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
Simon O’Connor
Grant Robertson
Dr Megan Woods

Steffan Browning replaced Catherine Delahunty for this item of business.

Evidence and advice received
The New Zealand Forest Research Institute Limited response to written questions 1 to 140, and 141 to 156, received 18 November and 9 December 2013.


Organisation briefing paper, prepared by committee staff, dated 18 November 2013.
Report of the Commerce Committee

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Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of New Zealand Post Limited, and has considered Petition 2011/61 of Pam Cornelius and 934 others, and Petition 2011/65 of Jan Henderson. The committee recommends that the House take note of its report.

Introduction

New Zealand Post Limited is a state enterprise operating postal services throughout New Zealand. Its revenue is obtained from a number of subsidiary groups including Kiwibank, Datam, Express Couriers, and Parcel Direct. New Zealand Post Limited operates in New Zealand and Australia in postal, banking, payments, and courier services, logistics, and customer communication management. Its chief executive is Brian Roche; Hon Sir Michael Cullen is chairperson of the board.

Financial and service performance

In 2012/13 New Zealand Post generated total revenue of $1,688 million. The group’s net profit after tax was recorded at $121 million, a decrease from $169.7 million the previous year. The lower profit was attributed partly to an impairment charge of $30.6 million against postal assets and one-off restructuring costs of $20 million. The Office of the Auditor-General rated New Zealand Post’s management control environment as very good and its financial systems and controls as good.

Changes to deed of understanding

In October 2013 the Minister for Communications and Information Technology approved changes to New Zealand Post’s Deed of Understanding. The changes apply from 1 July 2015, and introduce three-day-a-week delivery in urban areas, whilst maintaining five-day delivery in rural areas. We heard that letter volumes are declining at a rate of 7 percent every year, and that the average household currently receives post on three of the six delivery days each week. The agreed changes would also alter the standard for mail delivery from three days to four. We asked if market research had been undertaken about the changes. Mr Roche said the changes were discussed for 18 months and respondents were generally supportive but concerned about the impact on rural areas and the elderly.

We asked what New Zealand Post is doing to minimise the impact of the changes on communities. We heard that it has contacted a number of large-volume senders to advise them to allow more time when sending mail. The delivery of bills and notifications of appointments was expected to be mostly unaffected, as these kinds of mail are generally sent far enough in advance to accommodate the change to the delivery standard. New Zealand Post will also be offering a premium overnight postal service.
We asked whether reducing delivery days had improved the company’s business projections. New Zealand Post said that a current estimate of the value of their logistics and post business was $250 million, whereas a previous valuation of the business (without the changes) was approximately -$285 million.

**Closures and restructuring**

New Zealand Post is halving the number of its mail processing centres to three; they expect eventually to need only two. The closures, along with changes to mail delivery, will result in approximately 2,000 staff losing their jobs. We heard that the company is actively assisting staff with the redundancy process; it aims to have restructuring completed by 1 July 2015.

**Delivery vehicles**

We understand New Zealand Post is trialling motorised vehicles to support mail delivery, in addition to traditional delivery on foot, and requested further information. We were told each vehicle costs approximately $15,000 and two models are currently being tested. New Zealand Post assured us that ownership and operation of the vehicles will remain in-house.

**Petition 2011/61 of Pam Cornelius and 934 others, and Petition 2011/65 of Jan Henderson**

The petition from Pam Cornelius and 934 others requests

That the House stop New Zealand Post going ahead with any proposal to reduce its mail delivery service from current levels.

New Zealand Post asserts that changes to the deed of understanding were only proposed after a number of other options were explored; it considers that reducing the number of delivery days each week was necessary to ensure the viability of its business.

The petition from Jan Henderson requests

That the House of Representatives note that 782 people have signed a petition urging New Zealand Post to retain a Postal Agency in the Victory community of Nelson.

We heard that the contract with the Victory postal outlet ended in April 2013; the franchisee was not performing and they were unable to find another business-owner to take over the franchise. New Zealand Post acknowledged that the closure caused inconvenience to some of its customers.

We considered these petitions alongside the 2012/13 financial review of New Zealand Post Limited. We have no further matters to bring to the attention of the House relating to these petitions.

**Financial services**

New Zealand Post offers financial services through its subsidiary Kiwibank, which has approximately 850,000 customers. In 2012/13 Kiwibank’s net profit after tax increased 23 percent to $97 million with growth in loans and deposits. Its Kiwisaver scheme has over 100,000 clients. We asked New Zealand Post if there were opportunities for Kiwibank’s further growth in New Zealand. We heard that Kiwibank is continuing to grow, but its management is now shifting focus to gain more value from its existing customer base. A major reason for this is the high capital costs of growth. Kiwibank’s priority will be to
ensure its current customers sign up to more of its financial services, including insurance and Kiwisaver.

**Systems upgrade**

We requested more detail about Kiwibank’s information systems upgrade. At present Kiwibank uses a system which was designed for smaller credit unions, which is unsuitable for large banks. Over the last 12 months the bank engaged external consultants and advisers in its decision-making process; the project is expected to be completed within three years. Although it will not be publicly visible, Kiwibank believes the upgrade will minimise risk.

**Competition**

We asked New Zealand Post for comment after hearing reports that some government departments are using business mail specialist DX for large-scale letter delivery. Mr Roche said New Zealand Post was disappointed that some agencies had chosen alternative postal options, but considers itself to be very competitive in terms of cost and service delivery.

We asked whether New Zealand Post’s parcel volumes had increased much because of online shopping. We heard parcel volumes had increased by approximately five percent, mostly from international senders. We heard that although New Zealand Post offers the only nationwide delivery service for letters there is a lot of competition in courier services and parcel delivery.

**New retail model**

New Zealand Post said it was making changes to its retail format, and considered a trial of them in its North Shore outlet to be very successful. The new model was said to offer a wide range of services in a more accessible, cost-effective way; we asked New Zealand Post to outline the main features for us. We heard there is a clear separation between financial and postal services, with more use of self-service kiosks and concierge services for simple customer transactions. New Zealand Post has found that this resulted in higher sales. New Zealand Post acknowledged that some customers will require assistance to adapt to using kiosks and plans to have staff available to assist them.

**RealMe**

We asked New Zealand Post for an update on RealMe, an online identity verification service which is a joint venture with the Department of Internal Affairs. New Zealand Post said the uptake of the service was growing. The Bank of New Zealand had already signed up, and Kiwibank was expected to shortly. However, along with its other digital earnings, New Zealand Post does not expect RealMe to increase the group’s profit significantly in the short-term.
Appendix A

Approach to this financial review

We met on 13 February and 20 March 2014 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
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Evidence and advice received

New Zealand Post Limited, Responses to written questions, received 4 February and 12 March 2014.


Appendix B

Corrected transcript of hearing of evidence 13 February 2014

Members
Jonathan Young (Chair)
Kanwaljit Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Mark Mitchell
Hon Chris Tremain
Denise Roche
Jian Yang

Witnesses
Hon Sir Michael Cullen
Brian Roche
Mark Yeoman

Young Well, welcome to the Commerce Committee, and thank you very much for appearing today. Hon Sir Michael Cullen, Mr Roche, Mr Yeoman, thank you. We look forward to hearing a presentation from you, then we’ll come to questions. Over to you, sir.

Cullen Thank you very much, Mr Young. I thought I wouldn’t go over the actual annual report and the results for the year because I know past history is never the main focus of the select committee hearings in practice in any case; it’s what might have been happening since. I’ll just start off with the sort of general picture. I think you’ll be familiar with the fact that we’re now basically organised into two sort of broad business areas: mail and logistics on the one hand, centred particularly around, obviously, the New Zealand Post traditional functions; and financial services, centred around Kiwibank. But both parts of that—both of those halves, if you like, of the business—are faced with adapting to a rapidly changing world, which is changing the way in which they have to operate as businesses.

Just a few simple facts: banking on mobile applications is up probably something like fourfold or more in the last 2 years; one in three of us are paying our bills online, and that number continues to rise; online shopping continues to increase—Mr Roche can tell you more about that; he’s a perpetual online shopper—letters continue to decline, roughly about 8 percent per annum now is our run rate for decline in letters; and the average household now receives letters 3 out of 6 days a week—that’s already the current average experience of receipt of letters. Even for people like
yourselves, you’ve probably noticed that there are days when nothing actually comes through your direct letterbox at home.

For the mail and logistics business, what that leads to is effectively our new deed of understanding, which Minister Amy Adams agreed to late last year, where we moved to a standard operation of 3 days a week. But I would emphasise again that there is a choice there of a premium service for those sending who want to try to get mail through faster. It will be 3 days a week basically in the suburban areas, primarily; 5 days a week in the rural areas. The Minister wanted to maintain a 5-day-a-week service there because it is a different situation, as we discussed last year, in the rural areas.

We’re proposing to progressively change from a delivery mode which is centred around a combination of walking and cycling to one which is much more around walking plus vehicle support. In fact, the board will be looking at some of the new vehicles next week. We’ve been engaged in optimisation of the mail processing—which is one of those nice business ways of saying cutting down on the number we’ve got, with people losing jobs as a consequence of that—down to three and eventually to two. We’re simply, sort of, over equipped with what we previously had. And we’ve been simplifying offerings and obviously concentrating on growing the parcels business. That, of course, leads to very large reductions in staff numbers. You’ve seen the numbers released late last year, maybe up to around 2,000 or so. We have what’s called future zone within the business, which is a series of some six different elements, which are designed to assist staff through that process, which will obviously be largely completed by the 1 July next year when we move to the 3 days a week.

There are still new possibilities across the range of the mail and communications business, apart from expanding parcels, and we’re having a good hard look at whether we’re getting our fair share of the growth in parcels business. There’s RealMe, which is the identification service—you would have noticed if you go into a post shop, you’ll see the camera there, which has a contract from Government, particularly used by internal affairs, and able to be used for a range of purposes. There’s YouShop, which is a project for facilitating people using online and offshore shopping; YouPost, which has transmogrified from recently a kind of “how do we take on email and Gmail” to something which is something which is much more about assistance for online e-commerce and associated activities—though at the moment also being used in relation to examination results, so making sure all the right things are going to the right people, it’s associated with all of that; Localist; and the expansion of Converga, which is an Australian-based industry, although it operates largely here as—well, not largely; primarily in Australia. Also Philippines and the US, they’ve just completed the purchase of a similar Australian business that has potential for significant expansion.

In Kiwibank it’s a rather different issue. In Kiwibank growth continues in the bank. That’s been true of the first 6 months of the current financial year. We’re at about $800 million growth in assets and liabilities, but there’s been a shift under way, which I think was formalised this week at the strategic advance that we had, to moving from an approach which is
fundamentally about growth to one which is about a much more complex range of changes and approaches, particularly seeking to extract more value out of our existing customer base—more products being taken up by our customers. We have a rather low average number compared with the banking average within New Zealand. So getting much more value for limited additional investment in Kiwibank in that regard.

Moving to a much greater emphasis upon digital first as, if you like, the sort of first option within the way people deal with Kiwibank. So it’s driven in part by technological change, driven in part by the fact that we’ve reached a certain stage of maturity in that retail banking side of the business, in part by the fact that we have capital constraints, which mean that we have to look at extracting more value, growing our revenue without necessarily having to grow at the same rate, either our staff or in our capital needs, because we are capital constrained. It also means a greater emphasis upon the growth of the wealth in the insurance side of the business, which has much lower capital requirements than the retail banking side of the business does.

We’ve been in the process of some changes in our retail offering. The changes to the North Shore have been successful. We’re seeing a significant uptake in business there, but probably our judgment is that that is too expensive for us to roll out across the rest of the country in that format. So we are looking at a somewhat different arrangement for the future in that regard, and to learn from a number of overseas examples about how to deliver a broad range of services across the country in the most accessible sites but also in a cost-efficient manner. So it’s not necessarily need less points of presence, but those points of presence may look different and in some cases be sited in different places, because our current siting is often a legacy issue: old shopping centres rather than where the new shopping centre is within particular areas and so on and so forth. So we have to change for those things as well.

So, we’re open to questions. When they get hard I’ll refer them to Brian Roche or Mark Yeoman, or look behind me at an even more dispensable head in the organisation than these two.

Young Thanks, Sir Michael. Mr Roche, I’m not sure whether you’re a self-confessed online shopper, but certainly the chair’s said that you are. Obviously, this is a big trend that is, I know, affecting retail outlets, because a lot of people are buying online, and then consequently parcels being couriered, etc. Do you have any sense of quantity shift that’s been happening in your network around this?

Roche The numbers are actually very hard to define because everyone has a different view of the world. But if we look at our major inbound volumes, they’re probably up between 5 and 7 percent. We think that trend will accelerate irrespective of what other policy initiatives there are at the border. I think there is a globalisation of consumerism now. People are used to it, and although it does have a domestic impact for our business, it provides real opportunities.
Young: Do you differentiate between domestic parcels and offshore coming in?

Roche: Yeah, we look at domestic flows and inbound international. We have a lot of inbound international but we are seeing an increasing amount of domestic flows. We see it as net-positive. There is one aspect to it. Previously we would normally deliver from a warehouse to a store, which, you know, gave us a sort of good commercial outcome. We’re now transferring from the warehouse directly to the household. That’s, I think, just the dynamic that’s happening in our society.

Young: Do you have any sense of quantity around that or percentage?

Roche: I’m not sure. It’s hard to predict but we know it’s growing. And if we look at the international experience—because we don’t see ourselves as a unique business, every other postal business worldwide has the same opportunities and the same challenges, and we compare favourably with what they’re seeing.

Cullen: OK. One of the big things to always remember is that we have the only nationwide delivery system for letters. We are not the only nationwide or even regional wide delivery system for parcels. That is a completely different context of competition.

Young: Yeah. Thanks for that.

Cosgrove: Could I ask you—there’s been some comment around the nature of competition between DX and yourselves, and I would assume, given your capacity, you are the more competitive option than DX for large-scale distributors for letters. Would that be a reasonable assumption?

Roche: We would assert that we are but people have individual choices and they exercise them.

Cosgrove: Yeah, sure. So the question is: can you advise us on which Government departments are not using your service, and can you give us any insight perhaps on—

Cullen: The Ministry of Justice certainly isn’t.

Cosgrove: Yeah, and could you give us any insight as to—

Cullen: Everything I’ve had from them in the previous role I was doing came through New Zealand Couriers.

Cosgrove: Is there any work being done to re-attract those departments back to New Zealand Post?

Roche: Yes there is. I haven’t got the list in front of me but I’d be happy to provide that. We are very disappointed when Government agencies don’t use our services. We’re happy to be competitive, and as the chairman said, the Ministry of Justice would be the standout one. It’s a very big user of courier and mail services, and they don’t use us.

Cosgrove: Do you have a rationale as to why?

Roche: It’s hard to determine the rationale of a purchaser. We’re a service business. We just have to be there to do what’s needed.
Cosgrove: Well, I presume it’s either price or service.

Roche: We would argue our price and our service is equal to everyone else, if not better. I think it’s important also to remember that DX often put a lot of their mail into our network to do that hard last mile where the economics are not as good as the density.

Cosgrove: Have you discussed this issue with Ministers?

Roche: I haven’t.

Cullen: I think I made one brief comment at one point. I wouldn’t sort of expect Ministers to put pressure on their departments in terms of which postal system they use.

Cosgrove: But surely you’d expect Ministers to, if we assume your service is as good or better and your prices are as competitive or better, be asking their departments: “Give us a justification for using those guys as opposed to New Zealand Post.” I’m not suggesting Ministers would direct things, but I would have thought Ministers would have asked for a rationale because there could well be a saving to the taxpayer.

Roche: It’s probably a question—

Cosgrove: I’m asking a question. It’s not a strong intervention. It’s common-sense.

Roche: It’s probably a question best put to Ministers. I mean, we have to stand on our own merits and make our case and we’re not always successful. That’s the nature of our world.

Cosgrove: In terms of the transition to the, if you like, motorised sort of Norwegian model, motorised parcels, what are the cost estimates around that, because presumably there are vehicles and other things. What are the sorts of costs and capital inputs around that?

Roche: We’re trialling two separate vehicles. One is what the Norwegians use and another one which I think the Swiss post are using. The costs of those vehicles, I think, are up to $15,000 to $20,000, but once again I’ll come back to you. We have to trial not just the commercial economics but the practical elements, and I think, as the chairman signalled, and we have talked previously at the committee, we’re at a point where our posties—walking and cycling—have probably reached a natural end. And although we have less product, it is increasingly heavier and bulkier, and actually is probably needing greater security than just leaving it in someone’s letterbox.

We’re starting that trial in the next month. We’ve got the full support of the unions. They understand that that’s an important part of our future, and we see it as a genuine innovation.

Cosgrove: Can I ask you: is it going to track the same way as couriers—owner vehicles, contractors rather than full-time employees—or are these going to be employees where equipment and vehicles are owned by you guys? What’s the endgame?

Roche: We don’t have a view on the contractor model. Our stated policy on this is we want to create as many full-time jobs for as many people for as long as
possible, and we’re going to stick to that philosophy. But if you go forward 10 years, it is very hard to predict exactly.

Cosgrove  So your initial objective is to retain the full-time employee scenario rather—

Roche  We are buying the vehicles.

Curran  Thanks. Thank you for your presentation. I’m speaking to you as an electorate-based MP in an electorate where there are a large number of elderly people. Firstly, actually, I’d like to say thank you for keeping the 5-day-a-week service in rural and regional New Zealand. I think that was a sensible and important decision. Otherwise the impact on small communities would have been quite adverse, and I think that message did get listened to. Do you have one question around that, which is, is there any intention to review that at some point? Is there a time limit being put on that or is that just basically an ongoing decision that’s been made?

Cullen  Well, the deed comes up for renewal again in 2018, I think.

Curran  18.

Cullen  2018.

Curran  OK. That’s useful to know. Going back to the urban environment, particularly for low-income elderly people, whether they’re on superannuation or on a benefit of some sort, and also people who are heavily reliant on the health system and therefore on appointments being sent out and that sort of thing. I guess I’m interested to know whether or not you’re going to be doing or are planning to do any monitoring of that cohort in the community and how they are faring and if they are being affected by particularly, for instance—using Dunedin as an example. Now that there’s no mail centre in Dunedin, that mail has to go from Dunedin Hospital to Christchurch to go back to somebody’s house, and how that may affect people in terms of meeting their legal requirements or the requirements with a Government department or being able to attend an appointment.

Cosgrove  Could I just add one other point to that? Also it was raised with me, for instance, the discount we receive by paying, say, the power bill a couple of days in advance, and other issues, in fact.

Cullen  Well, take the last one. Those bills come out well before the due date for payment, and most people are—they don’t come out a day or two before payment. I mean, your rates bill comes out weeks before payment is due. The main danger is you forget to do it because it’s so far advanced if you’re not used to setting up automatic payment dates online, in which case you’re OK.

In terms of the others, the main change in terms of what happens because of three versus six is that the service delivery standard changes from 3 days to 4 days. So the important thing is that the people sending are aware of that change in the delivery standard. They’ve got to know therefore that they’ve got to allow maybe for an extra day compared to what they may have done if they’re sending out so close to time for appointments.
Curran  For example, if you’re going to have your benefit cut off for some reason because you haven’t fulfilled some requirement, has there been any discussions with those Government departments about the importance of making sure that they take extra time to send notifications of things that people have to do in the timeframes in which they have to do it? Have you actually undertaken those discussions?

Cullen  I’ll let Brian answer that.

Roche  There’ve been a number of discussions with the large senders and, you know, this is going to require some adaptation primarily by them and also by us. We are confident that we can meet the service standard. Is that a guarantee that from the odd time there will be a mistake? No, I can’t give that guarantee.

And, actually, to be honest—going back to the earlier point—a number of the DHBs use DX as their provider and so although people often say it’s New Zealand Post, it actually isn’t New Zealand Post, it’s often another provider.

Cosgrove  Could I just ask you a couple of quick questions around Te Puni, the mail centre, given the plan is to close and not relocate but the emphasis goes on expanding at Palmerston North. What’s the plan for the site and do you plan to sell it?

Roche  We definitely plan to sell it and it’s now being actively marketed. There’s a Bayleys sign up as we speak.

Cosgrove  What’s the current public valuation?

Roche  The exact valuation, I think, is about $15 million but once again I can confirm that if members require.

Cosgrove  That’d be good. And the likely redundancy numbers given redeployment from that shift?

Roche  I think from memory the likely redundancy numbers were about 200 people there, and we announced that and we are working with all of those staff. You know, regrettably, not many of them were able to shift to the Manawatū and that’s why, as the chairman said, we have actually got quite an active programme, which goes well beyond the minimum requirements to help.

Tremain  Well, firstly, I think the committee would acknowledge what a dynamic business you’re involved in and the tough decisions that you have to make now and, I guess, over the future. I mean, the point you made around a 7 percent decline in mail services annually points directly to that.

I want to focus on a couple of areas. One is, I guess, the projections in your core business and that core mail business going forward as a result of the significant changes you’ve made. Firstly, I guess the change you’ve got through Minister Adams signing off on the delivery and the changes you’re making with going from six distribution centres to three. How do those two things and the other changes you’re making in that area drive core
profitability? What are the projections over the next—I guess up to 2018, when there’s another chance to reassess that?

Cullen Well, I suppose to put it another way, in terms of valuation, the last valuation we had for mail and communications business based upon the projections of no change to the deed was negative $285 million. Our latest estimate based on changes to the deed is more around plus $250 million. So it’s quite a significant change in the financials of the business in that regard.

Beyond that kind of 5-year horizon, I think everybody in the world in terms of postal businesses is still unsure just what’s going to happen to that decline. Will it accelerate further? Will it bottom out in some way? People are still having to feel their way in that regard so one has to maintain a fairly high level of flexibility around the future. We haven’t basically changed the model. It’s not a structural change to the model; it’s an adaptation of the model—the fundamental model of letters in, sorted, letters out, delivered. It’s still there as it has been for 170 years.

Tremain So in terms of a *(inaudible)* value, and that’s indicative of the decision you make, what are the profit projections for the next—up to 2018? Obviously, I understand at the moment it’s pretty much break even in that core business?

Cullen Yeah, and therefore we’re assuming moving back into positive territory on the mail communication side but the biggest profit uplift is still forecast on the financial services side, particularly if we grow the wealth and insurance side of the business. Already, I mean KiwiSaver—he says modestly—is making a significant contribution to the profitability of the business. We’ve got over 100,000 KiwiSaver clients now. We are the sixth largest in the country.

Cosgrove I think there’s been a road to Damascus experience by a number of people in support of that proposition.

Cullen I’m happy to sell soft drinks along the line.

Tremain They were keen to move into financial services place pretty quickly. One last question on that core business. The premium service that you’re looking to offer in addition to the 3-day mail, can you just explain the proposal is there?

Roche That will be very similar to an express overnight. So if it’s time sensitive, it will go effectively into our courier network. We haven’t determined the price of that yet but it does actually put the value capture back into the sender. If it’s important they’ll pay, otherwise it’ll be, you know, 2 days later. So just to add to the chairman’s comments about your earlier question, the big decline is in our transactional mail and those declines are influenced very much by each company’s own sort of technology and digital strategy and it’s hard to predict.

Bakshi What is your strategy on the digital side, because you’ve two small services connecting to digital technology? Can you give us some update on that?
Cullen What I can say generally is that we can’t be a big supplier of digital services—that space is already filled and is being filled over and over again. And when the question is sometimes raised “Why didn’t New Zealand Post or Australia Post or Norwegian Post—or any other post—get in and invent email in the first place?”, then the answer is quite simply the culture of that kind of business is not the culture which creates something like Google or Yahoo!, or Twitter, or Facebook, or whatever.

Roche Yahoo!’s not doing so well.

Cullen No, and, interestingly, all those things actually tend to peak and then decline over quite a relatively short space in time. Facebook is being forecast now to decline rapidly so MPs busy on Facebook will have to move on to Twitter, on to whatever is next—whatever ghastly name now emerges as the next big thing where you can say everything in three letters.

Roche You say curmudgeonly!

Cullen So as not to tax people’s brains too much in the long-term future.

Bakshi Some of initiatives taken, like Internal Affairs, the RealMe; have you some growth on that area?

Cullen Yes, we are, but they are relatively small contributions to profitability and we don’t anticipate them being large contributions to profitability. The YouPost one, we will see how that develops. That's not really gone live yet in terms of public live. There is quite big potential in there, because we will be providing a service to a whole range of large businesses around the country, including other banks, and that is a business which may have some significant expansion. Post for a while I think was always looking for another Kiwibank, if you like. There is not another Kiwibank that we can see out there, if I can put it that way.

Tremain Can I just get to what Kanwaljit was saying there in terms of RealMe. Obviously, Post is offering a sign-up service to RealMe, which is progressing slowly but surely. In terms of leadership and the banking side of it with Kiwibank, just talk me through what some of the proposals are over the next 2 years, and how you are going to utilise RealMe to drive uptake of online services.

Roche Actually, Kiwibank along with several of the other banks are going to use it as one of the keys to allow them to sort of create an environment, a secure environment, where transactions can occur, and I think one of the pain points all the banks have, including Kiwibank, is when you’re online the multiple re-presenting of information and knowing that you are who you assert you are. So, at its simplest point, RealMe allows it to be an authentic transaction and we think the value of that, having regard to privacy and money-laundering and all of those things, provides a real opportunity for us.

The joint venture or the contract with Internal Affairs has not gone as quickly as some would have liked but we see quite increased momentum now.
Tremain I guess the reason why I asked the question is I see BNZ came out just this week with account sign-up online using the service. How far down the track are those sorts of services from Kiwibank?

Roche We expect them to sign up very shortly, and then there will be momentum.

Young All right. Can I just touch on the fact that we sent you a couple of petitions and Mr Roche you have replied back to us.

Roche Yes.

Young Do you have any comments around those petitions from Pam Cornelius, 934 others, and Pam Henderson?

Roche I suppose my only comments, which are recorded in the letters, the response back to you, is we only take these actions after we have explored every other credible alternative, and in both cases I am confident that we did that, and we could not get a workable solution. I really don’t have much more to add than that.

Young No, well in fact we do know that—

Roche We acknowledge that it’s a huge inconvenience to what is a small but important group of people.

Young And, of course, we’ve had yourself and Sir Michael come into the committee before in response to similar petitions, but we just wanted to give you the opportunity, in this hearing, to make any further comments.

Cullen Well, the Victory one was the classic case of a franchise operation, where the franchisee wasn’t performing and there was nobody else prepared to take over that franchise operation. That’s happened with a number of the closures; that’s been the reason—there’s nobody prepared to take over the business, because nobody can actually make any money about doing business. We have to make sure as best we can that those franchise operations are operating as efficiently and as properly—and I use that word advisedly—as if they were fully within, if you like, the New Zealand Post family.

Cosgrove Although, and this was before your time, you’d concede that even in the area that I come from, there were franchise owners—and I can think of one specifically close to my heart—who were performing over and above the margins?

Cullen Absolutely.

Cosgrove And were closed.

Cullen Absolutely. But we do tend to have sometimes more problems in terms of conformity with some of the rules with some of the franchisees than we do with the core post shops as such.

Roche Can I just add, with respect to the second petition on the deed and the changes to that, I think we’re on the public record that we believe that that was critical to the ongoing viability of our business. We did look at a
number of options. They were unavoidable. So, in terms of the petitioner, there’s not much more we can add to what we’ve said publicly.

Tremain Can I ask a couple of questions around—at the end of your presentation you spoke about the North Shore centre. Can you just describe for the committee what are the differences in services that are provided? I have had the benefit of going to that new facility. What are the new services provided?

Cullen Some of that was simply increased presence, because we didn’t have a big presence on the North Shore, so we increased the presence. There is a very clear separation between the Kiwibank part and the post part. There is more automation. There are screens and kiosks, etc., available. This has reduced significantly the amount of time. There is a greater use of concierge-type operations. So we’re getting more sales of other services through those new branches than we were in the existing branches.

So the business case has largely been met. But even in the time that it has been going on, the digital world has moved on even further, so we need to rethink, I think, how we are going to be doing all of this stuff in the future. How do we provide the best range of services, in a way which is economically efficient, across the broad range of New Zealand? We are, outside Auckland, a dispersed population.

Tremain Do you think, Dr Cullen—

Cullen Well, even within Auckland there’s a dispersed population, I think, (inaudible) that’s a different issue.

Tremain As Government services increasingly go online, particularly the transactional ones, (inaudible) and that (inaudible) there by 2017, do you think there’s an opportunity for New Zealand Post, particularly with its distributive network, to kind of provide that link as services move from mostly online to fully online to provide us with that digital assist service for a lot of the transactional work where those who are either older or don’t have access to technology still need help to access those transactional services?

Cullen One of the models I talked about at the recent Kiwibank discussions this week was, if you look at what Air New Zealand did with those check-ins, there was a lot of people—I mean, practically all their existing staff—on hand to help people work their way through and get used to the machines, etc., etc., and now they need far fewer people actually doing that kind of concierge work.

I think when we’re looking at the future, sort of the tiering of our retail network, we’ll need to think in those terms as well, and helping people, particularly older people—he says—get used to using those screens, using that kind of technology, because often there’s a bit of a fear factor there, as much as anything else, and once people have sort of got into it then they’re quite happy with it. In fact, they might be able to do their banking online at home, if they’ve been shown how to do that in a kiosk operation, etc., etc.,
So we need to take people on the journey. There is this enormous segmentation between the younger population, who almost prefer communicating by technology to face-to-face, and older people who still prefer very much communication face-to-face rather than via technology.

Mitchell
This is quite an operational question, because your shop in Ōrewa, of course, has been converted and seems to be working very well. But the staff who actually man it, are they cross-trained? Can they provide services to both the post and the Kiwibank side of the business?

Roche
As a general rule, yes. In the bigger stores we have got greater specialisation so that’s why we’ve made it very clear if you’re in the bank that you will be dealing with somebody who is completely au fait with the current regulations and compliance and other attributes around financial services, and so we do have a blended model but we want areas of specialisation. It depends a wee bit on the community and what their service needs are.

Cullen
It is important to remember that the level of regulation and compliance in the financial sector over the last couple of years has increased enormously and our Inaudible and it’s not driven out of New Zealand. It’s essentially driven from offshore. So we had a huge spend on the anti-money-laundering exercise, and bluntly, we were all cross-fingers come 1 July last year, whenever it was: is this going to work? Will it actually happen right, having spent a really large amount of money on doing it?

That wasn’t something that we chose to do. It was not actually something the New Zealand Government chose to do. It was a requirement if we are to do business with the United States that we had that legislation and level of regulation.

Mitchell
So you’re moving more towards specialised roles? The only reason why I ask is that, depending on the time of day, there may be a heavy demand for post shop services or Kiwibank services, and you may end up with staff who are a bit redundant, standing there.

Roche
That’s something we try to avoid. Ultimately, if there’s somebody in the queue they need to be served.

Mitchell
OK; thank you.

Cosgrove
Just going back a step. I notice from question No. 12 you embarked on quite a bit of market research, as part of your customer research framework. I wonder, could you just tell us whether there was specific market research done on the daily reduction issue and, if you’re permitted to, what the results of that were.

Cullen
On the what, sorry?

Cosgrove
On the postal daily reduction issue—delivery reduction.

Cullen
What we do know is we’re already delivering 3 days a week on average.

Cosgrove
But did you test the market and ask them what they thought?

Cullen
Deliverers or receivers?
Cosgrove Receivers.
Roche Yes, we did.
Cosgrove And in rural areas, particularly.
Roche I think it was in the year prior to that, because in the discussions around the change in the deed actually were 12 to 18 months, so we did do some research and we tested some propositions and we found that people were supportive of the idea but concerned about the impact it would have on the elderly and the rural areas. That actually figured a lot in our thinking, particularly around how we ended up with the rural solution and the urban one. So yes, we did do some.
Cosgrove Was there major opposition or support rurally?
Roche No.
Cullen No. The biggest concerns came from a rural sector, by a long chalk, but we had worked quite closely with both Fed Farmers and Rural Women New Zealand to ensure that we were getting appropriate feedback in that regard.
Roche We also engaged a lot with Grey Power to try to get past the generalisation that old people don’t use computers. I mean, they see it as actually a number of elderly use computers and are quite conversant with them, because they Skype their grandchildren. So, yeah, we had to get beyond the generalisation into the reality.
Curran They can’t always afford them.
Cullen Yes, which is why—I mean, Clare Curran’s point is a good one: if they can afford it. That is why we will probably need to be using facilities within our future retail network which enables people to use them there rather than necessarily having to use them at home.
Curran That’s really useful to know, because a number of people use computers at libraries because they don’t have one in their home.
Cullen Yes they do, absolutely.
Curran And, I’m using south Dunedin as an example, there is no library, so you’d have to then get on the bus and go into town to use the library to access a computer with the internet to access a Government department. So having more outlets that are close to where you live, if you can’t afford the connection in your own home, is actually quite critical.
Cullen All of the elderly of south Dunedin lining up to play games on the New Zealand Post computer, though, is not one that I would kind of want to get out there as what we’re about as a business.
Curran It’s not all about games, Dr Cullen.
Cullen We know what the internet is used for about half the time.
Roche We don’t want that in our stores.
Cullen We don’t want that in our stores.
Tremain

On a different line slightly, going back to Kiwibank, you made the point that you’re not pursuing perhaps so much a growth agenda in terms of customers. Do you think you’ve reached a ceiling there?

Cullen

No. No, no. We’ve got organic growth occurring but the emphasis has been very much within the culture of Kiwibank from the start has been grow the bank, increase our market share 1 percent per annum, so on and so forth. Every time we do that, of course, we have further capital requirements under, obviously the Basel and Reserve Bank rules. We are capital constrained. We can’t just rely upon that kind of growth. In any case, it’s clear we have large opportunities out of our existing 850,000 customer base, which is not being fully farmed, where there is very significant added value that can be gained from that existing customer base.

Tremain

So what are your projections in terms of revenue, up from those added (inaudible)? I guess you’re talking more insurance, more on KiwiSaver—

Cullen

Yes. Credit cards, etc.

Tremain

What sort of revenue do you think you can get from those areas?

Cullen

We’re still working on that. It would be fair to say, as I said, that this is a relatively recent, if you like, final agreement across the board in Kiwibank. That culture has now got to change to a different culture, which isn’t part, as I said, of a culture of maturation anyway, in terms of being no longer a little bank which is growing very rapidly, but a quite large bank by New Zealand standards. There’s still some way off the big four, but a sort of, if I might say so, Tottenham Hotspur or Everton but not a Chelsea, Arsenal, Liverpool, or Man City.

Young

So just following on Chris Tremain’s line of questioning, in terms of the modernisation of your core banking services, can you just give us a bit of an update on that, what you are looking at doing, and particularly where that modernisation is and how you are going to upgrade it?

Roche

This is a major project which we have signalled for the last 3 or 4 years. When the bank started, it basically used an Australian-based system which has both aged and is now increasingly not supported. So we had a decision that we had to make about the resilience of the operating system. We have spent the best part of 12 months going through a competitive process. We had three parties, got down to two, and the announcement will be next week on the successful candidate.

We spent a lot of time reflecting on lessons from others who have embarked on these sorts of projects in terms of blowouts and all those sorts of things, and we think about Novopay particularly in that regard. I think we are being very, very cautious. We have engaged with the Government’s CIO to get some engagement with him, although he is not formally accountable. So we were quite open to lessons from others and are very confident that we are starting in a good place.

Cullen

We had external consultants in review. We also had separate advisers for both the board and the senior management CEO of Kiwibank all the way through the process of consideration of the BSS up to signing up. And we
are expecting Kiwibank will be appointing in effect a senior person to manage the project through.

Young  OK. So what is your desired end state? What do you hope at the end of this process you are going to be able to deliver to customers.

Cullen  I think primarily a greater level of security and certainty about the performance of our system. The primary reason for investing in the new system is less to do lots of new things; it’s to make sure we can do our current things, because our system was designed for a much smaller organisation than Kiwibank now is. It was designed for Australian credit unions. We are the sole customer in New Zealand, so there is provider risk around that for all kinds of reasons. It was essential to move to a new business systems provider.

Young  Right. OK. So in terms of managing the risk of the old system, can you just give us some comment on that.

Roche  It’s important that we’re not saying there is a crisis here. This is something that we’ve got several years to manage, which is why we took an early decision, so we weren’t, as it were, up against it. We’ve got a very good risk management process to make sure the existing system is functional. And the Reserve Bank and others have very close inquiry about that, because it’s not just Kiwibank; it’s the financial system. So we’re doing what other banks have done: take an early decision that in 2 or 3 years’ time we need to be in a different place. We are looking at this being a 3-year project, which I know sounds a long time, but that’s the scale of it, and we want to take a very methodical approach to it. We don’t need to rush.

Young  OK. So you’ve got a 2 or 3-year window where, would you say that that 2 or 3 years is the maximum window that you need to be working to, just knowing that you’re increasing your customer base during that time?

Roche  We could function for longer without any sort of crisis. We just sort of think from a risk management and prudent perspective that if we can do it earlier, then that would be good.

Cullen  The most crucial functionalities are 18 months, is that right, from the timetable?

Roche  Before things change. But it’s not visible from the customer’s perspective; it just gives us greater sort of certainty.

Young  Right, thanks very much.

Yang  Looking at your website, I saw that under the products and services page, you have 10 items, like personalised mail, online shopping, gift cards. I’m just wondering whether you’re looking at any other areas or products and services which you believe have great potential and you are trying to develop.

Roche  Not really. Probably we want to simplify our product range and make it less confusing. That is the principle. We still remain very active with those large customers who want to do direct marketing. If we look internationally, as transactional mail reduces, direct mail is beginning to increase in value, and
the people who are involved in direct mail believe that there is real value, and the economics of that would suggest that if you were doing a marketing campaign, that is much more likely to be successful than putting it on the internet.

Yang So it is popular.
Roche Yes, but very targeted. It is using information wisely, and we sort of see that potentially helping level out the decline, but we can’t predict that.
Yang Are you looking at other countries, for example, trying to find new products that New Zealand might follow?
Roche We spend a lot of time learning and looking at what others do, and they look and learn from us. So I’m very comfortable that there is nothing that we are missing.
Young Good. I think we have asked all the questions we want. Thank you very much for appearing today, and all the best for the future.

conclusion of evidence
2012/13 financial review of the New Zealand Qualifications Authority

Report of the Education and Science Committee

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New Zealand Qualifications Authority

**Recommendation**

The Education and Science Committee has conducted the financial review of the 2012/13 performance and current operations of the New Zealand Qualifications Authority and recommends that the House take note of its report.

**Introduction**

The New Zealand Qualifications Authority (NZQA) is a Crown entity established under the Education Act 1989. NZQA's functions are to manage the New Zealand Qualifications Framework, manage the secondary school assessment system, provide independent quality-assurance for non-university education providers and Industry Training Organisations (ITOs), and recognise overseas qualifications.

During the 2012/13 financial year, NZQA’s total revenue was $83.4 million, a 3 percent increase from 2011/12. The increase in revenue was almost entirely from additional funding from the Ministry of Education for the Youth Guarantee scheme, and the Internal Assessment Resources project. Savings in the printing budget from removing redundant qualifications contributed to a five-fold increase in surplus from the previous year, to $385,000. The Office of the Auditor-General issued an unmodified audit opinion on the financial statements and non-financial reporting of NZQA. The office graded NZQA’s management control environment and its financial information systems as very good, and its service performance information and associated systems and controls as good.

**International reputation**

**Interaction with overseas jurisdictions**

During the year under review, NZQA provided qualification recognition services for over 10,000 people from overseas. NZQA is liaising with other countries on recognition arrangements, so that people who want to work or study in New Zealand can have their qualifications evaluated when they arrive in New Zealand. NZQA has completed this process with Ireland, and is working with Australia to achieve a similar recognition arrangement. NZQA has gained endorsement from the Malaysian Qualifications Agency Council to recognise Bachelor’s degrees, and made progress on a pilot project for recognising vocational qualifications with the Ministry of Human Resources and Social Security in China.

**Student cheating services**

In the year under review, NZQA and the New Zealand Police launched an inquiry into Assignment4U, an Auckland company that allegedly offered to complete assignments for international students at various New Zealand tertiary education providers in exchange for payment. No charges had been laid at the time of our hearing, and NZQA could not indicate when charges could be expected, but confirmed that it intended to bring either a civil or a criminal prosecution against the company.

The Education Act has provisions to address such fraudulent services. New Zealand is one of the few countries in the world that has such a provision in legislation. However, the
legislation deals only with cheating services located in New Zealand, such as Assignment4U. NZQA is aware that students could use cheating services operating overseas, and told us the best way to deter their use is by strengthening detection at an institutional level. NZQA is also working with sister organisations in overseas jurisdictions to prevent these services from operating. We will watch with interest any developments in this area.

**Evaluations in the tertiary sector**

NZQA uses various methods to assess the performance of tertiary education organisations, including a rigorous registration process and external evaluation and review reports. These reports indicate how confident NZQA is in each organisation, using four categories ranging from “highly confident” to “not confident” (category 4). In the year under review, seven private training establishments were placed in category 4. We understand that NZQA worked with the Tertiary Education Commission and Immigration New Zealand to investigate a number of private training establishments that were allegedly working as immigration scams during the year under review. NZQA is confident in its systems, and is sure it will catch any such establishments that are set up for purposes of immigration fraud.

**National Certificate of Educational Achievement**

**Results**

NZQA manages the assessment of National Certificate of Educational Achievement exams. In 2013, 164,000 students sat 1.3 million such assessments at 400 centres around the country. For the first time, NZQA publicly set a date for publishing the results on its website. We are aware that the release of these results each year is eagerly awaited by students and their families, and by the media. When the results of the 2012 assessments were published, NZQA’s website could not process the large volume of data requests promptly. We are pleased to note that NZQA’s website withstood heavy traffic in 2014 much better than it had in previous years. We hope to see continued improvement in this area.

**Special assessment conditions**

We are aware that candidates with a permanent or long-term medical, physical, or sensory condition, or a specific learning disability, may apply for special assessment conditions, such as reader-writer assistance. Any support offered does not address failings in the area being examined. NZQA is working on voice-recognition assessment tools, to allow some students requiring special assessment conditions to sit exams without reader-writers. The Ministry of Education recognised dyslexia as requiring special assessment conditions in 2007, which resulted in an increase in the number of eligible students. NZQA could not meet the resultant demand, so some students did not get the support that they needed. NZQA is working to ensure that this does not happen again.

Some of us expressed concern that students from high-decile schools are over-represented among those granted special assessment conditions. In the 2013 examination cycle, two-thirds of students with special assessment conditions for scholarship exams were from decile 8, 9, or 10 schools. NZQA suggested that the number of scholarship students eligible for special assessment conditions is consistent between deciles as a proportion of the total number of scholarship candidates. NZQA said that the ministry is investigating whether high-decile schools receive more support than others in this respect, and was due
to publish a report after our hearing. NZQA is confident that it will be able to address resulting recommendations regarding assessments.

**Relationship with stakeholders**

We are aware that a review NZQA conducted of the certificate and diploma qualifications on offer resulted in the removal of a large number of redundant qualifications. The review also made it clearer which programmes are needed to achieve particular qualifications, helping students understand what potential career paths their qualifications prepare them for, and helping employers understand the skills that a qualification describes.

Some of us are concerned that NZQA is not connecting well to small and medium-sized enterprises. NZQA recognises the importance of this sector, and we are pleased to hear that NZQA is seeking to improve its relationship with smaller enterprises. NZQA has produced a number of guides to help businesses understand the qualifications on offer, and is working with business groups to improve their understanding of records of learning.

We were interested in NZQA’s understanding of its relationship with ITOs, as we are aware that some ITOs have described NZQA as bureaucratic and out of touch with their needs. NZQA is confident that it has sound working relationships with ITOs, and is encouraging feedback from them. NZQA suggested that any unhappiness may have been caused by the quality demands it places on ITOs.

**New course providers**

We are aware that some private training organisations have been recognised as new providers of particular courses. We had heard some of these providers have no experience in teaching the courses in question, and approached polytechnics to purchase curriculum and course materials from them. NZQA said it would follow up any such report.
Appendix

Approach to this financial review

We met on 12 February and 12 March 2014 to consider the financial review of the New Zealand Qualifications Authority. We heard evidence from the New Zealand Qualifications Authority 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
Simon O’Connor
Grant Robertson
Dr Megan Woods

Evidence and advice received

NZQA, response to written questions 1 to 140, and 141 to 147, received 27 January and 26 February 2014.

Office of the Auditor-General, Briefing on New Zealand Qualifications Authority, dated 27 January 2014.

Organisation briefing paper, prepared by committee staff, dated 27 January 2014.
The Government Administration Committee has conducted the financial review of the 2012/13 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
2012/13 financial review of New Zealand Trade and Enterprise
Report of the Commerce Committee

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New Zealand Trade and Enterprise

Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 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, which was established under the New Zealand Trade and Enterprise Act 2003. Its 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 2012/13 financial year, NZTE’s total income was $174.805 million, and its total expenditure was $174.492 million, resulting in a surplus of $313,000.

A number of NZTE staff were seconded to Callaghan Innovation to help with its establishment, which took place on 1 February 2013. At the end of June the Better by Lean training programme was transferred from NZTE to Callaghan Innovation.

Botulism scare

In late 2013, fear that Fonterra milk products might have been contaminated by botulism culminated in a recall of products in a number of overseas markets, bans in Russia and Sri Lanka, and questioning by global consumers of New Zealand’s reputation as a source of clean, safe food products. After further testing showed that Fonterra products were not contaminated, Ministers, including the Prime Minister, sought to reassure global markets, especially China’s, that New Zealand food products were safe.

We asked NZTE to comment on the effect of the scare on New Zealand companies that export food products to China. It said that there had been a short-term impact on business, but the forthright, open response of Fonterra and the Government had demonstrated to Chinese consumers that New Zealand had good food security precautions. It highlighted President Xi Jinping’s recent labelling of New Zealand–China ties as “exemplary” and “pioneering” as evidence of progress. It also pointed out that the response to the incident had improved the supply chain for all the companies involved.

We were pleased to hear that the response of the Government and Fonterra, according to NZTE, has had more positive than negative effect on New Zealand’s reputation.

During the scare, NZTE established measures to help affected companies, including a market connection fund, which allowed smaller companies to fly to China and meet their customers. It also took measures to counter attempts by overseas dairy producers to capitalise on New Zealand’s misfortunes. However, we are concerned that smaller New Zealand food-exporting companies have been harmed by the botulism scare.

Business Growth Agenda

NZTE plays a crucial role in supporting the Government’s Business Growth Agenda, which seeks to promote the growth of New Zealand businesses. One of the agenda’s goals
is to lift New Zealand’s export production from 30 to 40 percent of Gross Domestic Product by 2025. To this end, NZTE is aiming to double its portfolio’s international revenue in this period. NZTE works with a portfolio of businesses to improve their capability. It focuses in particular on 500 New Zealand companies to help them grow internationally.

The number of businesses using NZTE’s services increased much faster than forecast for the year under review (to 3,115 rather than 1,500–2,000). We asked whether the organisation was coping with the increased demand for its services. We heard that NZTE had analysed the issue a year ago, and had ascertained that it would need more funding to match demand. We have been advised that Government intends to increase funding for NZTE in Budget 2014 to allow it to work intensively with 700 companies. However, it pointed out that a 10-percent increase in funding would enable it to provide 40 percent more businesses with assistance. NZTE said that it would continue to increase the number and the capability of companies that it assists, and also consider how the Government could commercialise intellectual property in the public service.

NZTE noted several highlights in the year under review, especially the success of a programme leveraging the America’s Cup, in which 64 New Zealand companies participated. It also mentioned collaboration with Tourism New Zealand and Education New Zealand to develop the New Zealand Story, which will create a unique New Zealand brand to aid export growth.

**LanzaTech**

We are interested in the type of assistance given to businesses in New Zealand, in the light of the biotechnology firm LanzaTech’s recent announcement of its intention to relocate its research and development arm to the United States, reputedly to take advantage of research and development subsidies offered by the Illinois State Government.

NZTE provides advisory services and programmes to businesses in areas such as research and design, access to capital, leadership, strategy, and marketing. It said that it had to work within its mandate to encourage businesses to move to, or remain in, New Zealand. It considered it would be dangerous for New Zealand to try to compete on a funding level with other governments; having abandoned the use of subsidies, New Zealand had to find other ways to promote its research and development capabilities and support its graduate scientists. NZTE also pointed out that LanzaTech would retain part of its operation and many shareholders in New Zealand, so some benefits would still flow back to New Zealand.

**Green, sustainable growth**

It is in New Zealand’s long-term economic interest to continue to promote green, sustainable growth. New Zealand’s environmental credentials are hugely important in terms of integrity, branding, and quality of life. We heard that the concept of sustainable growth pervades businesses in all sectors of the economy. Both government and business are aware that New Zealand must maintain the integrity of the “100 percent Pure NZ” brand. We were told that New Zealand businesses are generally more aware of their impact on the environment than their international counterparts.
Promotion of New Zealand trade and business by Ministers

Alongside a sound international growth strategy supported by Government agencies and Crown entities, Government Ministers and the Prime Minister can play key roles in facilitating trade deals, gaining access to markets, and resolving trade issues. NZTE considers the roles of the relevant portfolio Ministers to be an important potential advantage for New Zealand companies succeeding internationally, especially in cultures where “face” is important.

We asked whether Ministers could “open doors” for New Zealand businesses in China. NZTE considered that it would always be advantageous for New Zealand companies to be seen to have the support of the Government, but it was up to individual companies to find their own doors, and to New Zealand trade officials to assist them to open them. While the presence of a relevant portfolio Minister, such as the Minister of Trade, was likely to have a positive influence in resolving trade issues, any Minister should be seen as working for all New Zealand companies rather than any one.
Appendix A

Approach to this financial review
We met on 10 April and 8 May 2014 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
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Ann Genter
Mark Mitchell
Hon Chris Tremain
Jian Yang

Evidence and advice received
Office of the Auditor-General, Briefing on New Zealand Trade and Enterprise, dated 10 April 2014.

Organisation briefing paper, prepared by committee staff, dated 4 April 2014.

New Zealand Trade and Enterprise, Responses to written questions, received 1 April and 5 May 2014.
Appendix B

Corrected transcript of hearing of evidence 10 April 2014

Members
Jonathan Young (Chair)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Kris Faafoi
Kennedy Graham
Raymond Huo
Hon Chris Tremain
Jian Yang

Witnesses
Peter Chrisp, Chief Executive, NZTE
Andrew Ferrier, Chair, NZTE

Young
Good morning, and welcome to the Commerce Committee, Mr Ferrier and Mr Chrisp—good to see you. Those at review hearing with us, I appreciate you being here. We will ask you to make some introductory comments and then we’ll come to questions. Thank you very much.

Ferrier
OK. Thank you, Mr Chair, and good morning all. I am Andrew Ferrier, the Chair of New Zealand Trade and Enterprise. With me is Peter Chrisp, the Chief Executive of NZTE. As the Government’s international development agency, our focus is on growing companies internationally for the benefit of New Zealand. The approach is driven by four interlocking strategies in terms of how we go about doing our business. First and foremost, we try to work one on one with the major companies that we see have the highest growth potential. We have a “focus 500”. Pete will get into some more detail there. We apply a very tailored, sort of unique, one-on-one programme to the individual companies—those 500.

Secondly, and importantly, we also try to get groups of companies to cooperate together and use economies of scale in certain opportunities—sort of Coalitions of the Willing, where those companies can come together and collaborate on the things that don’t compromise their individual competitive interests, but work to the benefit of the whole.

Thirdly, we try to provide the right services at the right time in the right place for any New Zealand company that wants to take advantage of our services. Fourthly, we mobilise capital for companies in New Zealand in order to help them grow. Importantly, we do all of this in cooperation and
collaboration with our sister agencies in New Zealand—a very strong NZ Inc. approach.

The results that we’ve seen over the last few years, I think, are encouraging. We have seen the growth of our customers, which is tracking at a rate above the broader export sector. We’ve seen an increase in the value of deals done that have been supported by NZTE. Importantly, our customers are increasingly saying that we’re adding value to them.

We started a strategy 3 years ago called Playing to Win. It’s an improvement programme that’s been running and has contributed to improved services at lower cost. Importantly, it’s rebuilt the engine behind NZTE so that we can deliver greater value to business at a lower cost: more per customer for less investment. It’s been a bit of a mantra for the last few years.

Now we have the opportunity after bedding that down to really step up and have an impact even further. The initial funding that was announced by the Government last week will allow us to both deliver more to our current customers, to put additional people on the ground in international markets where the need is greatest, and to extend our intensive support to more businesses. I mentioned we were doing 500 before. We can go to more businesses than that. It will really allow us to step up that value-add. So the net result will be bigger impact per dollar invested and more benefit to New Zealand now and in the future.

I would like to assure everyone that our management and our board are restless and we’re determined to continue to see what we can do to improve the economic growth of all New Zealand businesses. One of the things we do is we liaise actively with economic development agencies around the world, trying to learn from some of the best ones in the world about what they’re doing. Ironically, they’re learning from us as well a little bit about what we’re doing. We’ll continue to do that to try to keep raising the bar of our efficiency.

I’d like to turn it over to Pete now, who will take you to a little bit more granularity about these activities. Thank you.

Chrisp

Thank you, Andrew. Kia ora tātou. Good to see you all again. I'll just take the basic skeleton of what Andrew has talked about and dive down into the details—about 10 minutes, if that is OK?

Firstly, some context—there are about 13,000 companies going international from New Zealand, of which 11,500 have under $5 million export revenue. Only 240 have export revenue greater than $25 million. So this is the world we live in: lots of small companies taking on the world. But if you look at them, they are clever companies with tailored products and services chasing global measures.

With the exception of our few very large commodity companies, which actually dominate the export trade systems, the de facto national strategy is to dominate the niche, asking premium pricing, chasing the value curve, and doing smart things. The world for these companies is fertile and laden with
opportunity, but the market entry is tough and unforgiving. The dilemma of scale and distance is real and significant every day.

So this is the backdrop of the decision we made nearly 3 years ago to focus explicitly on growing companies internationally. To deliver on this, NZTE is organised around four interlocking strategies that Andrew has referred to and free enabling platforms bound together by a tight and defined 90-day results methodology. These elements are as follows.

Firstly, the work with individual companies—our customer base includes up to 3,500 companies. We work intensively one on one with an active portfolio of just under 500. These are spread throughout New Zealand, with about 35 percent outside of Auckland, Christchurch, and Wellington. About half of these companies are food and beverage, many of whom are going up the value chain. Also, interestingly, we see the strong emergence of digital specialised manufacturing and service companies, many of whom are hungry and ambitious for growth.

Our recently implemented customer way methodology requires us to understand the development need of each and every one of these companies and design a written plan that aims to unlock the particular company’s constraints of growth. The emphasis here is to be practical, specific, and value-adding.

We also provide more general services for smaller companies around New Zealand, investing around $14 million in SME support, including a business partner network around the regions, training vouchers, business mentors, a BIZ 0800 hotline, and a redeveloped website, which attracts around 45,000 visits a month. Over the past 12 months we have also stepped up our investment in Māori business, with 68 businesses now in the customer portfolio—definitely an emerging new trend.

Secondly, we work with groups of companies. We call them the “Coalitions of the Willing”—or the potentially willing—who are prepared to co-invest in development with NZTE. We are currently working with around 280 companies in seven high-impact programmes including wine, global agribusiness, aviation, health, marine, high-value foods, and digital technology.

Thirdly, we aim to provide the right services at the right time in the right place. We link with others across the public and the private sector to deliver this value. These services match the capabilities that companies need to grow across R and D operations, marketing, capital strategy, leadership, and markets. There are currently 30 live modules, some delivered in New Zealand, some delivered internationally, some delivered by NZTE, and others by other agencies, and even others again by the private sector.

Fourthly, we are stepping up our role to facilitate capital flows into New Zealand, out of New Zealand for both greenfield and brownfield development. A key role here is to be a matchmaker in the capital market and to transfer capital from investors who are looking to invest, both locally and internationally, to those in New Zealand who are needing capital to
grow. This area has had a major makeover in the past 12 months with three
distinct streams of work. We’ve launched the Better by Capital service,
where we help companies understand their need for capital, prepare them
for capital injection, and find investors. So far 209 companies have received
that service. We are also taking a sector lens to the capital investment.
We’ve identified focus areas for foreign investment, including infrastructure,
software development, food and beverage manufacturing, high-value
manufacturing, primary sector production, and commercial shared services,
with a particular focus on call centres. We have also taken a regional lens to
capital investment and are currently building investment profiles for each
region in conjunction with the local economic development agencies.

So these are our four strategies where we wrap around the focus for
individual companies, working with Coalitions of the Willing, getting the
right services to the right companies at the right time, and matching the
flows of capital. Underpinning these strategies are three platforms—firstly,
to get the right people and to lift the bar on the performance of our people.
This has driven a focus on competence and training, on culture, and on
leadership. Secondly, implementing the cutting-edge digital technology to
manage and bank our knowledge—in the past 12 months we have launched
a new intranet, a new internal social platform, and implemented Lync
technology that allows us to better connect globally.

The third platform is we are strongly committed to NZ Inc., as Andrew has
spoken about. We have a strong belief that we work for a cause, not the
institution, and the cause is New Zealand. Our key partner agencies are
MBIE, MFAT, Callaghan Innovation, MPI, Tourism New Zealand,
Education New Zealand, TPK, Export Credit Office, and the New Zealand
Venture Investment Fund. In particular Callaghan Innovation is shaping up
to be a major domestic economic development partner, and we are
currently developing a ‘no-wrong-door strategy’ for New Zealand
companies.

So what are the results? We have put a massive effort in over the last 3 years
to measure performance, because in this type of game it is a very difficult
thing to do. We are now confident that we are leading, or close to global
best practice in this area, but there’s still a lot to be done. Across each of
our strategies, results are as follows. As specified in our annual report, the
portfolio of customers grew in total at 5.7 percent faster than the overall
economy. The average growth rate was 15 percent, buoyed up by a large
number of smaller, fast-growing companies. In the same period, the value
of new, unique, and attributable trade deals was $694 million, close to 60
percent more than the previous year. In 2013 87 percent of customers
judged we had added value to their business. The customer satisfaction was
96 percent. All of those metrics are a significant increase on previous years.
Over the last 12 months we’ve seen a significant step up in the mobilisation
of capital, from $386 million in 2012-13 to more than $1 billion in the
pipeline for this year.

The culture of the organisation continues to be the major driver. The
employee engagement scores have continued to rise—69 in 2010; 79 in
2013, compared to a public sector average of 69 and a private sector average of 74. However, as long as the average of the top 25 percent of best workplaces is 83, compared to our 79, we consider that we still have a long way to go yet.

During this period costs have also come down, predominantly driven by a 9 percent head count reduction since 2010. As a result we are now running at capacity. There’s also been a big change in the composition of employees, with 70 percent of new joiners now coming from the private sector. It’s also been a very active period across New Zealand Inc. Just a couple of examples—early uptake of the New Zealand Story, which was a joint effort between Tourism New Zealand, NZTE, Education New Zealand, also with MFAT and TPK involved. Since its launch in November, 1,200 users have registered to use the asset library, and more than 4,500 uses of the video and image assets have been downloaded. We’ve only just started on this journey.

America’s Cup, which was a joint activity with ATEED, the Auckland regional development agency, Tourism New Zealand, and MFAT, provided an opportunity to tell the New Zealand story on and off the water. In San Francisco 220 companies participated, with a deal flow of $200 million and a further $120 million in new sales opportunities and investor interest.

So, what of the path forward? Over the past 4 months we have again refreshed the strategy as a collaborative exercise across NZ Inc. partner agencies. We concluded that our international footprint is in need of investment. As we have followed our customers, our presence in Asia has grown. However, we are now facing significant capacity constraints that can no longer be met within existing resources—specifically, in the Gulf States, China, Latin America, and the Asia-Pacific. Over the next 4 years, this is an additional investment of $25 million. We are also conscious of an increased demand for service and supports, especially amongst the active, niche-seeking, high-growth companies, many of which are coming from pipelines of Callaghan Innovation incubators and the regional economic development agencies.

With the engine working well, the opportunity is now there to step up and move our high-intensity customer portfolio from 500 to 700. Over the next 4 years this is also an additional investment of $25 million. As a result of this refreshed strategy, the Prime Minister has now announced an additional $69 million to be invested in NZTE over the next 4 years. The efficiency of this investment is compelling, allowing us to service 40 percent more customers for only 12 percent more costs. However, this investment is not just about quantity; it’s also about quality. The challenge for the leadership team and the board—as Andrew referred to—is again to lift the real commercial impact of our efforts that help these companies grow in the interests of our economy and in the interests of New Zealand. Thanks very much for listening, and we welcome any questions.
Young Thank you for a good comprehensive report and some great activity in the last 12 months. We’ll come to members here for questions, and then we’ll come back to this side.

Cosgrove I’d just like to ask a couple of global questions. Firstly, Fonterra—they’ve had difficulties, as we know, in the last year. What impact has that had on any of your activities, or what feedback or insight can you give us as to how international markets and companies view us as a result of those?

Ferrier Maybe I’ll jump in to that. My experience of—prior to the current role at NZTE—with Fonterra in particular, is when Fonterra stumbles it gets a lot of attention in New Zealand, but it actually doesn’t necessarily get that much attention abroad. Although certainly there have been some stumbles, everything that I’ve picked up internationally with respect to the botulism scare and so on is that it actually showed the Chinese people that, No. 1, we were forthright and open, and, No. 2, that we had good food security systems. That, in and of itself, has actually become a net benefit to New Zealand’s reputation. Sure, you can stumble a little bit, but in the bigger picture I think it’s seen as that we’re responsible. It’s seen that we actually front issues very clearly, and we go on.

Now, clearly, there are companies that NZTE helps, smaller ones, who have struggled a little bit through this, and we did do what we can to help them. We created a market connections fund that allowed companies to fly up to China to meet with their customers and so on. So I think there were pretty good mitigation efforts in specific issues, but in the bigger picture I actually think it was more of a positive than a negative to the reputation of the country.

Cosgrove So you detected no negatives?

Ferrier No—sorry?

Cosgrove No negatives.

Ferrier Oh, I mean, I would say there’s always negatives, but the negatives were vastly outweighed by the positives from what I’ve picked up.

Cosgrove I’m thinking maybe for companies amongst the small to medium sized enterprises, you talked about impacts on them. What were those impacts?

Ferrier Well, I think what they would have felt in a short period of time would have been reduced deliveries as you had an automatic impact as consumers stood back for a little bit until they could see the bigger picture. Then they re-engaged. So there’s no question that deliveries would have been slowed down for a while, but you asked about the big picture.

Cosgrove And have they come back to pre-difficulty levels?

Ferrier That I don’t know. But let me just finish and say in the big picture what it created, I think, again for the benefit was a larger focus on ensuring a safe supply chain, whether it’s small or big. That we in New Zealand can say we have 100 percent have confidence in our supply chain. So some of the smaller players may not have been, perhaps, as good as they could have been, in terms of their supply chain through to China and other markets. So...
if this thing shook that up and improved their supply chain, it’s absolutely
going to benefit them for the long term, even if they did suffer from slightly
lower deliveries in the shorter term. I don’t know if we have statistics in
particular about individuals companies.

Chrisp

Just to add one more thing there as well—I was on the recent mission up to
China. I call it the LV Martin strategy: it’s the putting right that counts. So
when we actually fronted up in China, it was quite extraordinary the level of
audience that we got from that trip. President Xi said at the end that the
relationship with New Zealand is pioneering and exemplary. They clearly
weren’t making that up; they didn’t say that by accident. That was in their
press release, and the commentary made at the meeting. That recent round
of visits and trips wouldn’t have happened unless we’d had the difficulty in
the first place, so I agree with Andrew. I think out of it, the way it’s been
handled particularly in the last number of months, we actually managed to
resurrect something out of it.

Come back specifically to your question—I think whether individual
companies are fully recovered or not is very much a case by case. There
were definitely some—we know company by company who has fully
recovered.

Cosgrove

Can you provide us with those statistics?

Chrisp

It’s commercial in confidence. Yes, we could give you some probably. We’ll
give you what we understand to be the recovery. It’s not comprehensive,
but it’s generally recovered.

Cosgrove

If I change tack, for those of us who support the FTA, can you give us a
sense of where you think that’s at—progress, lack of progress. Any crystal
ball gazing you can do would be of assistance. Do you have a view? Where
do you think we’re at with the TPP?

Chrisp

Oh, the TPP, or the China FTA? No, I wouldn’t have a view on that.

Bakshi

Regarding the Fonterra incident—there were countries who were trying to
take advantage of it and to those markets which were directly affected,
particularly China. I remember seeing an interview by the Minister from
[inaudible] saying that we are trying to take advantage of what Fonterra is
doing. So did you plan any counter-marketing strategy on that—that the
marketing of Fonterra or New Zealand products are not affected by the
overseas companies?

Chrisp

Yes, post the whey protein concentrate crisis we had a market recovery
strategy, which was both aimed at the individual companies, where we
supported them getting up into market, and then some general messaging
into the social media carried out by companies we employ to do that in
China. So, yes, we invested in that reasonably heavily.

Ferrier

And there’s nothing like the Prime Minister going up to front. I mean, that’s
huge. From a business perspective it has a massive impact, a positive
impact, on the country’s reputation.
Cosgrove So if I could return to the TPP, you say you don’t have any view on it. I find that a wee bit strange.

Ferrier Yeah, maybe I’ll come in a little bit. You know, my view is going to be more formed by my Fonterra time than anything. I think the TPP is a very good venture for New Zealand as a whole in terms of creating an openness to certain markets which have been closed to New Zealand products, whether you’re looking at the United States—although it’s not the natural trade for our dairy products. But up into Japan, into Korea, and so on, I think there are going to be far more opportunities for New Zealand in a TPP than there will be things which we might have to concede, whatever they may be.

Cosgrove I mean, I agree with you, but what I’m seeking—as we all are, I suppose—is do you have any insight into progress? Do you have clear international contacts? Do you have a view as to how things are going? Is it going off the rails, on the rails? I mean, I’m not asking a leading question; I’m seeking your view.

Ferrier These are the things we all wonder. What I hear—and this is scuttlebutt, so—I mean, the scuttlebutt is it’s bumpy, a very bumpy road, but most trade agreements are bumpy. I wouldn’t say I’m confident that we’re going to see an outcome in the short term. I think that there is a reasonable amount of willpower to do it, but I think a number of these countries have suddenly opened their eyes to the fact that TPP calls for an abolition of all tariff protection—all. I mean, that’s a fantastic thing because we have virtually none anyway. So you’re always going to get jockeying for position by some countries not wanting to give up some of it. And it’ll take a long, grinding time to overcome that.

Cosgrove Is there anything else you think the Government could do, should do? Is there any advice you’d have for them in terms of, you know, kicking it along?

Ferrier I’ve got huge respect for Tim Groser. He knows more about how to progress these things than anybody, so I don’t think I’d give him any advice. I think he’s probably as good anybody at furthering our interests. [ Interruption] As a matter of fact, I had the same respect for Phil Goff when he was trade Minister. He was exceptionally good at that.

Young Over the weekend we had lots of reports about Australia’s negotiations with Japan, South Korea, etc., and progress they’re making. How does that stack up compared to our progress on some of those particular nations in terms of FTAs?

Chrisp The reason why I didn’t venture into the dialogue about the free-trade agreements is that the basic division of labour between us and the Ministry of Foreign Affairs and Trade is that they negotiate the free-trade agreements, comment on the free-trade agreements, and offer the public view of progress on the free-trade agreements, so that’s really their domain and we respect that.

Cosgrove Don’t be a shrinking violet.
And they’re very, very good at it. They really support the work. We need those free-trade agreements. They are enormously important—the basis for all our trade. I’d tend to reserve our commentary to MFAT.

I think that’s why I can comment—because I’m only part-time NZTE. I can comment as a businessman; Pete can’t.

Ah, yeah right! OK.

Thanks for your report, guys. I’m just interested in some comments around the Business Growth Agenda and your own part in that. You guys have been one of the key players in that. I’m interested in your thoughts on the framework and how that’s worked for you. Secondly, what do you see as the key things you’ve ticked off as part of that action plan over the last 3 years? And, I guess, most importantly, as the third question, what do you see as the top three things over the next 3 years that you have now added to that agenda and are priorities for you?

Nothing minor! I’m a huge supporter of the Business Growth Agenda, predominantly because it puts that light on the hill that the agencies can get organised around. And that’s not to be underestimated—just the importance of having a common language, some common metrics, a reporting mechanism for everyone to work towards. It’s reasonably straightforward and it’s immensely powerful. There’s no particular rocket science. A number of the programmes—not all, but some of the programmes were there already, but the fact is they’re aligned, organised, and share a common language on a common timetable. So it is gathering momentum, not diminishing in my view.

The big ones for us were pretty much all the stuff I’ve outlined in the presentation, as the Business Growth Agenda prescribed, so us, first of all, understanding who the customer was, which is a company that wants to grow for the benefit of New Zealand, grow internationally. So it’s understanding who the customer is. The customer way methodology was provided for in the Business Growth Agenda, working with these groups of companies in the Coalition of the Willing. They’re all inside the export leg. Then inside the capital part was the work on capital mobilisation and the reorganisation of that team and the approach—that was also in the Business Growth Agenda. And the establishment of the New Zealand Story was also in the Business Growth Agenda, as was the America’s Cup. So, pretty much, we don’t do that much that sits outside the Business Growth Agenda.

Going forward, once again, as I have said, the big thing for us now is that we feel like we’ve built a methodology and a way of adding value to companies who are growing. The implication is that if you add value to a company, the company grows, and growth is good for the country. So it’s a direct line of sight to the benefit of New Zealand from growing a company. So for us it’s just getting behind those companies, growing the number of companies that we’re dealing with, and giving them more capacity in the international market that they can work with. So it is these strands that have been announced in recent times.
There’s another one there that we didn’t mention, which is called the Government to Government commercialisation. This is the idea that there does sit quite a bit of intellectual property inside New Zealand’s Public Service—things like fishing quota, the way we manage our national parks, our qualifications system, our police intelligence system. All these things have got quite good value, but you need quite a good vehicle to properly commercialise that. And as you see a lot of these emerging Governments opening up, particularly in the Middle East, there is quite a demand on some of that intellectual property. So one of the new Business Growth Agenda items is that we find a good way to commercialise for the benefit of New Zealand some of that intellectual property that’s been developed over time, and that was also part of the funding announcement that the Prime Minister made.

Tremain Just further to that, I have one quick question. Can you give us an example of a couple of companies over the last 3 years, you know, excluding the Fonterras and the big players in this game, that you could demonstrate that these guys are really starting to get traction overseas, and you guys have played a significant part in taking them forward?

Chrisp OK, I’ll pick two: Comvita, an interesting company, which has grown from $20 million to $100 million. I think it’s a publicly listed company, so it’s publicly known information. They have developed a brand. They’ve got a lot of science behind them. It’s developing something out of our primary sector. And they’re going into the new emerging market, so that’s a good story. They’ve used the Better by Strategy; they’ve used Better by Design. They are a heavy user of the international offices. They’ve used the International Growth Fund. They’ve used a number of services. So they’ve been a good growth story.

Maybe in the digital area, Orion Health is also another very good growth story or BCS, the baggage handling conveyor company. Both have got big digital offerings, going to market, building up the market, so growing reasonably quickly—you know, 20 to 40 percent a year, depending on the year. All are consuming the services quite heavily.

Huo Talking about innovation, one of the best innovative companies in New Zealand, LanzaTech, is or has been relocating to the US, and one of the many reasons is the US has offered them tax credits similar to our R and D. So what should NZTE do to attract such good companies to stay in New Zealand?

Ferrier We’ll tag-team this one. By and large we have a lot of good programmes for companies already, and we have grants inside the system here that can help companies like LanzaTech and others. It’s a difficult and a dangerous road to start having competition for Government funds with other countries. You know, you can’t really win that one in many sectors. There are some exceptions, but it’s not something that I think that we would be able to do. What we can do is we can encourage R and D here. We can encourage the skills of our people here. And we’ve done a pretty good job at that, but we can do more through encouraging the right kind of graduates coming out of
our schools. I see the right steps being in place, but to get more people coming through the sciences, coming through information technology and so on, will provide a pool of people that will keep companies here as well. So I think there’s a whole series of activities in that space. There’s what we can do with the amount of money that we’ve got available as well. With a company like LanzaTech, at least it’s good to see some of their core R and D here in New Zealand, so that’s, I guess, not a bad outcome in the scheme of things. But we’re certainly not going to win them all.

Yang

Just to follow up on that, is the main funding for LanzaTech still from the United States?

Ferrier

I believe, only going by what I read in the papers, that the State of Illinois gave them some tax breaks and I’m not sure if they got anything from the Federal Government. I think it was mostly local.

Huo

Yes, the local government, for the following 10 years. So that’s quite attractive to any such company to see that sort of situation.

Chrisp

But also I think the other thing with LanzaTech is that their customers were never going to be in New Zealand, because they’re big steel mills. So they probably did need to have the company a bit more internationally based anyway. There is still quite a significant shareholding of LanzaTech in New Zealand, so you kind of get to this point of saying: “Is it better off to have a small ownership of something big, or a large ownership of something small?” That’s actually a significant thing to think about. And then the other point, as Andrew said, is that there’s still quite a bit of R and D resource and capacity staying in New Zealand. We talk about this topic a lot. If we all put money into a company, and it flies offshore, the whole thing is gone, and it never touches us again, then that’s probably a fail. That’s not a desired outcome. But if you get a company where some parts of it move offshore, it might take R and D, or their ownership might go offshore, as long as it’s got some leg in New Zealand and you can still track back a benefit to New Zealand, then we understand that companies are increasingly international in their presence. They don’t just sit 100 percent inside one country.

Huo

But another problem is that so many staff have been transferred from New Zealand to offshore, so that’s obviously very risky, dangerous.

Chrisp

Yes.

Yang

But I understand that the Government had you very supportive of LanzaTech, whatever it could have done.

Ferrier

Yeah. You know, the good side of that is you’re also seeing successful Kiwi companies increasingly recruiting from overseas and bringing good people here. So there’s a bit of both of that one. And I think it’s great to get some fresh blood, and I’m seeing that personally in businesses I’ve invested in.

Chrisp

And, as Andrew said, I think it’s very difficult for us to enter into the strict sort of footrace for subsidising companies to buy them to New Zealand. That’s quite a difficult race to win across all industries. I think sometimes we just have to be confident about the proposition. So we’re thinking
about—I don’t think I should name the company—a company that’s based in Kawerau, the owner of which is based in Sweden, that was looking at whether they should invest in Victoria or invest in New Zealand. The Victorian Government were offering reasonably large incentives for that investment. The local people in Kawerau argued 75 percent renewable energy in New Zealand, a lower cost base, cheaper ports, and a good place to get a major upgrade done. Ultimately, they won the work. They entered the footrace and they won the work. And I just think that for a lot of it, we have the same thing. We have quite a few of those situations where we’ve really worked with the company just to win the footrace amongst the international owner.

Young All right. We’ll go to Kennedy then I’ll come to you, Clayton.

Graham Thank you. I had a question, but just to pick up on that last one, just to query your point, if I understood you correctly. Did you say 75 percent renewable energy?

Chrisp You probably know better than I do. Is it somewhere around that?

Graham Well, it’s electricity.

Chrisp Oh, yes. Sorry. Electricity, yes.

Graham So my question is this. Just from what you were saying, I think, in response to Mr Tremain’s comment about the commitment to growth and the Business Growth Agenda—so growth is a wonderful thing. Is there a limit?

Chrisp Hmm? Is there a limit to growth?

Graham Yes.

Cosgrove What?

Graham I’m not asking him for his personal expression of hope. I’m asking you for your—in terms of the Business Growth Agenda.

Chrisp Growth should have all its natural constraints and checks and balance to make sure that the overall pattern of growth is sustainable and beneficial to the economy, generation after generation. So that’s what real growth looks like.

Graham So the word “sustainable” there—so, is it the case, then, that the principle of sustainability would be a component part of the Business Growth Agenda, or the other way around? Would the Business Growth Agenda sit in the context of the principle of sustainability?

Chrisp I don’t really want to be that drawn into the whole strategy of the Business Growth Agenda except for our part on it, which is to grow our companies. But when I look at the Business Growth Agenda, I believe it’s a growth strategy for the long-term interests and benefit to the country as a whole in the long term.

Tremain Just in terms of the BGA and coming up from Kennedy here, and I understand a component part of that is a green growth strategy. One of the points that you raised was the different sectors that you’re currently
growing, and you mentioned digital in a range of those. I notice that you
don't put green growth companies as a particular sector, right? So I'm
interested in some comments around that. My sense is that they're probably
across a range of different sectors anyway. So I'm interested in your
comments about that. Secondly, I'm interested in your comments about
that whole green growth initiative. How much does New Zealand play a
part in that? If you were to take those businesses across the sector, are we
playing our part there?

Chrisp Is it all right—?

Ferrier Yeah, I think I'll let you, because you were in the middle of that one. I'll see
if there's anything else I want to add.

Chrisp I think the whole concept of sustainable growth and green growth is it's not
a vertical line of business; it's a thing that pervades all businesses. You could
have a Track Map, a highly digital business that improvise a fertiliser
application, which is as much a green business as a wind farm or businesses
that people would normally think of as green. So businesses that contribute
to production in waste and better utilisation of resources are all over the
place. So I think it's very hard, if you start naming things green businesses
or green growth businesses—I'm not quite sure. We've never found that
definition to be a particularly useful organising category, because they're
everywhere and it's so much part of the ethos. But it's definitely the case
as—just coming back to the questions you're raising before—that as you
grow New Zealand, the environmental credentials of New Zealand are
crucially important and not just because we want to live in a good place. But
even on straight-out economic and commercial terms, we need a country to
be environmentally sustainable. It's a huge part of our food and beverage
branding. A huge part of the integrity of the country is underpinned by our
environmental positioning. So it's a very natural tension, of course between
the way we grow and the way we serve our environment.

Tremain In that regard, you're big on benchmarking, you guys. How do you rate
New Zealand businesses in terms of their commitment to those sorts of
philosophies vis-a-vis other businesses that you see internationally? Because
my sense is we're often criticised for that, which for the life of me I can't
understand.

Ferrier Well, Pete's also spent quite a bit of time internationally. I think Kiwi
companies by and large have a greater awareness of the environmental
impact of their businesses in aggregate. You know, it's on the mind, it's on
our collective consciousness here, and I think that's a good thing. It's
because we are a small country and we realise it as we grow. You know,
there are only so many resources that sit within our boundaries here and we
have to be responsible about that.

Secondly, of course, we've always been viewed internationally as this magic
clean place and we want to keep that brand going as well. So I think that
there's a general consciousness and then there's a brand importance, which
has in aggregate made the awareness of New Zealand higher than I've seen
in America or Canada, for example, or the UK.
And one more thing: I think what is absolutely in our DNA—and when we did the underpinning research for the New Zealand Story, we could see it came out very, very boldly—is the whole integrity of the setting here is very high, whether it’s food integrity or the way we govern or the way we set our rules. Just the integrity of the way the society runs, the lack of corruption, the transparency—that’s a very, very important part of the positioning of New Zealand. Internationally we’re known as clean and green, but that integrity positioning is one of the best things that we’re known for internationally. I put our sort of environmental position within that broader framework of our high integrity setting.

Yeah, I’m interested in your comments, and I don’t disagree with them about the impact of the Prime Minister on the latest tour to China. I’ve got some questions around that. How significant is it having the Prime Minister being supportive of open doors? What impact do Ministers have, particularly in the China jurisdiction, in terms of supporting business growth?

I think it’s hugely significant. I think it’s a competitive advantage we have. You know, I think many of the members would be aware I moved to New Zealand 10 years ago. I’m a Canadian citizen—also a Kiwi now. One of the things that I recognised here was because we’re only 4.4 million people, our international activities—we’ve got more ability to have our senior Ministers and Prime Minister come behind our international activities because of the relative size of New Zealand compared to what might happen in bigger countries with a larger population, where you’re spread out too far. I think it’s a competitive advantage for us to have our politicians out there fronting our activities and, certainly, when it comes to some markets where face is so important, it’s just immeasurable.

A supp on that—

Hang on, I’ve just had one question. Could I just continue the line of questioning? So would it be fair to say that Ministers could open doors, particularly in China, of significance within the Chinese jurisdiction to support—I think this is funny. I’m actually quite serious about it. I used to work for a former trade Minister in a past life. I’ve lost my train of thought, thanks to the chairman, but I’m sure that was deliberate. Would it be correct that Ministers can open Government doors in China in areas where companies can’t go to assist in their growth?

I see it a little bit the other way round in the sense that companies have an obligation to find their own doors, and our trade officials can help them get it open. Ministers, and my comments on Ministers and the Prime Minister, are coming in from behind a company as opposed to in front of a company—and coming in and supporting the aggregate activity, just as the Prime Minister did with this tour to China recently. I think that’s where the bigger impact is.

But in a practical sense, presumably Ministers going and actively supporting companies in China—who just say, you know, face is important—would
open doors within the Chinese bureaucracy and Government that a company by itself wouldn’t be able to access.

Chrisp  I wouldn’t lock it down to China. I think you get that—

Cosgrove  I’m interested in China, because it’s one of the biggest—

Chrisp  But I think you definitely get that all throughout Latin America, throughout India, throughout south-east Asia. That’s a global phenomenon.

Cosgrove  China—Mr Ferrier, do you think that is more prevalent, more important?

Ferrier  I would agree. You know, I’ve seen Ministers in Chile when I was at Fonterra. China is really no different than any other market in terms of the impact of knowing that the Government supports the sector.

Cosgrove  Any particular businesses—that’s helpful to the business?

Ferrier  Well, I think you can always nail down from a sector to an individual business. I can certainly tell you from Fonterra’s perspective as an individual business it would have helped us immensely that countries knew that we had our country’s backing.

Cosgrove  So if we use the Fonterra example, Ministers showing up singing the praises of Fonterra, as they should, because it is New Zealand owned—that opened doors into China for Fonterra?

Ferrier  Yeah. No, back to my earlier point, I don’t think it’s about opening doors as much as it’s giving a comfort level. But it’s up to the individual companies to open the doors. That’s really what I see.

Young  A supp to that—so the Prime Minister’s recent visit brought assurance around the regulatory regime that the Government were providing for food safety?

Ferrier  Yeah, so that sends a huge message to the society up there that we mean business. As a result of that key message, then companies can move ahead. It’s more about the policies being lined up correctly. It’s not about an individual Minister and an individual company—

Cosgrove  You’d have to concede—

Ferrier  No, because in the big world they’re not interested in just a one on one; they’re interested fundamentally in: what does New Zealand believe in? What is our food security focus, for example? Do we really mean business when we say that we want to have perfect product getting through to the market? Those are the important messages.

Cosgrove  But in practical sense, access is king, and access to Government bureaucrats and others to get your product through, which is legitimate. There’s nothing illegitimate about that. Would you concede that having present Ministers being seen to be supportive of New Zealand companies can’t be disadvantageous to them? It would have to be advantageous to them in terms of getting access to Government bureaucracy, surely?

Ferrier  I think it’s not about an individual Minister and an individual company.
Cosgrove No, I’m not asking about that. I’ll be a bit clearer. Is it an advantage to a company or group of companies to have ministerial support in terms of gaining access to the bureaucracy in a jurisdiction or politicians or people of influence within a Government who could assist that company, for instance in exports and various things? Is it an advantage or a disadvantage? Simple question.

Chrisp I think you’re narrowing it down.

Cosgrove You tell me if it’s an advantage or a disadvantage.

Ferrier It is always going to be an advantage for a company to be seen as having their Government’s support, so that probably answers your question. If a company is seen to have the support of the Government, then of course it is going to be viewed as a positive for that company. Will it open doors? It totally depends on the circumstances. I don’t know. My view personally is that the key thing about opening doors is knowing the customers, and Ministers aren’t going to get you into the customers and into the distribution channels and countries. You’ve got to do that on your own.

Cosgrove But they can clear some blockages from bureaucracy, presumably?

Ferrier But perhaps blockages shouldn’t be there in the first place. Things like the FTA with China are how you do it. So obviously I don’t want to get pinned down on an individual basis, because I think that’s the wrong issue.

Cosgrove But I haven’t mentioned a company.

Ferrier No, I understand.

Bakshi Is this something new that is happening now—that Ministers are coming to support the businesses? What is your experience—that in past, the Ministers have come to your support or not?

Ferrier I think if my experience in Fonterra—but it would be not on a sort of “I’ve got my arm around Fonterra and here’s a great company.” It’s more about: what does New Zealand bring as opposed to an individual company? So if a Minister is travelling—Minister for Economic Development, Minister of Trade, and so on—they are moving New Zealand as a whole across, and so if you’re an individual company, you get sucked along with that.

As Fonterra, because it’s such a material one, it’s almost glued to the hip with New Zealand, so it’s extremely beneficial. But it’s more on that policy side, and that’s what I was trying to explain. There’s a line there, Mr Cosgrove, in terms of—it’s the policy things that help. It’s not just having a Minister having their arm around one company. I don’t think that really moves the needle. It’s more about what the Government policies are. The Ministers come in in support of Government policy, and that’s where you get your big bang.

Bakshi I agree—

Cosgrove Hang on, hey, you’ve had your supp. Are you going to supp?

Bakshi No, no, I am continuing on that.
Young Gentlemen, I’m the Chair. Settle down. Settle down.

Cosgrove It’s a singular event, not a line of questioning.

Young No, no, you’ve taken a couple of supps before. We’ll have one more to supp to this man, then we’ll come back to you. No, no, you’ve taken two in a row.

Bakshi Is something new happening now, or in the past the Ministers have been going there and helping the businesses of New Zealand? I am not talking about Fonterra.

Ferrier I think that’s a fair question. It’s important for me for my former role and my current role to be agnostic to politics. I mean, quite seriously. Fonterra—

Cosgrove No one’s asking you to do anything?

Ferrier No, and so I try to be objective in these things. That’s why I gave you a preamble like that. And I genuinely think it’s no different. We recognise this potency we have as New Zealand Inc., no matter who happens to be in Government. It’s a great thing. It’s what I said before—it was our competitive advantage. And so by having Ministers on the forefront and by having the Prime Minister on the forefront, it absolutely gives all of our businesses probably a little bit more help than the equivalent American business would get. You’re not going to have Barack Obama opening the door for as many companies as John Key can or Helen Clark could for New Zealand.

Mitchell I’ve got my question, Mr Chair.

Young We’ll come back to you, sorry.

Mitchell Yeah, I was next in line.

Cosgrove Well, how many minutes have I got left? Six? Seven? I don’t mind. As long as I get my 6 minutes, I’m a happy camper.

Mitchell It seems to be my role in the committee today to take us away from the political intrigue and back to some questions about what you’re doing. I just have to say I want to commend you on the job that you are doing, because I run business forums in my own electorate of Rodney, and back in 2011, it would be fair to say that there were a fair few companies that were exporting that were not that engaged with NZTE. I would have to say now they all want to have NZTE as part of their own business model moving forward.

Ferrier Can I say 100 percent—first of all, thank you. It is thanks to Pete Chrisp.

Mitchell Yeah, without a doubt.

Ferrier Peter and his team, obviously, have made a huge impact. So thank you for that, and you know where the credit is deserved.

Mitchell Without a doubt—absolutely. But the next thing I wanted to say was—and maybe I’m completely wrong, but I can see that you’re almost at risk of running into problems because of your own success, and the reason I say
that is because now you do have a heavy demand on your services, without a doubt. I see that being driven out of my own electorate. I think there’s even a risk of some companies seeing you as a silver bullet in terms of helping them enter markets and grow their business. I just wonder—how are you dealing with that? Because I’m sure—or maybe you aren’t seeing that as a problem or as a future problem, but how are you dealing with that in terms of the way your people are engaging with businesses? There’s an old military saying around mission creep, when you can start moving from what your vision is and the service you want to provide into areas that are almost starting to assist the company around development and their own business plan and market entry plans. Have you got any comments on that?

Ferrier Yeah, sure. I’ll start at a high level and Pete can come in. You know, I appreciate the comment of victim of our success. What it allowed us to do well over a year ago was sit back and look at the platform that we’ve put together. As Pete said in his remarks and I did as well, you can see that we were far more efficient at bringing all these services to customers. Not only were we doing it for less money, but we were doing it for significantly better impact and the ratings of the customers is one way of measuring that. So as a result of that, we could see that we would have more demand than we could supply and so we started the leg work around how we grow the impact that we can have on companies. And that resulted obviously in the Prime Minister announcing some incremental funding.

Because the economies of scale were tremendous in this—as Pete said, 40 percent more customers getting intensive help for 12 percent more money. So in aggregate, I think we dealt with this by recognising ahead of time it was coming, by doing the leg work on how we were going to deal with it, and ultimately putting together a programme that had the support of the Government. In terms of companies using us as a silver bullet, I think my gut tells me: why not? We’re here to help any New Zealand organisation succeed internationally, but part of success has to be that they’ve got to learn to stand on their own feet. So we can come in and provide the core programmes that help them, but in conjunction with those programmes, it’s about self-sustainability of the company and their business models.

So one of the things that I’m really encouraged by in the evolution of NZTE under Pete’s leadership is bringing in more and more private sector account reps who have been there and done that in the real world. They’re not there to really tell companies what to do; they’re there to tell companies how to find goods and services around them in order for them to succeed. So it’s more—help them succeed themselves as opposed to tell them what to do, and I think that’s a fundamental part of it. So mission creep—no, I think we know where we help and we know where Callaghan Innovation can help. And I don’t think we’re going broader than those parameters.

Cosgrove I’d just like to return to my line of questioning and I don’t know why certain people are getting defensive about this, because I don’t think it’s an issue, but I’m interested in some practical impacts with Ministers. I used to work for a guy called Mike Moore—right? I know for a fact that he had a very practical impact on behalf of New Zealand companies when he was
2012/13 FINANCIAL REVIEW OF NEW ZEALAND TRADE AND ENTERPRISE

trade Minister, as does Minister Groser, as did Helen Clark, as does the Prime Minister. So I don’t know why we are sort of getting a bit defensive but I’d like to ask about the practical impact of that.

I want to focus on China because it is our biggest market. It is keeping us alive as an economy. So, for instance, can a Minister—just short question, short answer—open doors for companies in respect of the bureaucracy, having been supportive to those companies? For instance, if there’s a customs blockage, a phytosanitary issue—various other issues that can hinder companies in their export endeavours. Simple question.

Ferrier I would say only to the extent that it is the Minister responsible for the issues that you’re talking about. For example, a trade Minister, whether he’s Minister Goff or Minister Groser at this time, if they’re coming in—and again it would be because they would be perceived as dealing in the aggregate rather than the individual. I don’t think people see an individual Minister with an individual company being able to open doors other than their broad portfolio that that Minister is responsible for and trade is the best example.

Cosgrove So are—and I have a little bit of experience in China; not as much as your good selves—officials, for instance, and politicians in China likely to turn up to events, company events, or a group of company events, if a Minister is present and they can interact with that Minister, despite their portfolio?

Ferrier Probably.

Cosgrove Or are they likely to say: “No, don’t give a damn and we’ll go somewhere else.”

Ferrier I’m sure you may get some more people coming if they recognise that there is a Government official—

Cosgrove Officials, Chinese officials, politicians?

Ferrier I actually don’t know about that because I haven’t experienced it other than—I’ve certainly been there with Ministers when they’ve been there in their own capacity as opposed to the capacity of being there with me.

Chrisp I’d say as a general principle throughout the world if you’ve got Ministers involved they have got pulling power and platform-building gravitas that businesses stand on. And that’s not specific to China; that is all over the world and thank goodness our Ministers are active in that environment. It’s the whole basis of a trade mission.

Cosgrove Indeed, absolutely. Are politicians and officials more likely to attend company events if they can get face time with Ministers if they’re supportive of companies, in your experience?

Chrisp I think it’s about the whole sort of gravitas you’re putting around an event.

Cosgrove Is that a yes?

Chrisp Um—you’re obviously after a very, very particular answer to your question, which I think you’re struggling to get because it’s not there.
Mitchell: Can I take a point of order just very quickly? Because the line of questioning is as if we’re in court. We’re not in court and Mr Cosgrove keeps trying to pin the chair and the CE down to short answers. Maybe they need to make a longer answer for some context. You know, we’re not in a courtroom.

Young: Yeah, no, I guess it’s obvious that they need to answer appropriately, as they see—

Cosgrove: Yeah, indeed, but with respect, I’d like an answer to my question. I’m not asking for a particular event, particular Minister, particular company; I’m asking you quite seriously if Ministers—and many of our Ministers were engaged in this—were in China with groups of companies. There were events. Politicians, officials could get face time with Ministers, being supportive of those companies. Are they more likely to turn up or not—it’s a relatively simple question—in you experience?

Young: And by the way, we are doing the financial review of NZTE.

Cosgrove: Yeah, and these things happen. There were trade missions in the last financial year last time I heard.

? Not speculative—

Young: Yeah, exactly, and the inner workings of—

Cosgrove: Well, with respect, I’ve been at this for 15 minutes, and you’ve only now ruled it out. So you can’t rule out at the last 15 minutes. You accepted it. Could I get a basic answer to that question?

Ferrier: I would think, if I was setting up an event in China for my company and I said “I’ve got a Minister coming with me.”, the first question of my Chinese customers and so on is going to be “What’s the portfolio of that Minister, and is it relevant to the business that I’m doing?” If it was very relevant to the business I was doing—and I keep coming to trade because I think that’s a good example—then I think you are clearly going to attract people, because they’re going to see a relevance. If you just bring any Minister, I don’t think at a senior level people see that as—you know, I think in general you’ll certainly get more people. They want to see a Minister. But I don’t think at the policy level you’ll see people knocking down doors to do it. So I do think it’s part of the Government’s strategy, obviously, to come in and help companies with Ministers, and I think it’s fantastic. As I said, it’s our competitive advantage.

Chrisp: What I would say too, just to add to that, is I don’t think it’s necessarily face time with the Minister, actually. If you think about how a mission works, generally it’s the context. What the companies do is they bring their distributors and their supply chains in. The fact is they’re coming to an environment that is effectively—it’s got a certain amount of integrity to it; it’s Government, the implementer of Government. It’s all there. What the companies value is the face time with their counterparts and the presence of it, rather than—
Young A great example is the APEC conference, where NZTE had a very good presence.

Cosgrove Just a final question, and it’s this: presumably, and you can use Fonterra as an example, as you say, having a Minister, to quote you, putting their arm around a company—Fonterra—presumably not always the case, but presumably financial benefits can flow to that company, legitimate ones, through breaking down barriers with bureaucracy and counterparts in China?

Ferrier I think my point, when I said put their arm around, is that’s not the way it should go; it should be pulling New Zealand as a whole. So if we have the support of our Government and it is known that we have the support of our Government in any export market, and our customers know that and the politicians know that, in all likelihood we’re going to be more successful in that market, and that’s what I think New Zealand Inc. is all about. It’s about the Government coming in and supporting our businesses. That’s what NZTE is all about, and it’s great—you know, get out there and help those companies succeed.

Cosgrove Absolutely.

Young And congratulations on the great work you’re doing.

Cosgrove Is Oravida a client of NZTE?

Young Our time has come to a conclusion—sorry, Kennedy, and sorry, Jian; sorry, gentlemen.

Chrisp Can I say one thing as well. It has been a good 3 years and one of the things that has really made a difference has been the political support. Reasonably even-handed political support has given us an enormous amount of confidence. We’ve always felt the support of this committee, and we really appreciate that.

Young Well, you’re doing a great job.

Ferrier Thank you very much. I always enjoy all this—my second one in my NZTE role. I had one or two in my Fonterra role—always interesting.

Young Yeah, I remember last year’s.

Cosgrove You’re happy to accept any written follow-up questions we may have?

Chrisp Yeah, sure.

Young Thank you very much.

conclusion of evidence
2012/13 financial review of the New Zealand Transport Agency

Report of the Transport and Industrial Relations Committee

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New Zealand Transport Agency

Recommendation
The Transport and Industrial Relations Committee has conducted the financial review of the 2012/13 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 whose core functions include planning the land transport network, investing in land transport, and managing the state highway network.

Financial and service performance
The agency finished the year with a net surplus of $56.75 million, compared to a surplus of $41.38 million for the previous year. Total income was $2.06 billion, an increase of 3.2 percent on the previous year; the agency spent $1.183 billion on its main asset, the state highway network.

Public transport
We note that the investment in the New Zealand public transport system over the period of the 2012–15 National Land Transport Programme amounts to $1.74 billion, an increase of 21 percent on the previous three-year period.

The agency told us that its focus is on the effectiveness of the public transport network and meeting the needs of users. It is working with local government in Auckland and Wellington to improve the capacity and reliability of services, investing in trains, lines and technology.

We note that the agency did not reach its value-for-money target for public transport (expressed as boardings per dollar invested), and we heard that the use of public transport in Auckland has been fairly static over the past year, probably because of big changes to the city’s public transport infrastructure. A new ticketing system was introduced, and bus routes were changed. Costs have gone up, with large investments in the rail infrastructure and a more explicit charging regime for track access. We were assured, however, that the agency expects the benefits to become apparent in the longer term, and we note that Auckland City is aiming to double the number of rides on public transport over ten years.

Roads of national significance
The agency confirmed that work has just begun on the MacKays to Peka Peka section of the Wellington Northern Corridor. We were told that negotiations to purchase some of the required properties are continuing, and at least one resident is taking her issue to the Maori Land Court. If the decision is in the resident’s favour, the agency said it will have to consider alternatives.

We are aware a kōiwi tangata (human body) was found in the Waikanae section of El Rancho, and expressed concern at reports that workers had been breaching the tapu of the site by eating their lunch there. The agency assured us that it has been consulting...
throughout the project with local iwi and the Takemore Trust around cultural concerns and tapu sites in the area.

We asked about progress on negotiating a contract for the construction of the road through Transmission Gully, and were assured that a public-private partnership will proceed only if it represents a better deal for the taxpayer than the more traditional procurement process. A comparison with projected public-sector costs has been undertaken and will be released when negotiations have concluded.

We were also told of good progress with other major road construction projects: construction continues on the Waterview Connection and the Tauranga Eastern Link, the contract has been awarded for the Cambridge section of the Waikato Expressway, and consents are being sought for the Puhoi to Warkworth section of the Puhoi to Wellsford Corridor. We were told that major challenges are expected in the Dome Valley, which is difficult terrain.

**National Land Transport Fund**

The National Land Transport Fund is lower than forecast two years ago, and the agency said it would borrow to pay for Transmission Gully if necessary. We heard that it has borrowed on other occasions, for example to buy new trains in Auckland.

**Road safety**

The agency’s chief executive is a member of the National Road Safety Committee, along with the chief executives of the Accident Compensation Corporation, the Ministry of Transport, and the Police. Road safety work is focusing on a system-wide approach to vehicles, speed, road use, and roads and roadsides.

While new cars usually have five-star safety ratings, we were told that some new utility and passenger vehicles merit only two. We encourage the agency to be more proactive in removing unsafe vehicles from the fleet.

We were interested to hear about initiatives to improve young people’s driving, including a higher licensing age and a longer and more challenging practical driving test. We were pleased to learn of a 16 percent improvement in the safety of young drivers and their passengers. We were pleased also to hear of work to make roads more forgiving of human error, especially at intersections. Investment in this area has been prioritised.

**Freight**

We were told that most of the demand for freight in the next 30 to 50 years is projected to be concentrated from Taupō north; the agency has been working with KiwiRail, the ports, and the local authorities to plan the development of freight infrastructure in the upper North Island. We support the agency’s intention to encourage fewer trucks carrying more tonnage per truck, and safer trucks.

**Walking and cycling**

We were pleased to hear that walking or cycling tracks are being built alongside many state highway developments, and that the agency works with local authorities on local walking and cycling initiatives. They are funded from the relevant road budget if they are part of a new or improved road, or otherwise from the agency’s “walking and cycling” output class.
In successful initiatives in Hastings and New Plymouth, the agency and the city councils have encouraged cycling and made it safer. We hope that the lessons from these projects will be applied in other areas.

Recommendations in a recent coroner’s report have led to the agency making a commitment to set up an expert panel on cycling safety. We were told, however, that this will raise a number of complex issues.

**Warrants and Certificates of Fitness**

The agency updated us on changes to warrants of fitness and certificates of fitness to be introduced in 2014. WOFs will be required annually for cars manufactured after 2000, and there will be more options available for owners updating COFs. We were assured that these changes would reduce costs to car-owners and trucking companies without compromising vehicle safety.

**Mountain passes**

We asked about the potential of slips in mountain passes and gorges to damage the tourism industry. The agency confirmed that some roads, including key tourist routes, are very difficult and expensive to keep open, and that little can be done proactively to reduce the fragility of the terrain. We noted that the agency had done well with the quality and timeliness of its communications with the public during a recent slip and road closure at the Haast Pass.

**Logging**

We are concerned about the large number of accidents, injuries and deaths in the logging industry, and asked about regulation of logging trucks and roads. We were told that the logging industry is subject to the same rules as other truck operators, and it is up to the police how and where they check that logging trucks are safe. The agency considers that the main issue may be overweight vehicles rather than poor roads. We were told the logging industry has its own code of conduct, in addition to the requirements for trucking in general.
Appendix A

Approach to financial review
We met on 5 December 2013 and 30 January 2014 to consider the financial review of the New Zealand Transport Agency. Evidence was heard from the New Zealand Transport Agency and advice received from the Office of the Auditor-General.

Committee members
David Bennett (Chairperson)
Chris Auchinvole
Carol Beaumont
Dr Cam Calder
Darien Fenton
Andrew Little
Simon O’Connor
Denise Roche
Mike Sabin

Evidence and advice received
New Zealand Transport Agency, responses to written questions, received 27 November and 23 December 2013.


Organisation briefing paper, prepared by committee staff, dated 3 December 2013.
Appendix B

Corrected transcript of hearing of evidence 5 December 2013

Members
David Bennett (Chairperson)
Chris Auchinvole
Dr Cam Calder
Clare Curran
Darien Fenton
Julie Anne Genter
Simon O’Connor
Mike Sabin

Witnesses
Geoff Dangerfield, Chief Executive
Christopher Moller, Chair
Celia Patrick, Group Manager, Access and Use

Bennett Morning, Geoff and Chris. Thank you very much for coming along to the financial review of NZTA. Welcome to the committee. You’ve been here before and know what to do, so we’ll just have a brief introduction of ourselves. We’ve got to about 11am. So we’ll give the introduction then we’ll open up to questions. Welcome.

Moller Thank you, Mr Chairman. Good morning, ladies and gentlemen. Thank you for the opportunity to discuss the Transport Agency’s work for the 2012-13 financial review. We produce a very comprehensive annual report, the document I’m holding now, so that our stakeholders can see how we are tracking and the services we are delivering for customers and New Zealand communities.

This year we also reported on our performance and delivery directly to our stakeholders by convening 15 highly successful regional quasi-annual general meetings that were held throughout the country, from Whangarei to Invercargill. We also prepare a quarterly report on our performance throughout the year, and this is made available to all interested parties on our website.

Over the last year we have continued to see a shift in the quality of our land transport system through improved safety on road and rail, more efficient service delivery to our customers, and an increasingly effective transport network through new road and public transport infrastructure. The 2012-15 National Land Transport Programme includes investment of $1.74 billion
in New Zealand’s public transport system—a increase of 21 percent on the previous 3-year period.

In Auckland and Wellington we are supporting local government to increase capacity and improve reliability of services, and we are investing in new trains, rail upgrades, and in technology that improves the user experience. Our focus is on ensuring public transport services meet the needs of users and help make the whole transport network more effective.

Over the last year we have also been working hard to drive more efficiency into our own operations and the land transport sector generally. For example, we have changed how we specify a contract for road maintenance and operations. Where it makes sense we will also increasingly do this with local authorities in an integrated, one-network approach to achieve greater value for money.

We have reviewed the regulatory settings for transport. Jointly with the Ministry of Transport, we have examined the vehicle licensing regime, and the Government has made decisions to change the warrant of fitness system. The changes will save New Zealanders time and money, whilst maintaining focus on road safety outcomes.

We are accelerating the uptake of high-productivity motor vehicles to improve the efficient movement of freight and to help make goods cheaper and more competitive for New Zealanders and for New Zealand as an exporting nation. Many routes and bridges have been opened up to high-productivity motor vehicles. For parts of the road network where heavier high-productivity motor vehicle access is not feasible, we have developed the 50MAX concept, allowing for five extra tonnes of freight per truck with minimal infrastructure upgrades.

We have led collaborate central and local government, and private sector freight planning processes around the country. We are working with our partners to better integrate the road, rail, air, and maritime networks. The roads of national significance are key to a high-performing, strategic freight network and will improve travel times, safety for all road users, and travel reliability to and from processing sites, ports, and markets.

We continue to focus on the delivery of important infrastructure improvements on the busiest parts of the State highway network. In Auckland, Alice, the tenth-largest tunnel boring machine in the world, is up—or should I say down—and running, as we continue construction of the Waterview Connection, New Zealand’s largest-ever roading and infrastructure project. We have completed another section of the Waikato Expressway. The construction contract for the Cambridge element of the expressway was awarded, and work has commenced, with the construction soon to also begin on a further section of the expressway. Progress on the Tauranga Eastern Link continues, and we have begun construction on the MacKays to Peka Peka section of the Wellington Northern Corridor. Earlier this week we announced the next step in the Transmission Gully PPP process with our selection of the preferred bidder for the project.
We are continuing to deliver key projects that will help grow Canterbury and support Christchurch’s recovery. In the last year we have invested $96.8 million in earthquake-related emergency projects, with roughly two-thirds of that sum coming from the National Land Transport Fund. We have been working closely with Christchurch City Council, CERA, and SCIRT to coordinate the repair and construction of the damaged roads and other infrastructure in the city. Our joint transport operations centre with Christchurch City Council and ECan went fully live in July. This will increasingly ensure that Christchurch operates as one network. We also completed the initial stage of the Christchurch Southern Motorway ahead of schedule and under budget.

We continue to deliver important nationwide road safety programmes and initiatives. A 16 percent improvement in young driver and passenger safety is the result of many fundamental changes, including a longer and more challenging practical test. We have worked with the Automobile Association and local council and community groups to trial a driver-mentoring scheme in some parts of the country, and we have ensured that young people were made aware of the changes in the driving laws, which lowered the blood-alcohol tolerance to zero for drivers under 21.

We are targeting areas of greater risk throughout the system by strengthening our focus on rail safety, and have appointed a director of rail safety in addition to a director of road safety. We are making roads more forgiving of human error, with investment prioritised in accordance with new guidelines for intersections and rural roads. We have been applying technology around rural schools, and introducing variable speed limits and electronic signage to slow traffic at the beginning and end of the school day. We have worked behind the scenes to support the recent law change to booster seats for children up to the age of seven. For heavy vehicles our operator rating system encourages safe choices by commercial operators and their drivers.

For motorcyclists we have introduced the learner-approved motorcycle scheme and improved the basic handling skills test. We have also been working with the Motorcycle Safety Advisory Council to develop a best practice guide for road maintenance, to take into account the needs of cyclists.

We have launched the “Drive Social” campaign to encourage different conversations about how we all interact with other road users. We are building knowledge and skills within the transport sector to grow understanding of the safe system approach, and we have developed our own safe system training course—a world first. This month we are bringing together an expert panel on cycling safety in response to the recommendations raised in a recent coroner’s report.

I am privileged to lead a very talented and experienced board and team of officials. We have focused on ensuring the Transport Agency is a high-quality and customer-oriented organisation and that it delivers value for money in everything it does. The board was not surprised that the
Transport Agency’s chief information officer was recently named New Zealand’s CIO of the year, and last week our chief financial officer was named public sector CFO of the year. These awards are testament to a very talented team, led extremely well by our chief executive, Geoff Dangerfield.

With those opening remarks, we are now happy to answer the committee’s questions.

Bennett Thank you, Chris, and thank you for that very strong introduction. I just want to congratulate your staff as well on their achievements, and I think that reflects well on the organisation but also on Geoff as well, who has done a great job in running NZTA. I know your leadership from the top has been very important as well, so we appreciate that. My eyes lit up when you said that construction was soon to begin on a further part of the Waikato Expressway, just after you mentioned the Cambridge one, so would you like to expand on that?

Moller We'll have it completed in a month, Mr Chairman.

Dangerfield The Rangiriri section is under way, and I think a week on Saturday we’ll be opening the Ngāruawāhia section, on Saturday 14th. On the following Monday it’ll be open to traffic.

Fenton I compliment you on a very comprehensive annual report. It’s got some very interesting information in it. I wanted to start with one of the statistics there, which is around car use in Auckland declining yet public transport not increasing. Do you have a comment on why you think people are using cars less but they’re not taking public transport?

Dangerfield Well, a lot of what we think goes on behind patterns of car use is related to both the social and economic circumstances that people are in. So we’ve seen over the last 5 or 6 years pretty static per capita use of vehicles, and most of the growth comes in areas where actually population is increasing. Auckland is the part of New Zealand where that still applies. Some of our latest data shows that on the State highway network, there is actually a difference in volume on the network at this point in the year when we compare it with 12 months ago. So some of the numbers on some of our key sites are up 2 percent, 2.5 percent, sometimes a little more than that. But in other parts it’s variable.

Public transport—overall public transport use in Auckland has also been relatively flat in the last 12 months. And, you know, some of that is actually it’s going through quite a lot of service change. There’s a whole lot of work that’s being rolled out on the rail system, new ticketing, changing bus routes. And we can see from other jurisdictions that when public transport systems themselves go through periods of change like that, sometimes patronage falls away. But the patronage objectives in Auckland are actually quite bullish to get a lot more people on to the public transport system. So I think there’s something like about 70 million trips on public transport in the last 12 months—69 million something or other. Let’s say 70 million. And the city itself has an objective to double that to something like about 140 million over I think it is about a 10-year period. That is a pretty bullish
objective, but reaching towards 100 million I think would be a very good outcome.

Moller Geoff, I think it’s worth saying also that Auckland Transport are on the case and working very hard, under the leadership of Lester Levy, in terms of this.

Fenton You describe your target that you didn’t reach around public transport as disappointing.

Dangerfield Well, the target we have is actually a value for money target, because we’re looking at what is the National Land Transport subsidy per passenger boarding. And we set a benchmark when that first came in. It’s about 51c from the National Land Transport Fund, and there’s typically another 51c coming from the relevant local authority, making up the total public subsidy. In the last year or so, I think that’s probably closer to 54c per boarding. So in somewhere like Auckland, the costs are going up and the boardings are remaining relatively static. And the reason that the costs are going up is because so much investment is going in. We’ve had a more explicit charging regime around track access charges between KiwiRail and local authorities for running metropolitan rail, plus of course there’s a lot of investment going into the new train systems. So those things are adding to the cost side; we’re not seeing at this point an upswing on the passenger side. But if we do all these other things right, and it’s a reasonably long game, we would expect that to flow through in a period of time.

Fenton I wanted to move on the roads of national significance, starting with the Kapiti Expressway. You said that you’ve started construction there. What are the outstanding legal issues there that are yet to be resolved with residents who are losing land?

Dangerfield This week we have started construction—a few weeks ago we started construction, with a formal ceremony earlier this week on the MacKays to Peka Peka section. I’m not sure we’ve got all of the land that’s required; there may well be a few that are yet to go. And there’s a formal process under the Public Works Act and other issues for people to be able to resolve—issues about, basically they’re coming down to valuation of properties. If there’s a compulsory acquisition, we try to work through a willing buyer and willing seller basis before we get to that point. I’ll just refer to my colleague. I don’t know whether there are any outstanding issues on the Kapiti Coast that we can draw to your attention?

Official No.

Moller Other than the property ones, I’m not aware of any—

Dangerfield Other than those, there is no other regulatory or resource management or any of those issues; they’ve all been worked through.

Fenton What about Patricia Grace, who’s taking her case to the Māori Land Court?

Dangerfield That’s got to work its way through. She’s got a particular issue that she’s raising, but it’s not a legal impediment to getting on with the project.
Fenton: But her house is right under the urupa, and the plan is for the expressway to go right through it. So how can you get contracts for that when that’s not resolved?

Dangerfield: Because the resource consents and the board of inquiry have dealt with that issue and the alignments with that. If the Māori Land Court found in a different way, we’d have to work our way through that and think about what alternatives were required.

Fenton: Do you believe you’ve properly consulted with iwi groups before you started construction?

Dangerfield: I guess there’s been a lot of consultation with iwi groups.

Fenton: So how were iwi informed that there was a kōiwi tangata in the Waikanae section of El Rancho?

Dangerfield: I can’t answer the detail on that, but I went to various iwi meetings right back to 2009 on the Kapiti Coast. We’ve worked through those issues constructively, and of course all those things were aired in the board of inquiry process.

Fenton: Well, this is a recent occurrence. This has happened in the last month, as I understand it—

Dangerfield: Sorry, I have no—

Fenton: I met with kuia and kaumātua yesterday, who understood that the site was tapu until the archaeologists had finished their work, yet we found workers having lunch on the site, which was extremely offensive to the local Māori.

Dangerfield: I’m sure if there’s those sorts of incidents that have happened, they will get back to it, and the contractors will take appropriate action.

Bennett: Maybe you could take that back to the organisation?

Fenton: Well, I’d like an answer to that, thank you, because, as I say, it was extremely horrifying for those local iwi yesterday to find that. And also you sent along your stakeholder adviser who, I have to say, wasn’t very constructive or helpful with the kuia and kaumātua in helping them understand what was going on.

Dangerfield: I’ll take that back and we’ll work our way through that.

Calder: Thank you. A lot of money is being spent on road safety, and there’s some outstanding results. You’ve alluded to the importance of getting a better, safer fleet, with 5-star safety ratings, and obviously, the design of roads, etc. But would you like to go into some of the—do you have any measurement tools for seeing how road safety is improving and some of the other strategies you’re using?

Dangerfield: As the chairman talked about in the introduction, we’re approaching the road safety challenge with our partners in the public sector and across the entire transport system to work on what we call a safe system approach. And I think everybody all around the world has realised you can’t solve this by looking at one particular thing. You have to look at a whole lot of things.
So the safe system approach says to think about what are your requirements around safe vehicles, safe speeds, safe driver behaviour, and safe roads and road sides. I’m a member of the National Road Safety Committee, which is the four CEOs of ACC, the Ministry of Transport, the Police, and ourselves. So our work is through a programme across the entire Government, grappling with exactly that. And in the action plan around the Safer Journeys strategy for this period, we’ve got actions around safer vehicles, which are largely aimed at taking unsafe vehicles out of the fleet. All fleets around the world are getting older, but fleets are also getting safer. And there are more—you know, on purchase of new vehicles, a very high percentage of those are 5-star vehicles. So that’s about as good as it gets. But to be honest, we still have some 2-star vehicles as new vehicles coming into the fleet across the board.

Calder Are these mainly passenger vehicles?

Dangerfield Passenger vehicles. There’s a real issue here about should we be more proactive about dealing with that sort of thing, because there’s no point in having them—

Calder Or are they motorcycles?

Dangerfield No, they’re utility and passenger vehicles. But also being able to get better roads and road sides—we’re pretty comprehensive there. We’ve done a lot of work on intersections, intersection guides, lifting quality, because that’s where most accidents happen in relation to intersections. There’s a lot of work that we’ve been doing on driver behaviour, and the chairman talked about lifting the age at which you can get your first licence and having a much tougher restricted licence test, and so on. So you’ve got to work at this in a pretty comprehensive manner.

Genter Thank you very much. Thank you very much for your presentation. I have two primary areas of questions. The first one is about the Transmission Gully public-private partnership. Has a public sector comparator been undertaken for this project?

Dangerfield Yes.

Genter Can we see a copy of that?

Dangerfield That will be released when we get to the conclusion. It wouldn’t make sense to put that into the public arena when we’re trying to negotiate an agreement, because we’re trying to get the best deal for the taxpayers and we don’t want to give away our position.

Genter How would that put you in a bad position, given that—

Dangerfield Because it says what our bottom line is, and the deal that we are needing to reach to be the best deal for taxpayers, it has to beat the public sector comparator. So why would we put our bottom line of what you’d have to beat into the public arena, because then that gives our negotiating position.

Moller But we will release that once we’ve progressed to a final contract.
Genter Would it be possible for taxpayers to be assured that the public sector comparator is a smaller number than your anticipated cost for the PPP?

Dangerfield As I’ve just said, we’re quite happy when we get—if and when—to an agreement on the preferred bidder, or the preferred arrangement, to put both of those things into the public arena so people can clearly see that while we have here as a PPP process, it gives taxpayers a better deal than doing it through a traditional procurement route. This is the basis of the entire proposition.

Moller And we’ve had Treasury heavily involved, and I can assure you that they’ve held our feet to the fire on this one.

Genter So can you confirm for the committee right now that the number in the public sector comparator is smaller than the anticipated costs of the PPP?

Dangerfield No, the anticipated cost of the PPP is smaller than the public sector comparator—

Moller Has to be. Otherwise we wouldn’t be proceeding.

Genter So you’re confirming now that the public sector comparator is definitely going to show that the anticipated cost for the PPP is a smaller number than what Treasury and yourself have calculated as the public sector comparator?

Moller Based on the bids they’ve made today. There are a number of matters we have to resolve. That’s why the preferred bidder, and we have to go through those negotiations—as of today.

Genter I’m a little confused as to how it would be giving away your position given that the Government’s already given me in an answer to written questions anticipated annual repayment costs for the PPP.

Dangerfield The public sector comparator and the value of the PPP both need to be expressed in exactly the same terms. So they have to be expressed in what’s called net present cost. So your comments earlier about this costing three times as much is a complete fallacy. The alternative have to be brought to a common base. On the one hand we have to be able to bring the costs of a traditional procurement to the net present cost by discounting what that future flow of costs would be, not only the construction costs but the maintenance and operational costs for 25 years, against what’s the flow of costs to meet the delivery by the private sector, again, expressed in a net present cost. The net present cost of the PPP must be lower than the net present cost of the public sector comparator for this deal we go through.

Genter OK, it must be—I’ve just—

Dangerfield The Government’s position on that has been perfectly clear—

Genter I’ve heard leaks from people from Treasury that the public sector comparator is smaller than the PPP, and I think that this committee probably needs to know before you get to the point of signing a contract that taxpayers are going to get good value for money.
Bennett Julie Anne, I think they’ve answered that question. Do you want to go into your second one now?

Genter Sure. Is it possible to move a motion under Standing Order 193, that we request a copy of the public sector comparator?

Bennett You can do that after the hearing, but not during the hearing.

Genter So, revenue from the Land Transport Fund, from petrol taxes and road user charges—is that lower than what was anticipated this year?

Dangerfield It all depends which base of forecast you want to work off. The revenue is tracking according to the budget-based forecast pretty much as expected. Nevertheless, revenue is down against the forecast on which we based the initial programme about 2 years ago. So the initial programme was initially sized on a forecast which today tells us is probably about $300 million less over this 3-year period than what we’d initially hoped.

Genter Given that, for example, future repayments for the Transmission Gully PPP are going to be coming from the National Land Transport Fund and there’s been a consistent over-prediction of what’s going to come in from National Land Transport Fund and petrol tax and road user charges, in part because vehicle kilometres travelled have been declining for quite a few years now—is there any danger of there not being enough money in future National Land Transport Funds to cover all of the needs of the transport network when so much has been committed on just one project?

Dangerfield Well, we have a very clear policy about revenue cover for long-term commitments. If the Transmission Gully proposition is to go ahead at $125 million a year and around $3 billion worth of income every year, I think you can clearly see that there’s plenty of revenue cover for that. But you’re dead right. There are more long-term obligations than the Transmission Gully proposition that we have to meet. For example, we have loan agreements and loan commitments to meet for public transport up and down the country too. The purchase of $630 million worth of electric trains in Auckland is also being met out of debt finance.

Genter Isn’t that Auckland Transport that’s paying that back to you?

Dangerfield Pardon?

Genter Isn’t that Auckland Transport that’s paying that back?

Dangerfield No, the Auckland Transport’s paying half of that. We’re paying half of it too—similarly, with the loan finance for the purchase of the Wellington trains or the other loan finance that we have. So we have to look at all of our future commitments, and some of these are for very long period. The payback period from the electric multiple units in Auckland is a 35-year time frame. So not only for road development but for public transport and other issues we have to look at the long-term cash commitments for those, and we look at those against our revenue, and we’ve got a policy about what sort of cover we think is appropriate and we’re well within that.
Yes, it was partly a sup on that. Can you just expand on the work that’s going on in terms of the upper North Island freight story—what benefits are arising from that?

The upper North Island freight work has been us working with KiwiRail and the ports and the local authorities in the upper North Island, basically—you know, Taupō right through to the north—looking at what are the future needs of the freight system in that area, because that’s where most of our freight demand comes from into the future, and we’ve been taking a 30 to 50-year view, Mr Sabin, in terms of what are the key elements of that network in an inter-modal sense—how you get proper connectivity into the port of Tauranga, port of Auckland, Northport; what’s the interrelationship with rail; where do we see the interconnection points between modes. And we’re seeing increasingly the growth of freight hubs, and we see that in Hamilton, in particular. And I guess, you know, the long run and in the next few months we’d want to take that from some freight story work to a much more, you know, what’s the right freight strategy that will guide us and those other infrastructure providers about the service levels that we’re looking for out into the future so it can guide our future freight resource planning.

Trying to find more efficiencies in the freight system is absolutely crucial. We’re pretty pleased with what’s going on in the high productivity motor vehicles. We’re actually having less trucks on the road carrying better weights and things like the 50MAX initiative is actually leading to the industry refreshing its vehicle fleet with a lot safer vehicles and, you know, that’s giving us real benefits across the spectrum.

Yes, just a supplementary on that, talking in the same infrastructure space, I guess. The roads of national significance—obviously, the Pūhoi to Wellsford is now fast tracked and becomes an integral part of that upper North Island freight story, if you like, in terms of the Northport, Auckland, Tauranga, and so forth. So can you just give us an update on the Pūhoi to Wellsford and the nexus with the freight story?

Well, the Pūhoi to Wellsford corridor we’re approaching in two parts. We’ve got most of our effort focusing on Pūhoi to Warkworth, and in the last wee while we’ve entered into the consenting process. The Government’s accepted that as for the national consenting process, and that’s really the work for the next 9 or so months. We’ve done all the preparatory work and I guess, you know, if and when that flows through, we’ll turn our minds to how we’re actually going to deliver that on the ground.

Next year, in 2014, we’re going to reactivate our work on thinking through the Warkworth to Wellsford part of it, which, you know, has got some real challenges through there. The Dome Valley is a very difficult piece of country. It has a very high accident rate, and by this time next year we’ll have a better sense about how we can tackle that. But all of that, you know, how Auckland connects to the north—I mean, these roads of national significance are largely about how do we get better connectivity around our
key metropolitan areas and our integration with our export stories, and that’s essentially what the Waikato Expressway is doing to the south of Auckland, and our connectivity between Hamilton, Waikato, and areas further south right down to Taranaki and the like, and then, in an economic geography sense, what the connectivity is to the north.

Fenton

Yeah. Just on those and all of the road building that’s going on, what is the focus on walking and cycling, given that was under spec last year as well?

Dangerfield

Walking and cycling—we work with very closely with local authority partners on local walking and cycling initiatives, and then we also put walking and cycling facilities alongside many, if not all, of our State highway developments. Even this week, with the opening of the start of the MacKays to Peka Peka section of the Northern Corridor, there’s 16 kilometres of cycleway coming alongside that. Now, we don’t actually account for that—and it’s possibly one of our failings—in the walking and cycling activity class in the Government Policy Statement. It tends to be met out of State highway budget. There’s $80 million over the 3-year period for walking and cycling initiatives in the National Land Transport Programme. That’s leveraged with money from local authorities themselves.

We’ve taken an approach to, basically, concentrate investment in a couple of areas around model communities. That’s been both around Hastings and New Plymouth, where we’ve done a partnership with the city councils in those areas to really see whether we can lift the engagement on cycling, make cycling safer, and lift cycling numbers across the network. That’s been pretty successful, and what we’ve done is we’ve done a review of the learnings from that and we’re applying that in the other areas.

We’ve also got some issues that we’re trying to grapple with about cycling safety. The coroner has made a very useful report in the last few weeks, and we’ve undertaken to set up an expert panel on cycling safety between now and Christmas. And it’s quite a complex problem and will require us to work across the board on a whole lot of initiatives.

Fenton

Will that include looking at cycling safety around schools?

Dangerfield

Yes it will, and we’ve been doing quite a lot around speed limits around schools in both urban areas and rural areas. We’ve mentioned a trial around variable signage, speed signage, around schools, trying to slow traffic on State highways around start and finish times—that’s looking very successful—and, again, we’re trying to roll out that in the future.

Fenton

Couple of more questions, actually. What planning have you done in the last year to ensure that drivers aren’t sitting in long queues where construction work is taking place on State highways or roads of national significance over the summer? Because I actually live on a motorway that is constantly held up on.

Dangerfield

Traffic management on existing roads when it comes to upgrades is a real challenge for us. It’s a bit like the old saying that you’re trying to fix the plane while flying—you’ve got to be able to keep the road moving as much as possible and undertake some pretty extensive works. Some of our work
on the causeway State Highway 16 in Auckland may be what you were referring to.

Fenton Yes, that’s where I live. That’s a good guess.

Dangerfield It’s been a real challenge for us. There’s not an easy answer, because we have to be very careful about trying to minimise disruption, especially at peak flows. But, as you know, peak flows in Auckland are becoming longer and longer—longer in a peak sense: that roads are very busy for a lot of the time. But the team on the causeway project have been experimenting in different ways of trying to modify that, and I think we’ve been pretty happy with some of the flows that were perceived—

Bennett Simon O’Connor, you got anything you want to add to that?

Dangerfield Our traffic operations centre in Auckland has that pretty much under control.

Fenton If you could fix Lincoln Road soon, I’d be very happy.

Dangerfield We’re endeavouring to get on with it, so Lincoln Road interchange is a key—

O’ConnorSwitching round to the COF and WOF—when those changes are coming in, really what you’re seeing, I suspect, around the projected savings, can you just expand on that for me?

Dangerfield The first of the warrant of fitness changes takes place in 3 weeks, I think, on 1 January. So, basically, the change is that all vehicles first registered after 1 January 2000 will move to an annual warrant of fitness. People whose vehicles are due for a warrant on a vehicle after 1 January this year, first registered 13 years ago, will move from a 6-monthly system if they were past that initial 6-year-old group into an annual system, and then we’ll take another tranche on 1 July. All vehicles then will roll through on a 12-monthly warrant of fitness, and all vehicles that are older than that, older than the year 2000, they’ll remain on a 6-monthly system.

O’Connor So if you go through projected savings then for the consumers, for us?

Dangerfield We added up all of the benefits of that over, I think it was, a 30-year period. It’s a large number—$1.5 billion or something like that. So, it’s a very large saving to the households without any reduction in safety. The certificate of fitness changes are not so much around the frequency. We’re not changing the frequency with which trucks need to come and get inspected, but we are changing some of the business models of delivery, which allow, basically, more players to deliver those services. So people needing those services have more choice and that will save some businesses long trips to testing stations and the like. That’s a series of changes that we’re going to roll out next year and beyond.

Genter I wanted to ask about the number that you mentioned—$80 million for walking and cycling. Is that coming under the State highways activity class or is that under the walking and cycling

Dangerfield That’s under the walking and cycling activity class. That’s the 3-year—
And does that include the contribution from local authorities?

I think that includes it. Yes, I think that includes it.

OK. So, in fact, the contribution from the National Land Transport Fund is less than $80 million.

Yes, if I’ve got the numbers right.

What percentage of the total overall is that, of spending, of the National Land Transport Fund?

$80 million out of about $12 billion over that 3-year period.

So it’s about less than 1 percent.

Excluding the State highway.

If you included the spending on the State highway, what percentage is that—

When we estimate what goes on in other parts of the budget—when local authorities put a green cycle box at a set of lights to make it safer for cyclists, that’s not coming out of the walking and cycling budget. Our work on State Highway 1 in Dunedin, for example, where we’re trying to shift to make more room for cyclists—that’s coming out of the State highway budget. We think there’s probably about another $80 million coming out of other parts of the system, which would probably be about the same as the $80 million there in the walking and cycling activity class.

There’s been, as you know, a lot of interest in what’s happening in forestry in the last few weeks—the people who actually work in the industry—but have you got any concerns about logging trucks? Because there seems to have been a number of accidents, injuries, and deaths this year, as well as other years, and part of it seems to be the roads they drive on, but also I wondered about that—how much they’re regulated, and what your rule is on that.

Well, the logging industry has to live by the same rules as all other truck operators, and we’ve been concerned about some of the roll-over issues. Police are the enforcers under the road policing programme. We, basically, contract with the police to deliver traffic safety on the roads—$300 million a year comes out of the National Land Transport Fund, and nearly $900 million over the 3-year period. They focus on hot spots, they work according to risk, and there are some risks in key areas, and a lot of that is requiring the vehicles are safe and the loads are safe. There is not quite the same accuracy when people are loading logging trucks as you might get with some other loads because it’s hard to be able to do the right weight things. So the police and ourselves are a little concerned if there’s overweight issues going on in the forestry sector. So, largely the enforcement is an issue for police, and we’re asking them to target to where the risks are.

How much does the state of the roads have—how much impact do they have?
Dangerfield: Well, they may have some impact, but most of the issues are not likely to be road related.

Auchinvole: Earlier in the year—I dare say you were aware of it—we had quite a situation south of Haast with road damage and very major slips. It generated a lot of public interest, a lot of apprehension, and a tremendous amount of myths and legends, and all sorts of things. I just want to pay you the compliment and particularly the people—Mr Pinner, I think, is the lead person there—for the way they handled the public information. There were regular bulletins several times a day and then public meetings in Hokitika, Greymouth, right through all the settlements down to Haast. And they were followed up by extensive myths and legends and actualities, which put everything back in place. My compliments to you for that and it was much appreciated by everybody.

The second thing, though. When we look at the security of communications in those areas, it does have major effect on tourism operators and that sort of thing. So I guess that’s just the reality of living in the west of the Southern Alps. Is that right?

Dangerfield: Well, the Haast Pass issue, in the last few months, has been a difficult one—the Diana Falls slip has been real trouble. I think, we have, as you say—and thank you very much for your comments—have got much better at interacting with our customers and keeping them informed over that. There are major issues with the Manawatū Gorge 18 months ago and we learnt a lot about that. If we can keep stakeholders informed—and that’s a key route for tourists and tourists through all of that area—then people can understand where we’re up to and that builds trust and the ability to plan around that.

But this is difficult country. Some of these routes are fragile and don’t necessarily have the resilience that you’d like, but they are incredibly expensive to take proactive action on. We need to work very hard to make sure we keep those routes open.

Genter: There were changes to the road-user charge system not long ago and one of the rationales for that was that we could reduce RUC evasion. Am I right about that? Now the total proportion of the National Land Transport Fund coming from RUC has fallen relative to petrol tax, if I’m not mistaken. Has there been a decline in RUC evasion to the knowledge of NZTA, because there’s an answer to the question here which seems to suggest that there was actually more RUC evasion last year than in previous years. So do you think the changes have been successful?

Dangerfield: Well, the changes were designed to get away from people declaring the weight they were carrying to having to pay a charge according to basically the carrying capacity of the vehicle. So that tries to get away from that problem of: “I’ve declared that I’m carrying 20 tonnes. I’m actually carrying 25.” When a truck is designed to carry 25, you’ll pay for carrying 25. That actually changed the incentive for those truck owners to load and carry backloads as a result. So you get a much more efficient fleet and that is
highly sensible. It saves on fuel it saves on wear and tear, and saves some of the important things that [inaudible]

I think it would be naive if we all thought that that would take out all of the potential and possible evasion we might have in the RUC system. We’ve taken out a very obvious route. And we keep on auditing and working on making sure that people pay their fair share of contribution to the upkeep of our roads by chasing RUC and RUC payers to make sure they pay their proper amount.

Fenton Just going back to the logging thing. What does the Log Transport Safety Council—what’s their relationship with you and how much weight does their code of practice have?

Dangerfield I think that’s a specific thing of the logging industry and perhaps Celia, you could answer that.

Patrick It is. So there is a specific [inaudible] within the logging industry. We help them and work with them as required [inaudible]

Fenton Right. So their code of practice for log trucking—how much weight does that have? Is that just something that they’ve made up or have they worked with you on that? They have a code of practice, which is for log transport safety. How much weight does that have and have they worked with you on it? How enforceable is it and how does it relate to other obligations that they have in terms of road safety?

Patrick We’ve provided input [inaudible] over recent years. It’s a mechanism by which they regulate and manage themselves.

Fenton So, self-regulation.

Patrick Over and above our set of requirements that we have for truck drivers.

Bennett OK. Well, thank you very much, Chris and Geoff. We appreciate your time and thank you very much.

**Conclusion of evidence**
2012/13 financial review of the New Zealand Walking Access Commission

Report of the Local Government and Environment Committee

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New Zealand Walking Access Commission

Recommendation

The Local Government and Environment Committee has conducted the financial review of the 2012/13 performance and current operations of the New Zealand Walking Access Commission and recommends that the House take note of its report.

Introduction

The New Zealand Walking Access Commission is a Crown entity whose primary purpose is to lead and support the negotiation, establishment, maintenance, and improvement of walking access.

In 2012/13 the commission’s total revenue was $1.912 million and total expenditure was $2.293 million, resulting in a net deficit of $381,000. The commission’s budgeted revenue and expenditure for 2012/13 was $1.915 million and $2.039 million, with a budgeted deficit of $124,000.

Financial and service performance management

The Office of the Auditor-General issued an unmodified audit opinion on the commission’s financial statements, giving “very good” ratings to its management control environment and to its financial systems and controls. Service performance information and associated systems and controls received a “good” rating, up from “needs improvement”.

Reserves and Enhanced Access Fund

The commission is holding reserves—as short- and long-term investments—of just over $2.1 million, and cash or cash equivalents of just over $0.5 million. Of these reserves, $1.65 million is held against the Enhanced Access Fund.

The fund is contestable, and is designed to support projects that will enhance access to New Zealand’s outdoors. Originally, the commission intended to run down the money over 10 years until it reached a zero balance. We were interested to hear that it is now considering making the fund permanent. It suggested that engaging in commercial partnerships was one option for making the fund sustainable.

Walking Access Mapping system

The $381,000 deficit recorded by the commission in 2012/13 was mainly due to the overwriting of several IT components of the original mapping system to enhance its capability. We were told that, subject to approval from the responsible Minister, the commission plans to make planned investments to improve the mapping system over the next two or three years. The operating system will be upgraded, and public access to data and recreational information improved.

The commission’s governing legislation, the Walking Access Act 2008, requires it to compile, hold, and publish maps and information about land “over which members of the public have walking access”. We heard that although various agencies, including local authorities and the Department of Conservation, had mapping systems for their own
land—which the commission might have used—there was no national system; the commission has therefore chosen to develop its own.

Launched in 2011, the Walking Access Mapping system provides clear, accurate maps and information as to where the public can enjoy walking access. It combines cadastral information, topographic maps, and aerial photography. We were interested to learn that people have been using the system for other purposes, for example using the cadastral component for information about property boundaries.

We consider the mapping system to be an extremely useful tool, but are concerned that relatively few people are aware of it. The average number of unique visitors per day has grown from 202 (in 2011/12) to just 265 (in 2012/13). Working with agencies such as the Department of Conservation to maximise promotion of the Walking Access Mapping system might be a useful undertaking.

**Role of the commission**

While it is a “walking” access commission, its role is not limited to pedestrian activity. We were interested to hear that it is also involved in issues regarding access by bicycles and other vehicles, dogs, horses, and firearms. The commission gets involved with cycle trail trusts and landowners only when access discussions have reached an impasse, at which point it can act as a circuit breaker and provide “new eyes”. We note that the commission has most recently worked with the New Zealand Transport Agency on road safety regarding horses.

We were pleased to hear that the commission is actively working on its engagement with Māori, and note its view that this is a gradual process.
Appendix

Approach to this financial review

We met on 30 January and 6 March 2014 to consider the financial review of the New Zealand Walking Access Commission. We heard evidence from the New Zealand Walking Access Commission and received advice from the Office of the Auditor-General.

Committee members

Nicky Wagner (Chairperson)
Maggie Barry
Jacqui Dean
Paul Goldsmith
Claudette Hauiti
Hon Phil Heatley
Gareth Hughes
Moana Mackey
Eugenie Sage
Su’a William Sio
Phil Twyford
Andrew Williams

Evidence and advice received

New Zealand Walking Access Commission, Responses to written questions, received 25 February 2014.


Organisation briefing paper, prepared by committee staff, dated 27 January 2014.
2012/13 financial review of the Office of Film and Literature Classification

Report of the Government Administration Committee

The Government Administration Committee has conducted the financial review of the 2012/13 performance and current operations of the Office of Film and Literature Classification 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
2012/13 financial review of the Privacy Commissioner

Report of the Justice and Electoral Committee

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Introduction
The Privacy Commissioner is an independent Crown entity established under the Privacy Act 1993. The commissioner has wide-ranging functions regarding the protection of personal information. John Edwards took over the Privacy Commissioner role on 17 February 2014, and he is supported in carrying out his functions by an office established for this purpose.

Financial and service performance management
In 2012/13 the total revenue of the commissioner was $3.643 million and total expenditure was $3.508 million, resulting in a net operating surplus of $136,000 (compared with a surplus of $128,000 in 2011/12).

The Office of the Auditor-General rated the Office of the Privacy Commissioner’s service performance information and associated systems and controls as needing improvement. The Auditor-General considered that the office’s systems for recording satisfaction survey data do not provide enough detail for auditing purposes, but he expected this issue to be resolved next year by planned changes to the office’s processes.

Privacy environment and resources
We note the statement in the Office of the Privacy Commissioner’s 2013 annual report that the office’s capacity to respond to rising external demand, from data breaches, government and business requests, media enquiries, and new information sharing agreements was under pressure. We asked whether the office has sufficient resources to meet demand in the future. The commissioner said he will carry out the work required with the resources provided, even more ably if additional resources are provided, and he is seeking to use the office’s resources more effectively. We will follow with interest the commissioner’s progress.

Privacy and human error
We recognise that human error can have wide-ranging effects on individuals’ privacy, and asked how this risk can be managed. The commissioner said that systems need to be carefully designed to minimise human error; risk assessments regarding security, privacy, and technology assessments can reduce the potential consequences of human error.

We were interested to hear that the typical behaviour of recipients of mistakenly released personal information has changed over the last few years, a matter which has not been widely discussed in public. The commissioner said he is disturbed that people find something in their inbox that is not intended for them, and believe they are entitled to publicise the material or use it to their advantage against the organisation concerned;
whereas no right-thinking person would think they had a right to keep a wallet they had found. The commissioner recognises that some people are stressed and frustrated by their dealings with public agencies, and he suggests that organisations could benefit from examining the way they deal with people who believe they have been treated unfairly.

The commissioner expressed the view that progress has been made in the handling of information, and privacy and security matters are now more to the fore. He recognised that there is a trade-off between safeguards in systems and efficiency; a balance needs to be struck between businesses functioning well and protecting people’s privacy.

The commissioner is concerned to make sure that the lessons are learned from privacy breaches and errors are not repeated, and that the public feel they can engage safely with public agencies in an online environment without fear that their personal information may be compromised.

**Contractors**

We noted that the Office of the Privacy Commissioner contracted forensic computer analysts in July 2012 for just under $10,000 to investigate the ACC data breach case, and asked the commissioner whether he was comfortable with this expense. The commissioner recognised that computer forensic analysis is very expensive, whether provided in-house or outsourced. He observed that no one agency can be the repository of all expertise. We heard that the office has staff with technology expertise but also maintains strong relationships with agencies including the Government Chief Information Officer, and NetSafe.

**Priorities**

We asked the new Privacy Commissioner what his priorities are. The commissioner told us his vision for the office is to “make privacy easy” for businesses, government, consumers and citizens. The commissioner is also keen to build capacity in the provision of privacy services, and he wants easy remedies to be available for people who have had their privacy breached.

We asked what the commissioner would like to be able to report in 12 months’ time, and heard that he would like to see the public recognise that the Office of the Privacy Commissioner is looking out for their personal information, and is contributing to an environment in which it is safe for them to deal with government and businesses online or offline.
Appendix

Approach to this financial review
We met on 20 February and 26 March 2014 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 (Chairperson)
Paul Foster-Bell
Joanne Hayes
Raymond Huo
Alfred Ngaro
Denis O’Rourke
Hon Maryan Street
Holly Walker
Hon Kate Wilkinson

Evidence and advice received
Office of the Auditor-General, Briefing on the Privacy Commissioner, dated 20 February 2014.

Organisation briefing paper, prepared by committee staff, dated 10 February 2014.

Privacy Commissioner, responses to committee questions, dated 25 February and 14 March 2014.
2012/13 financial review of Quotable Value Limited

Report of the Primary Production Committee

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Quotable Value Limited

**Introduction**

Quotable Value Limited (QV) values property and sells property-related information. It is a state enterprise under the State-Owned Enterprises Act 1986, and a company registered under the Companies Act 1993. QV owns three subsidiary organisations (New Zealand Valuation Limited, Darroch Limited, and Quotable Value Australia Pty Limited); and during the review period its 50 per cent holding in a joint venture company, PropertyIQ New Zealand Limited, was reduced to 40 percent. PropertyIQ merged with Terralink International and the new business, known as CoreLogic NZ Limited, began operations on 1 January 2014.

QV is responsible to the Minister for State Owned Enterprises and the Minister of Finance. Its chief executive is Bill Osborne.

**Financial performance**

In 2012/13, QV (including all wholly and part-owned subsidiaries) had a total revenue of $42.33 million and a total expenditure of $41.512 million, resulting in a profit of $0.818 million.

**Business acquisitions**

Following disappointing results in Australia from QV’s former subsidiary Egan Australasia Pty Limited, we asked about the business culture behind QV’s acquisitions. We were told that any business operating in a small market looks for efficiency gains such as those offered by the merger with Terralink. When QV was formed in 1998, it had 100 percent of the market in New Zealand. Subsequently, to retain talent and compete with new rivals, it needed to find new markets, and the only viable market at the time was Australia. Egan Australasia Pty Limited has now been divested and shareholders now clearly demand that the business should focus on its core activities, grow its market share, and improve productivity.

**Rural valuations**

We asked if the rural valuation process is working as intended, or whether it relies entirely on the prices realised for similar, nearby properties. We were told that the Valuers Act 1948 is very prescriptive as to how industry members must arrive at a valuation. Valuers in the rural sector consider farm income streams, productivity, and fertiliser use, as well as sales of comparable blocks of land at similar production levels.

**Capital gains tax**

We asked if QV and the profession generally, had thought about issues of trust regarding valuations, or other possible implications for the industry, should a capital gains tax on
property be instituted. We heard that QV has not looked into the implications of such a tax. QV is not a policy arm of the valuation industry, and like others in the profession it is subject to the Valuer-General’s rules and regulations. These rules, based on the Valuers Act, are promulgated by the New Zealand Institute of Valuers, and in case of a new tax on property being instituted, QV will receive a ruling on how to act at the time.

**Darroch Limited**

We asked about the health of Darroch Limited, and particularly its property management division. We were told that the company’s business model relies upon large-scale operations. Since the global financial crisis, rivals in the market, which are not obliged to produce a profit but need to generate cash flow, have taken business from the company. This has reduced the company’s scale of operations and brought into question its business model. A major restructuring which began last year is now beginning to produce results and Darroch is now trading profitably. The board will continue to monitor the situation carefully, in line with shareholders’ expectations.
Appendix

Approach to this financial review

We met on 13 February and 6 March 2014 to consider the financial review of Quotable Value Limited. We heard evidence from Quotable Value 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
Organisation briefing paper, prepared by committee staff, dated 24 October 2013.
Quotable Value Limited, Responses to questions, dated 21 February 2014.
2012/13 financial review of Radio New Zealand Limited

Report of the Commerce Committee

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Radio New Zealand Limited

Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of Radio New Zealand Limited, and recommends that the House take note of its report.

Introduction

Radio New Zealand Limited is a Crown entity established under the Radio New Zealand Act 1995. It is New Zealand’s only independent public-service broadcaster and operates three nationwide networks: RNZ National, RNZ Concert, and the AM network (which broadcasts Parliamentary proceedings). Radio New Zealand has two shareholding Ministers, the Minister of Finance and the Minister Responsible for Radio New Zealand. The board of governors is chaired by Richard Griffin. Paul Thompson has been chief executive of Radio New Zealand since September 2013, following the departure of Peter Cavanagh.

In 2012/13 Radio New Zealand received a total income of $38.673 million, and total expenditure amounted to $38.668 million. It reported a net surplus of $50,000 (compared with $111,000 in 2011/12).

Funding

Crown funding for Radio New Zealand has not increased in six years; we asked how this had affected staff and services. We heard that Radio New Zealand’s management has been concentrating on making the organisation more effective whilst seeking efficiencies and savings. We heard that staff levels and programming have been maintained, and Radio New Zealand’s overall audience has grown. We congratulated Radio New Zealand on their achievements. Radio New Zealand said, however, that all reasonable efficiencies and savings and additional revenue generation from traditional services had been achieved with current funding levels. Funding would not be sufficient for more than 12 to 15 months, and it will be preparing a detailed business case for more Crown funding for specific services.

Efficiency

We asked if Radio New Zealand has become a more efficient entity. Its chairman believes it has, and said that its operations had improved significantly, especially in the last year. We were told that staff morale and engagement are high. Radio New Zealand said efficiency had been improved principally by rearranging its management and developing digital platforms for content delivery.

Digital media

Audiences are increasingly demanding the delivery of content through digital channels; we questioned whether Radio New Zealand could compete in the digital space with limited funding. Radio New Zealand said it has reprioritised its spending for this purpose. Its chief executive was confident that the company could work within its funding constraints for the next financial year, delivering content through multiple platforms.
Capital expenditure

We asked if capital expenditure had been deferred because of budget constraints. Radio New Zealand said that all its proposed capital expenditure is carefully scrutinised to ensure it is necessary; it has invested in new media platforms and purchased software for its production system. Radio New Zealand considers its infrastructure to be “solid”, with any risk being managed well.

Alternative funding

Radio New Zealand is exploring alternative revenue sources, the details of which are commercially sensitive. However, we were assured that this would not endanger its pursuit of non-commercial public-service objectives.

Radio New Zealand undertakes consultancy work relating to transmission and engineering. It helps South Pacific countries develop transmission capability, and leases out its production equipment for movie-making. Radio New Zealand raises considerable revenue by hosting organisations requiring transmission services.

Diversity

We sought information about Radio New Zealand’s strategy for ensuring diversity in its programming. Radio New Zealand aims to double its audience within 10 years, which it recognises will involve offering diverse, relevant content for all demographics. Its regular audience of approximately 550,000 tends toward the older demographics, and Radio New Zealand is increasing digital work to attract younger audiences. It plans to partner with other media organisations to access new audiences, for example expanding its work with iwi stations to deliver news bulletins. Radio New Zealand also plans to use its website to deliver special-interest and themed content.

Employment

Radio New Zealand’s workforce lacks diversity. We note that it runs a diversity internship programme. Its chief executive believes that if its content is to remain relevant it is important for staff to reflect the diversity of the community, and said that more work was needed in this area.

Network performance

We asked about the performance of RNZ Concert, whose audience numbers and audience satisfaction levels came in below target in the 2012/13 year. Radio New Zealand is aware the audience for RNZ Concert has been decreasing; with just below 14 percent of its budget committed to the Concert network, its management will be looking at ways to make it more relevant for listeners. In contrast, Radio New Zealand reported an extremely strong performance for the RNZ National network, which has been rated top national radio station for the last three years.

Regional and international coverage

We drew attention to savings attributed to regional news and reduced coverage of international events. Radio New Zealand has seven regional offices and considers its coverage of regional news to be strong. We heard that previous plans to expand regional coverage have been halted but it will not be reduced. However, outside broadcasts of international events are very expensive and their number has been limited. Radio New Zealand now covers some of these events from the studio to lower costs.
Diversification of content

To remain competitive Radio New Zealand is diversifying its delivery of content into multimedia channels; we pointed out the associated risks. The chief executive acknowledged that all changes bring risk. However, he believes that ensuring the comprehensiveness, quality, and trustworthiness of content will help to mitigate the risk. The transition to multiple platforms is viewed as an exciting opportunity by Radio New Zealand.

System upgrade

Radio New Zealand’s purchase of the CoStar production system source code allowed it to make a major upgrade to the system whilst avoiding the approximately $7-million cost of replacing it. We heard that the system is expected to last at least five years, and can produce content for digital platforms. Radio New Zealand has purchased the commercial rights to CoStar, which will allow future sale of the upgraded version.

Sound archives

Radio New Zealand has entered into an agreement to hand over custody and management of its sound archive to the New Zealand Film Archive. However, Radio New Zealand still owns the archive and is accountable for its preservation. We noted that a small fee is still payable to Radio New Zealand for access to sound files.
Approach to this financial review

We met on 8 May and 22 May 2014 to consider the financial review of Radio New Zealand Limited. We heard evidence from Radio New Zealand Limited and received advice from the Office of the Auditor-General.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Evidence and advice received

Office of the Auditor-General, Briefing on Radio New Zealand Limited, dated 8 May 2014.
Organisation briefing paper, prepared by committee staff, dated 1 May 2014.
Radio New Zealand Limited, responses to written questions, received 1 and 20 May 2014.
Corrected transcript of hearing of evidence 8 May 2014

Members
Jonathan Young (Chair)
Kanwaljit Singh Bakshi
Clare Curran
Kris Faafoi
Julie Anne Genter
Raymond Huo
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Witnesses
Richard Griffin, Chairman, RadioNZ
Paul Thompson, Chief Executive, RadioNZ
Ken Law, Deputy Chief Executive, RadioNZ

Young Welcome, Mr Griffin, Mr Thompson—Mr Law, is it, as well? Mr Thompson, welcome for your first time at the Commerce Committee—look forward to hearing from you during our hearing. So, Mr Griffin, we welcome you and your team, and if you would like to present to the committee, then we’ll come to some questions.

Griffin Thanks very much, Mr Chairman. Thanks for your welcome. Great to be back, as they say—my third time. I think we’ve come with very good news. That aside, on my left is Ken, as you know—Ken Law, the man who essentially has exercised the fiscal discipline over this company over the last 10 years and, over the last few with considerable rigour has run the finances and kept the place together. It’s been a remarkable achievement, and under difficult circumstances, Ken has kept the boat very, very steady.

On my right, as you say, Paul Thompson—this time last year appointed to the chief executive’s job. 30 years in Fairfax and a huge boost, dare I say, to the culture and the management of Radio New Zealand in the sense that it’s a new broom, a very substantial broom, and a broom that brings with it, I think, considerable hope for the future, not in the sense that we need hope but in the sense of renaissance. As a company, we’re very lucky to have both these men at the helm.

I know we’re here to talk about 2012-13 finances, but of course you very rarely do, in the sense that it’s a wide-ranging discussion and we’re very happy to answer any questions about anything over the period of time involved and subsequently. As you know, during the 2012-13 time, we moved the management of archives on to the Film Archive, who manage
the organisation under our auspices, in a sense, but that responsibility has been taken out of our hands and gives us an opportunity to focus more on the core business of Radio New Zealand. We do, of course, still continue to have an oversight of just how those archives are handled, and the archives are still ours.

At the same time, the chief executive was appointed, as I say, a year ago, so that transition took place during this period very successfully. In recent days, perhaps most important, the monkey on our back of a long-term employment issue—so called Snowdon case—which has gone on for considerably more than a decade has finally been resolved, much to the relief of all concerned.

I would just like to say that, in terms of public broadcasting, particularly given the new regime of management, I think we’re looking forward to not just a renaissance but a very exciting and creative renaissance on a very different platform to what we’ve used to in traditional terms. I believe—and it’s not just a gut reaction on my part; it’s empirical in the sense that I’ve talked to a lot of people—that public broadcasting as an institution is probably more valued now that it ever has been in recent years, and we’re looking forward to not just extending that enthusiasm for the concept of public broadcasting as a litmus test within the media confines, but as a substantial player in the business of media in light of this community of ours.

At this juncture, unless there’s anything specific to me, I’d like to suggest that we get into the questions—whatever you feel is appropriate under the circumstances.

Faafoi Good afternoon. Welcome to you all. I’ll cut straight to the chase: you’ve been under a pretty difficult financial situation for 5 or 6 years now. I notice in the questions that you gave back to us that you’ve managed to make some savings of around $2 million in the last year, but how much longer can you cut your cloth until there is no more cloth to cut?

Griffin We’re very conscious, obviously, of the constraints of our fiscal position. Ken will outline that to you now, but I would like to say—and I think the chairman made the point at the last meeting here—there is always an upside to everything. The constraints have forced us to do several things, including perhaps looking very effectively and efficiently at the operation itself. With the new chief executive who is very used to this environment, I think we’ve achieved great results.

Over the 6 years, as you say, that there has been no extra funding, what we have achieved is a real focus on how efficient, how effective, and how authoritative we are in the market. That’s been a real upside from my perspective and the board’s perspective. Ken will give you the facts and figures of the operation, but his ability to keep fiscal discipline, financial rigour over the place, has resulted in us continuing to operate without losing personnel, without having to cut back in programming, and still being a very—in fact, a more effective team than we were 6 years ago, I would suggest. Certainly a bigger audience—Ken.
As to your question — how long can we go — I think we’ve pretty much achieved all the reasonable cost savings and efficiencies and additional revenue generation from our traditional services that we can without, in the near future, really having to look at what we do and how we will fund it. I would suggest that that funding will have to be externally generated. But we have been very successful. We’ve made a number of savings, particularly in production systems. We have some excellent expert staff in audio production. They’ve made some major savings in audio production systems and procedures. We’ve taken out some of the resilience or some of the duplication in transmission networks. That’s been a very calculated risk, but one that we think we’ve been able to manage and we can manage into the future. But really your question — how much longer? Not much longer.

Just a supp on that, then — can I congratulate you on doing what you’ve done with what you’ve got over the last 6 years, because I think you’ve done a very good job with that, but you’ve also got some technological challenges ahead of you that the rest of the industry faces as well. How do you compete with those advances when you’re saying that you’re forecasting not much increase in your budget either?

How do we compete? Well, maybe that’s a question for the CEO, but to date we have been able to start on the move to digital platforms through reprioritisation of our spending coming away from some of the more traditional activities into the newer platforms.

Yeah, if I can just make a couple of comments — we are in decent shape financially, and I can certainly see that we’re going to continue to be in decent shape in the next 15 months to a year. That’s as far as I’m looking out at the moment doing our budgeting for the next financial year now. We can continue to maintain our current levels of quality and quantity of programming, and push in place new platforms within those constraints. Ken is right — we’re getting to the point where the headroom is narrowing and we’re going to have to come up with some arguments and some ideas within the next financial year of how we’re going to deal with that.

Just to make a point, I’ve come from a world of media turmoil and relentless tendency to cuts each year, so whilst I’m not for a moment saying that we haven’t got some challenges, it does feel a little more comfortable than the world I came from, and the pressure has really put an onus on the organisation to be very smart, and Ken’s outlined some of the ways in which we responded — really impressed with that financial discipline. It has held us in good stead, and we’ve got some thinking to do.

Can I just supp on that — in terms of coming from Fairfax print media sort of environment, what are you bringing across to Radio New Zealand that is actually at the front end of some of these transitions in terms of thinking?

Probably the key aspect is leading change in media organisations and becoming focused on becoming a multi-media organisation, rather than solely a radio broadcaster. So my experience in executive management of media organisations and had the role of editor-in-chief, and as part of that played a big role in the rewiring in the news rooms, making them more
efficient and helping them flourish on the web. So that’s probably the sharp end of what I’ve brought, as well as, I guess, some management skills from a more commercial environment.

Tremain Firstly, for 6 years, congratulations on where you got to. Would you say that 6 years ago the organisation was inefficient?

Griffin Yes, I would. It’s the nature of the beast, I suppose, to be operating to a minimum rather than a maximum under the circumstances of financing every year—a similar equivalent every year. It’s not a criticism; it’s just part of what I think was probably a more introspective organisation than I felt comfortable with, certainly when I started on this board. It’s been an effective organisation, largely because of the efforts of its staff. It had been a long time since anyone had taken a blow torch to it, and I think we now have a chief executive—I’m not suggesting that the previous chief executive wasn’t very professional at all; he was. But a new pair of eyes has made a huge difference, both to morale, to engagement, to communication, and to looking across the horizon and seeing new worlds. So it has been a huge step forward in the last year.

Tremain So the morale is pretty strong? Pretty strong—

Griffin Morale is splendid compared with perhaps 3 or 4 years ago.

Tremain And for my last question in this—if you’re thinking about those efficiency gains, what would be the top three efficiency gains that have driven you to this point over the last 6 years, when you’re thinking about where you’ve come from 6 years ago?

Griffin What we have done over a period of time is had to look to whatever assets we had, including—dare I say—selling grand pianos and some land to find very efficient ways to run rosters, for instance, and we haven’t achieved that goal yet. But there’s been a series of management rearrangements that have made a great difference to the way the place operates. That’s going to continue afoot with some alacrity over the next few months. We don’t make any secret about that.

Over the period of 6 years there’s been change in defining how we get our message across and on what platforms we get them across. Those platforms have been developed rather more slowly than we would have wished, but nevertheless, they have been developed over those 6 years. In the last 18 months it’s taken on a whole new momentum.

The place is a very different outfit than it was 6 years ago culturally, operationally, and—dare I say—in its perspective of where it stands in the market place. We are now engaging too with a range of people within the industry that we previously didn’t, including not just other broadcasters but other media organisations both here and offshore. There’s been some really interesting and I think—I hope—long-term financially advantageous contacts that have been made in the last year that could just make a big difference to how we’ll stand. I’m not suggesting for a moment we can operate on a minimum budget for too much longer on the same platform as
we presently are, but we’re looking at every possibility and it won’t include selling pianos or selling land.

Genter I’d also like to congratulate you on getting quite good results in an extremely constrained financial situation, but I have to ask: has the funding freeze led to a more short-term focus on spending? Has there been a deferral of long-term capital expenditure that maybe will come back to bite in the future?

Thompson I can perhaps make a couple of comments then pass on to Ken. There certainly has been a lot of scrutiny around capital expenditure and some very good decisions made around what actually needs to be spent as against what would be nice to spend. I can certainly assure you that there’s been no shortcuts taken there and there’s no risk around that. It’s been done in a very prudent and managed way. Just to give one example of the kind of innovation—I know the committee’s heard it before with our purchase of the software around the production system, which allows to upgrade the system at a very minimal cost and avoid the depreciation and any capital costs around that. So from where I sit coming into the organisation, I can see some real discipline and some good results from that and I don’t have any concerns on that front. But Ken will be able to provide some more detail.

Law Well, I don’t think we’ve run down our asset base, our infrastructure, at all. I think we’ve probably over the last 5 to 6 years introduced a lot more discipline around capital investment. We’re investing smarter rather than more. We really do ask the question why and where does it deliver in terms of expectations, shareholder expectations, and how will it be funded. So it’s smarter. The infrastructure is as solid as it should be.

Thompson And there has been some significant investment into new media platforms throughout the process as well.

Faafoi Mr Law, you mentioned before that to get more revenue streams you may have to do more things to bring some money in. Can I get an idea of what you’ve got in mind?

Law Well, I have a lot of ideas—

Faafoi Do tell.

Griffin I’m not trying to distract you in any way, Kris, but some of them are edging into commercial opportunities that we really don’t want to put on the table at this time.

Young I think we understand that proviso.

Kris Can I put my question in a different way? Would some of those opportunities in any way put at risk the non-commercial arm of the national public broadcaster?

Law Absolutely not.

Young But would they enhance them in terms of the added—
The ideal commercial opportunities for Radio New Zealand are the ones that leverage off our current asset base and our expertise. And that's where we've been successful, particularly successful in just the last 3 years or so, in terms of consultancy work around transmission engineering and helping particularly in the South Pacific nations in developing transmission capability. We lease out a lot of our own production gear and expertise to help in various parts of the economy—particularly, for instance, movie-making, *The Hobbit*. We do sound recordings and sound engineering for those sorts of enterprises. And they are ideal because, you know, we leverage off our existing assets and expertise.

And another big revenue earner for us is what we call co-siting. We host other broadcasters and organisations that want some form of transmission. We host their transmitters on our own networks and charge them for them.

The brand cachet has a worth of its own. The Radio New Zealand brand has a huge cachet. We believe we can use that—dare I say commercially; it's not a dirty word—to good effect long term in areas outside the sort of concerns that you've expressed in the past and I'm sure will express again.

The challenges to this are the lack of opportunities or shortage of staff for you to create more income in addition to Crown money.

I made a pledge to myself and to my Minister that before we’d come to the Government for any more funding we would come with a real business case, not: “We'd like some more money because we’d like to do this or we have to pay the staff.” We’re in a position now to be able to say, I think unequivocally, this is an organisation going places, the show’s rolling, we have big plans, plans of consequence. They will need finance from audiovisual through, but whatever we come to the Government with, or to the Parliament with, it will be a plan that makes sense. We’ll be asking money for specific services. That includes ethnicity broadcasting. We won’t be coming with “We just want more money.”

That’s where we are effectively from a position that 3 years ago we were saying we need more money without real specifics around it. Now we’re saying long-term, obviously, we’re going to need more financing—if you believe in the concept of public broadcasting, and, quite honestly, apart from vested interests, I believe everybody in this country believes in the concept. If we want to support the concept, make it more effective, and we want to make it more effective, then it'll need more financing and it’s pointless to dance around that. We will be coming with a business plan of consequence, as I say. I can't emphasise that more.

In the annual report, the chief executive mentions that there’s a growing support from the public and you’ve got more than 20,000 hours of content online, and technology’s changing, your app has been getting popular day by day, and in one of the surveys it says that 85 percent of people agree that the cultural diversity on your programme is appropriate. So what are your future plans, looking at the recent census, in the change in the demography, the number of ethnicities growing? So what are the plans for the future for Radio New Zealand? How are they cooking up?
Griffin  Paul has a very clear focus on this. I was hoping he could talk to that question if he could.

Thompson  We’re setting an ambition to double our audience in the next 10 years. That sounds quite bold—yes, it is. But I’ll just explain how we’re going to get there. At the moment we’ve got a very intense and loyal audience—about 550,000 a week. Those are really strong, loyal listeners that love what we do. Sometimes they hate it, but they’re always listening. That audience skews older, and because it skews older it does not fully represent New Zealand demographics. I think this is the biggest challenge that we face. If you believe that Radio New Zealand has an important role to play—and we certainly do—then we have to make it relevant and reach out to all sorts of New Zealanders from every walk of life, every demographic, every part of the country, and certainly people who keep listening.

So we’ve got that growth plan to double in 10 years, primarily through developing new digital products and services and apps. We’ve started to do that for wireless, which is our new initiative that we launched last year. It’s already got a strong and growing audience. It’s the perfect example of how we crafted new things and new groups. My challenge to my team is not only to say that we’re going to grow our audience but that we’re going to grow its diversity and try to reach out to as many different groups as we can.

We won’t do that all under our own steam. We’ll be very happy to work with any organisation, commercial or voluntary, who have an audience who would like to take some of our content, our high-quality, trusted, distinctive, unique content, and share it with their audiences. So you can think of it in two ways—we’re going to do new things in that digital realm, we’re going to keep radio really strong, and we’re going to work in partnership with other media organisations to piggyback, if you like, on their audiences.

I think what we’ll see, in a very measured way, in the next 10 years we’ll grow our reach and content. We’re very serious about that. We believe what we do is very important to New Zealand. The more that we can spread the word, if you like, the more benefit the country gets and the stronger our case is for continued support from the taxpayer.

Faafoi  Can I ask a supplementary? What will that sound and look like, potentially?

Thompson  It would probably look and sound a lot like it is now. There’ll be a lot of continuity in it. I think we’ll continue to have very strong radio networks. I think there’ll be an element of audio-visual, of televisual content in there—perhaps delivered on-demand via the internet, perhaps delivered on a more traditional TV network—who knows? I think there’ll be a very, very powerful Radio New Zealand website that’s just a fantastic portal to not only our on-air content but also a lot of themed and special-interest content.

We’ll have a lot of partnerships with other organisations who value our material and want to share it with their audiences. So it will be dramatically different, but there will be still be foundations there around our quality, our trust, and our impartiality.
Bakshi Do you plan, as you mention, that you will have different content available for other organisations? Similarly, do you have any plans to get content from other organisations on your platform?

Thompson Well, that’s the exciting aspect of developing partnerships. If we build these relationships with groups with whom we have that common cause, the content and knowledge go both ways. We think that could be a good strength—so, yes, I do.

Genter Can you just give us some examples of the organisations that—

Thompson Well, at present a couple of iwi stations take our news bulletins. In future could we make it available to every iwi station? Could we craft it around their audience, so we actually make sure it works for their audience? Do we put it in te reo—there’s just one example. There’s a strong network of access stations throughout New Zealand, community-based, could we develop them quite a unique bulletin at the top of the hour, which they could use? So those are just things that are at the top of my mind at the moment. The key thing for me is that we wouldn’t be sitting there on high and shovelling stuff down; we’d actually work with them and ask them what they want and understand their audiences. So it would be relevant for them and differentiated from what we’re doing on our networks.

Genter Sorry, I just wanted to come back to what we were talking about—the business case for increased Crown funding. Have you made any such approach to the Government for increased funding?

Griffin We have regular discussions, obviously, but there’s nothing organised. There will be in a matter of months. Got an election and all that, so we don’t anticipate any further assistance in this project, no. But just on the topic that Paul’s just been exploring, we’ve also forged relationships with global organisations that also broadcast in the Pacific. I think there’s a big opportunity there for us to enhance our reputation on a rather wider scale than New Zealand and the Pacific. What we’re looking for is every opportunity. The business case will include all of those things.

Genter Just to follow up on the lack of increased Crown funding, given that there is some inflation occurring, so this has been a real cut for 6 years, do you think that it’s going to jeopardise the quality—

Griffin We live in the real world. We live in the real world. I live in a world surrounded by hospitals, by a whole range of Government organisations that need more money. We’re well down the pecking order. Look, we’re prepared to take our cuts, but we’re also prepared in the 7 years of good times to ask not just for financing but financing for specific moneys that will help us expand ourselves. No one’s whinging. We live, as I say, in the real world and in a circumstance where we never expected big injects of finance into our company over the last 5 or 6 years. Why would you? You’d have to need your head read to think.

Genter But realistically, it must be having an impact on staff and—

Griffin No, it’s not. We’ve become efficient.
Thompson I think the organisation’s just done a terrific job of managing that frozen funding. It’s been tough; it is hard, but staff have just got on and done their job. They’ve certainly not been at any kind of penalty in a direct way, and it just reflects the professionalism of the organisation. It’s just a reality of where we’ve been. As we have said, it’s getting harder and we’re looking ahead now and developing a plan where we will have a case hoping to develop funding sources, as Ken said, but also have a strong, compelling case for increasing our Government support around specific objectives.

Young OK, just a quick procedural matter—Raymond, your whip’s look as to replace Clare. She’s back. I don’t have an objection for you to stay; we just need leave of the committee. So your question, away you go.

Huo As a supplementary to Mr Bakshi’s question, there are conflicting views with regard to the role ethnic media can play, and some argue there’s too many and some argue there’s too little. So, basically, some experts even suggest that the ultimate goal for the ethnic media is to destroy themselves as part of the process of integration into the mainstream society. So what kind of role can Radio New Zealand play in encouraging, as you said, more migrant community to tune in and listen to Radio New Zealand?

Thompson One aspect of it is making sure our programming is relevant to all sorts of different groups and that we’re living and breathing our charter, which requires that of us. That’s a constant process of improving everything we do at present on air and online. In future, I think, positive opportunities created by the internet can create new services for discrete groups in the community. You’d hope that that would draw an audience who in turn would be drawn to our more broad-interest content.

Huo Can you compare content specifically?

Thompson No, I can’t.

Huo Or the types of recordings?

Thompson Sorry?

Huo I mean specific content.

Thompson Yes, content specific. It has to be, or people won’t listen to it or watch it or read it. So it has to be crafted for that audience, and hopefully that brings a new group to experience everything we’re doing as well as that specific content. And I think it also goes back the other way. We’re a Public Service media organisation. We want to be a force for good in the media ecosystem in New Zealand. We’ve got a lot of expertise, we’ve got great standards. If we can help develop the skills in other media organisations, it will help the whole thing work better. I see that as very complementary to our role and a key part of that role.

Curran Thank you. Apologies for lateness—couldn’t be at two select committees at the same time. It’s really going back to the funding issue, and my question is to the chair, because I suppose I have to ask you, and this is a bit of a tough question, but are you—

Griffin I wouldn’t expect anything else, Clare.
Curran With respect to the fact that you’ve had frozen funding for almost 6 years, you’ve come before the committee today and you and the chief executive just talked about Radio New Zealand wanting to be a force for good in the media sphere generally, and all of the really good and creative thinking and innovative thinking that’s going on, but you come before us and say that you’re perfectly OK with the fact that there’s been a funding freeze, and that you’re working within your means and everything’s fine—

Griffin No, Clare, I said we live in the real world.

Curran Well, you say you live in the real world, but you’re basically—we are a committee of the Parliament, and should you not be saying that in order to be a true force in the media as the public sector media organisation in this country, that in order to realise that goal, that there needs to be, and that the committee should hear that there should be, an increase in resources, and that that is what you want and need in order to do that? Because otherwise, are you saying one message to us—

Tremain You missed out quite a bit of the committee’s question around that before you came in here. And you missed the fact that they made the point that they had 18 months to—

Curran Well, just to finish my question—thank you—just to finish my question, though, because it does appear to me, and I acknowledge the fact that I wasn’t here at the beginning, but it does appear that there’s a message to the public in front of the select committee and perhaps another message being delivered through other means—

Young Can you just come to the question, please?

Griffin Could I have your question, please, Clare?

Curran Well, the question is, is that what is happening? Is that—

Griffin No, it’s not. No, it’s not, and if you’d like to refer to your colleague after this meeting, you’ll see we’ve been down this track earlier in the piece, and I feel we’ve given a fairly substantial answer to it. If you see a contradiction, it’s a perception rather than a reality.

Curran Well, I’m sorry, but I don’t actually think that’s an adequate answer. Could you—

Tremain Well, yes, it is. If you’d been here at the start of the meeting, Clare, you’d understand. He made the point that they have 18 months’ clear funding ahead. Now, you know, that’s pretty good. And they’ve got the best situation they’ve had in terms of morale, they’ve grown their audience share—that’s a pretty good situation to be in.

Young So as Mr Griffin said, perhaps if you talk to Chris. Obviously, it’s going to be in the transcript as well—a very extensive answer to your questions. So what I would suggest to you is that you will get an answer to that question; it’s in the transcript. If you go to a fresh question, that would make the best opportunity of our time with these gentlemen.
OK. Can I point to—it’s a coverage issue now, in terms of content—your response to question 5, where you have made some savings, and it’s come at the expense of regional news coverage and reduced live coverage from international events. I guess my understanding of what your core operation is is to reflect New Zealand and New Zealand’s place in the world for New Zealanders, but it seems at the very local level you’ve had to have a reduction in service, and in terms of international coverage as well we’ve lost some there. Is there a concern in terms of coverage that that’s happened?

I can talk to a couple of points. I’m sure Ken will join me. We’ve got a strong network of regional journalists in New Zealand—got seven branch offices, I think, and they do a great job of covering the country and covering their patch. I think it’s a distinct part of our mix. There’s no plans to reduce that. I think that may have referred back in the past to when there was an actual proposal to expand it, and perhaps it was pulled back. I think that’s going back a few years, but Ken will be able to tell us about that. We definitely have had to limit the number of outside broadcasts that we do because they are expensive, and we’ve had to come up with new ways of covering events from the studio, which is more cost-effective.

In terms of international coverage, I think we have access to a very strong range of material that gets a very good airing on Radio New Zealand International and on National and on Concert across music and talk and documentaries, and there are no plans to take that back any further. So I think the content mix is strong.

Would it be different and would we have more regional reporters if we weren’t under funding constraints? I think yes, that’s always a possibility, but that doesn’t mean that what we’re providing is inadequate, and I think if you look at our research we do on audience satisfaction and, indeed, our audience numbers and the growth both of our radio audience and our digital audience, it’s telling us that we do most things pretty good. Ken, you want to talk specifically on some of those?

Yes, you’re right. We did have proposals to extend the regional coverage which did not proceed. I’m not sure of the details, but I think also that one of the smaller regional offices that we did have a number of years ago, when there was a vacancy there we didn’t reinstate, but I’d like to get back to you on that detail, because I’m not sure of it. And as Paul mentioned, the other big issue is outside broadcasts, which are extremely expensive. We can’t do as many as we’d like.

Yeah. I just wanted to come back to the question area that Kris was asking about in terms of the audience and you’ve set some pretty big goals in terms of doubling the audience over the next 10 years, which is admirable. I’ve got some information here about some reduced performance in audience numbers and satisfaction levels for the Radio New Zealand Concert, with some targets being missed. It says that 108,000 listeners connected with Radio New Zealand Concert through traditional means but the target was 129,000 and 74 percent of Radio New Zealand Concert listeners were
satisfied or very satisfied with Radio New Zealand Concert programming against a target of 81 percent. So I’m really quite keen to understand those figures versus I guess some of the bigger targets, which are great.

Griffin

There is a diminishing audience and we can’t avoid that. It’s a reality, I suppose, of demographics as much as anything. Paul, I’m sure, will apply himself to the specifics, but it’s something that the board is very conscious of. It’s a substantial piece of our budget and in a sense there’s no real answer at this moment on the table. But we are very conscious of the trend and it’s a trend we’ve going to have to address significantly in the very near future.

Tremain

What percentage of your budget is devoted to Concert approximately?

Low

It’s about $5 million out of about $38 million.

Griffin

So we’re looking at 14 to 15 percent.

Thompson

There’s no question that the Concert audience is the part that’s showing some signs of stress. I have to say that in the wider context of how media consumption’s going and looking at other radio broadcasters, it’s not a significant decline compared with the market, although it doesn’t reflect well compared with National, which has been so strong. I think it may have had an uptick in the last 12 months, and we can perhaps give you some updated figures on that after the meeting, but the issue remains that we need to think about how we can make Concert more relevant to New Zealanders. That’s going to be a big strategic goal over the next few years. We’re going to have to do that thinking.

Tremain

On the other side of the coin, what has seen the most growth in the last couple of years?

Griffin

By far and away National Radio, which, of course, is our powerhouse, and our signature tune in a sense. It’s what the business is—well, the whole business pivots around National Radio.

Thompson

Extremely strong performance on National and on all the key shows. In a pure proportion sense, though, the growth of our digital has, from a low base admittedly, grown very quickly.

Griffin

Radio New Zealand National rather; I’ve been too long on National Radio. But it’s been an extraordinary success in difficult circumstances. We’re really very pleased.

Mitchell

I just wanted to acknowledge and congratulate you on the great job that you are doing with this company. In your last appearance in front of the committee, it’s obvious that you’ve got some pretty talented people in the organisation as well—

Griffin

Thank you very much. I think so.

Mitchell

—in terms of the sort of internal research and development that you’re doing.

Griffin

The board’s very, very happy with our appointment of the chief executive, who has a vision that is very well married to ours. I might say we did that
internally too, just as a matter of reference to the committee. We didn’t use outside agencies. We put a chief executive in place, a matter of significance, without having recourse to agencies that I think other Government departments in the past have found wanting. We were very fortunate in having two other Government agencies, Treasury and State Services, assist us but it is possible to go through these exercises without costing a fortune to the company. It’s another thing we found out the hard way—well, the easy way, in fact.

Mitchell You’re definitely a shining example of how to do that, without a doubt.

Griffin Thank you very much.

Mitchell I just wanted to touch on something very quickly. There are lots of examples of companies that have diversified and gone away from their core product. And when they’ve done that, because obviously it sometimes requires extra investment in capital, resources, training, all of a sudden they’ve gone from performing at the top level in the core product and then becoming a mid-range player because they’ve spread themselves too thin. I’m not saying at all that this is the case. Everything I’m hearing today is that you understand the risks and you certainly understand the market. I was just wondering if you could talk to that a little bit, sort of run through your thoughts on that.

Thompson That’s a really good question. Our core product is really strong, independent, trusted, compelling journalism and programming for New Zealanders. It’s not radio or internet or print or whatever—the core product is really engaging in trusted and unique content. We could sit on the status quo and continue excelling at radio. The problem is that the audience is moving much more to multimedia content delivered online. And what we have to do is move with them but continue to be great radio at the same time. It creates some stress and some strain. It also creates some innovation and some energy. It’s a transition that every legacy media organisation is doing. You’re right, there is a risk that you lose something that’s essential. My way of managing that risk is to focus on the quality, trustworthiness, and comprehensiveness of the content, and make sure we give it to the punters how they want it. And that’s a real exciting transition, transformation, for the organisation. But we’re going to have to do it well.

Sabin Absolutely—great.

Young So just a supplementary question on that. Actually, you know, in that competitive space, knowing your background and the work you did, radio is actually not just competing against radio; you are also competing against print media that’s moving into the online medium as well.

Thompson Television

Young Yeah, television—so right across the board.

Thompson So what’s happening is all media are convergent into multimedia, and that doesn’t mean we’re going to wake up tomorrow and not be able to switch on the television or the radio, but that transition is well under way. That’s not driven by me or by TVNZ or the BBC. That’s driven by human beings
exploiting new technology to make their lives better. So we have to intersect where they are and not think that we just keep doing what we’re doing and they’ll come to us. I see it as very exciting. It’s a great opportunity.

Young: Just before we go to Chris, can I just follow up in terms of the multi-platform that you’re working on? Last year Radio New Zealand reported about the CoStar programme that you bought the code for and developed, and saved yourself a lot of money in terms of having to replace it and also licence fees. How’s that going in terms of that software, or that capability, and is it able to be used across the different platforms that you’re working on?

Law: It’s going fabulously well. As we reported, I think we probably futureproofed it for maybe 5 years. The product from it can be adapted across the whole platform range.

Young: So you’ve actually developed a very innovative product.

Law: Absolutely. And we’re continuing to develop it.

Young: I know it poses quite a significant saving for you, but does it also pose a commercial advantage or possibility for you?

Law: When we took over the rights we did also make sure that we took over all commercial rights around that, which gives us the opportunity, once we have fully developed it, to meet our own needs. We can look to selling, marketing, that system if others want it.

Young: Well done.

Faafoi: This is very similar to what I was going to ask too, but is it going to be efficient when you start delivering on all sorts of platforms?

Law: It’s a far more efficient system now than it was when we first bought it, probably 8 or 10 years ago. And it will be efficient over all of the platforms. And it’s far more versatile a product than it used to be.

Faafoi: So with what you’re doing new now in terms of digital delivery, there are no problems on the shop floor in terms of interacting with what the radio output is and what you’re putting out on other platforms?

Law: No.

Thompson: I think most of it is exciting, challenging, and a good opportunity to start to do new things. There are always challenges around any kind of transformation. We do some things really well and easily, and other things need a little bit more work. But we’re producing a lot of multimedia product now, including photographs and video, as well as our audio and our text now. So we’re getting there. In time, will our tools change? Will we invest in new technology? Yes, we’ll need to. Do we need to in the next few years, given the investment in CoStar? No, we don’t. I have always believed that what drives transformation of an organisation is more around culture and staff excellence and expertise and development, rather than trying to provide a technology solution. I’ve seen that attempted and that really
doesn’t work. You’ve got to change the organisation and use the technology to enhance it.

Faafoi So there’s no trouble with double or triple handling things to make sure it’s accessible?

Thompson Every media organisation faces this challenge, and there are inefficiencies in every workflow. Can we do some stuff about that? Can we do some things about that and address it over time? Absolutely. Is it slowing us down drastically? No. We have suddenly had to do things like hire a photographer and learn how to store and publish images. That’s happened in the last few months, and we’ve done it and it’s working really well. So there’s a fantastic, flexible can-do attitude in the team.

Faafoi Can you walk me through what the situation is with the archive now? Because I know it’s been part of some of the revenue stream that you’ve been able to bring in before, but I don’t know quite how much it has been and whether that’s been affected now.

Griffin The archive is still under our management, but I’ll leave Ken to explain that.

Law The sound archives—yes. Radio New Zealand still owns the actual archive, the archive material, and is accountable to the Chief Archivist, the national archivist, for its preservation. What we did, though, is enter into an agreement with the New Zealand Film Archive to give them custody of the archive and for them to manage the archive on Radio New Zealand’s behalf. And they are funded separately through the Ministry for Culture and Heritage to do that. But there is a management agreement in place between Radio New Zealand and the New Zealand Film Archive.

Faafoi So do you still get revenue from it if someone accesses it?

Law Yes, there is provision in there for fees associated with our copyright in a lot of that material.

Faafoi I just want to make sure you haven’t got a revenue stream that hasn’t been—

Law I can assure you it’s not particularly large.

Griffin It’s very minimal. They are, I think, going be—they live in our Auckland premises at the moment, don’t they? They’re going to be lodgers, anyway, one way or another.

Law They have premises in Christchurch, Auckland, and Wellington also.

Griffin It’s a very cohesive relationship and, as far as I know, no tensions exist.

Bakshi Looking over your annual report, mostly your employees are of European descent. A very less number are of Māori, Pacific, and Asian ethnicity. Do you have any plans to encourage any ethnicities to join your workforce?

Griffin I’ll leave this to the chief executive—but none of it’s my intention.

Thompson We do have initiatives under way at the moment, including a diversity internship programme, which we’re finding is effective. Like every other media organisation in New Zealand, we’re not diverse enough, and we
struggle to get that diversity through our recruitment. We always have to have the best people, but we also need to make sure that our staffing reflects our audience. That is a goal that we’ve set. It’s not going to be something that we can move quickly on. It will take time, but I certainly think it’s important that our staffing reflects the community, because that’s how we make sure that our content will be relevant to the community we’re looking to serve. So you’re absolutely right—we lack diversity at the moment. It’s an issue for us to think about and do some work around. It’s going to take a number of years to address.

Bakshi That’s good to know.

Mitchell I think Kanwaljit would like to be a radio star at some point!

Faafoi I think he’s ruled himself out already!

Young Are there any further questions? Right, thank you very much, gentlemen. We appreciate your availability and all the best for the future. Thank you for a very encouraging review that we’ve had with you. All the best.

Griffin Thank you very much for your courtesy. Thank you.

conclusion of evidence
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Reserve Bank of New Zealand

Recommendation

The Finance and Expenditure Committee has conducted the financial review of the 2012/13 performance and current operations of the Reserve Bank of New Zealand, and has examined the Reserve Bank of New Zealand’s Financial Stability Report, November 2013. The committee recommends that the House take note of its report.

Introduction

The first part of this report covers the financial review we conducted of the Reserve Bank’s performance in 2012/13 and its current operations, while the second comments on the Reserve Bank’s half-yearly report on the stability of New Zealand’s financial system. Inevitably, there was overlap between the topics, and we suggest the two parts be read together.

Financial review 2012/13

Reserve Bank’s role

As New Zealand’s central bank, the Reserve Bank carries out various functions to maintain a sound and efficient financial system, including oversight of banks, non-bank deposit-takers, and insurance companies, and the management of wholesale payment and settlement systems, domestic liquidity, and foreign reserves. It manages monetary policy under a policy targets agreement with the Minister of Finance, which sets the bank’s inflation target.

Graeme Wheeler replaced Dr Alan Bollard as Governor of the Reserve Bank in September 2012. A new policy targets agreement was signed, which continues to require the bank to keep Consumers Price Index inflation between 1 and 3 percent on average in the medium term, with the added requirement that the bank try to keep average inflation near the 2 percent midpoint. The new agreement also requires the Reserve Bank to include asset prices among the price indicators it monitors, and to have regard to the soundness and efficiency of the financial system when implementing monetary policy. It continues the requirement that the bank seek to avoid provoking unnecessary instability in output, interest rates, and the exchange rate in pursuing its price stability objective.

Financial performance

The Reserve Bank’s operating expenses are financed under a five-year agreement with the Minister of Finance. The current agreement specifies net operating expenditure of $52.7 million for 2012/13; actual net operating expenses for the year were well below this, at $48.3 million. This was $1.3 million (2.8 percent) more than the previous year, reflecting the expansion of the bank’s statutory roles in licensing insurance companies, and in detecting and deterring money laundering and the financing of terrorism.

The Reserve Bank’s main source of income is the interest it receives from its holdings of government bonds and foreign reserve assets. Its profits are volatile as they are affected by interest rate changes, and because the bank does not hedge its foreign exchange reserves, allowing it to intervene if necessary to support the New Zealand dollar.
In 2012/13 the bank’s net income from interest was $260 million. This was $20 million less than the previous year as interest rates in New Zealand and overseas were lower. The bank made a gain of $29 million on its holdings of foreign exchange, compared with a loss of $38 million the previous year; the difference reflects lower foreign exchange rates for the New Zealand dollar at the end of June 2013.

Overall, the Reserve Bank made a profit of $308 million in 2012/13, compared with $118 million in 2011/12. It paid a dividend to the Crown of $175 million. The bank also retained $100 million of realised earnings, in line with its policy of holding sufficient equity to cover the risks entailed in performing its functions.

The Office of the Auditor-General assessed the Reserve Bank’s management control environment and its financial information systems and controls as “very good” in the 2012/13 audit, requiring no improvements.

**Reserve Bank’s tools**

During the year under review the bank developed a set of macro-prudential policy tools for use when needed to build additional resilience into the financial system and to dampen excessive growth in credit and asset prices. The governor noted that lessons from the global financial crisis have led central banks around the world to focus increasingly on measures to counter emerging asset bubbles. In May 2013 the Reserve Bank signed a memorandum of understanding with the Minister of Finance about operating guidelines for such tools. It subsequently announced that it would start to use one of the tools from 1 October 2013: restrictions on high loan-to-value ratio (LVR) lending, in effect a “speed limit” on the amount in new residential mortgages that banks can lend on low deposits.

We discussed with the bank the implications of the measure during both our financial review hearing and our inquiry into the Reserve Bank’s financial stability report, which is covered later in this report.

**The housing market**

**The problem**

The Reserve Bank regularly expressed concern during the year about growing imbalances in the housing market, particularly in Auckland. Strong demand for housing has been fuelled by exceptionally low interest rates, net migration inflows, and banks’ willingness to accept low deposits as they compete for mortgage customers. Coupled with a shortage of housing, this has led to house prices increasing rapidly despite being already high relative to average incomes. In Auckland, prices have increased at an annual rate of 16 percent over the past six months. As the Reserve Bank has explained in successive monetary policy statements and financial stability reports, these developments pose risks for borrowers, for the financial system, and for the economy in general.

It notes that the IMF, the OECD, and the rating agencies agree that house prices are overvalued in New Zealand. With household debt already high (currently 146 percent of average disposable income), the Reserve Bank sees a danger that an external economic shock could trigger a correction in house values, precipitating the situation that arose in several countries during the global financial crisis where many householders found themselves owing more than their homes were worth. Highly-leveraged borrowers are most vulnerable in such a scenario, with flow-on risks for the stability of the banking system.
Lending restrictions

To address such risks from the housing market, the Reserve Bank announced in August that with effect from 1 October it will require banks to limit new residential mortgage lending at LVRs of over 80 percent to no more than 10 percent of the dollar value of their new lending for housing. It hopes these “speed limits” will curb demand pressures in the short term, as it will take several years for the supply of housing to increase; it estimates that the restrictions will subtract 1 to 4 percentage points from annual house-price inflation over the next few years.

Some of us are very concerned about the equity implications of the LVR restrictions, believing that, in the absence of a capital gains tax, property speculators and foreign investors will be the likely beneficiaries, while first-home buyers and others who struggle to find the necessary deposit will suffer. The Reserve Bank said the limited evidence available so far does not indicate that first-home buyers are being displaced by investors; a BNZ survey in October indicated lower demand from all kinds of buyers. However, it says it is too soon to gauge the full effect of the measure.

The majority of us, and the Reserve Bank, share concern about the effect the restrictions will have on some prospective home buyers. However, we recognise that the alternatives would be more worrying. If large interest rate increases were needed to cool inflationary pressures, there would be widespread effects on the economy as a whole, probably including further appreciation of the exchange rate. We also consider the measure important to protect vulnerable borrowers, particularly those on lower incomes who are likely to be more highly geared, in the event of another economic shock. We will be watching the effects of the policy closely, and intend to seek an update from the governor when we meet to discuss the Reserve Bank’s monetary policy statement on 12 December.

Housing supply

The Reserve Bank considers that a large part of the problem in the housing market comes from the supply side, with shortages that have built up over many years, often because of regulatory issues and the way land is zoned. The high cost of construction in New Zealand compared with Australia and other advanced economies has also been an important contributor. It notes that about 10,000 houses are estimated to be needed in Christchurch, while in Auckland the shortage is about 20,000 to 30,000 houses.

We asked whether enough is being done to address Auckland’s land supply problems. The Reserve Bank told us it is quite impressed by the efforts being made in Auckland to streamline the council approval process and to work with developers to accelerate planning and consenting. It sees as important the recent launch of the first special housing areas, bringing an initial 6,000 sections onto the market toward the goal under the Auckland housing accord of having 39,000 homes built over the next three years. The Reserve Bank said it remains to be seen how rapidly progress is made to fill the gap in supply, but considers it promising that concrete steps are being taken. Some of us remain concerned that the Government appears unwilling to do more to tackle issues in the housing sector.

We note that some commentators have suggested the LVR restrictions might have the unintended consequence of dampening new housing construction. The Reserve Bank told us it is watching the situation closely. It acknowledged there could be some such effect initially, but said demand for new building appeared to be remaining strong, with 50 percent more consents than there were in 2011. Since our hearing, however, the Reserve
Bank has decided to exempt lending for newly-constructed residential houses or apartments from the restrictions. We understand its decision followed further consultation with the building industry about the practical effect of the restrictions. We are pleased to see the Reserve Bank is monitoring the market and taking steps to ensure that its policy does not constrain an increase in housing supply, which is very much needed. We understand that the change is unlikely to weaken the effectiveness of the restrictions in curbing demand, as high-LVR lending for construction is only about 1 percent of total residential lending, although it finances about 12 percent of residential building activity.

**Adjustment in the housing market**

The Reserve Bank views the LVR restrictions as a temporary measure, and says it will remove them when there is evidence that imbalances in the housing market have abated. Asked what sort of adjustment it is looking for, the Reserve Bank told us it does not want to see house prices falling—this would be undesirable for financial stability, affecting both households and lenders; rather, it would like to see the rate of house price appreciation slowed. It hopes the restrictions will curb demand, to allow time for supply to increase. The governor would not put a figure on an acceptable rate of growth in house prices, but said that average appreciation of 10 percent nationwide was clearly out of line with current CPI inflation of 1.2 percent and the mid-point inflation target of 2 percent. He said the Reserve Bank assesses various measures, including house prices relative to rents, and the ratio of household debt to disposable income, which is very high by both historic and international standards.

**Foreign investment in housing**

The Reserve Bank has commented that foreign buyers are unlikely to be affected by the LVR restrictions. We raised our concern about this, noting that some surveys suggest foreigners make up at least 11 percent of Auckland house buyers. The Reserve Bank said its comment does not mean the restrictions favour foreign buyers; merely that such buyers tend to have more cash available for a deposit. It added that it is unclear what proportion of buyers are foreign investors, since such figures include foreign immigrants and returning Kiwis, nor how much pressure they add to the market, whereas first-home buyers represent a substantial 40 percent of high-LVR lending. The Reserve Bank also noted that in Australia, restrictions on foreign buyers and a capital gains tax appear to have made little difference to property prices.

**Other regions**

We are concerned about the effect of the restrictions on prospective homeowners in regions other than Auckland and Christchurch, where the main problems appear to lie. The Reserve Bank said prices have also been increasing rapidly in several other areas, including Taranaki, Hamilton, Hawkes Bay, Nelson, and Marlborough. It believes trying to tailor the LVR restrictions to specific regions would have created other problems. The bank thinks their bite will be felt most in the regions where price increases have been highest, and that buyers elsewhere may be able to offset the effect of the restrictions through Government measures such as Welcome Home loans.

**Non-bank deposit takers**

Since 2008 the Reserve Bank has been the prudential regulator of non-bank deposit takers (NBDTs), which include finance companies, building societies, and credit unions. During 2012/13 it carried out a review of the effectiveness of prudential arrangements for the
sector, and reported to the Government in September 2013. It also worked toward the licensing of NBDTs under legislation due to come into force in April 2014. Its review concluded that the prudential regime has helped to reduce the risk of failure in the NBDT sector and encouraged sounder management. It has recommended retaining the current supervisory structure, with some adjustments to streamline its operation.

We asked about the rationale for retaining trustees as the front-line supervisors of building societies and credit unions, in addition to the Reserve Bank as regulator. We are aware of concern that this arrangement is inefficient and adds an unnecessary layer of bureaucracy, since these deposit-takers do not carry similar risks to finance companies, most of which collapsed during the global financial crisis. The Reserve Bank told us it sees pros and cons in various possible models, but on balance it sees advantages in keeping the same regime for all institutions in the sector. It noted that building societies and credit unions are not without risk; in particular, they carry a large maturity mismatch, with a lot of on-call deposits against term lending. The Reserve Bank acknowledged there is a trade-off between soundness and efficiency, and said the recommendations in its review seek to strike an appropriate balance.

**Money laundering and the financing of terrorism**

As a result of recent legislation, the Reserve Bank has taken on the supervision of measures to counter money laundering and the financing of terrorism, and has built its expertise for the role. We discussed the way it undertakes this work, which we see as very important for protecting New Zealand’s international reputation. The bank told us it carries out detailed inspections of banks, non-bank deposit takers, and insurance companies to verify that they have good systems for detecting and reporting any such activities. It undertook to provide us with a list of countries whose controls are inadequate compiled by the international Financial Action Task Force.

**Financial Stability Report**

The Reserve Bank is required to report twice a year on the soundness and efficiency of New Zealand’s financial system. The following are the main points from its November 2013 financial stability assessment:

- New Zealand’s financial system remains sound. Banks are well capitalised and have strengthened their funding base; there are fewer non-performing loans.

- The main risks to the financial system come from growing imbalances in the housing market, which the Reserve Bank has been taking steps to moderate. Households and banks are both highly exposed to this market.

- The strength of the New Zealand dollar remains of concern, particularly for the tradable sector.

- The New Zealand economy continues to grow quite strongly; GDP growth of about 3 percent is forecast for the coming year, and is expected to be sustained.

- Strong terms of trade are supporting New Zealand’s exports, particularly dairy, but high debt levels in the dairy sector leave farmers vulnerable to any fall in commodity prices or increase in interest rates.

- Growth has slowed in emerging markets, but growth in the major advanced economies is strengthening.
The balance of this report covers the main issues we considered during our examination of the financial stability report and in our discussion with the Governor of the Reserve Bank.

**Restrictions on high-LVR mortgage lending**

The Reserve Bank sees growing imbalances in the housing market as a major systemic risk for financial stability; to address them, it introduced restrictions on high-LVR mortgage lending in October. The changes were well signalled; banks started to increase premiums for low-equity loans from September, and tightened the availability and terms of pre-approvals for high-LVR loans. The Reserve Bank considers that the restrictions are starting to reduce riskier lending, but notes that it is too early to assess the full effect.

We asked about the risk that banks may try to get around the LVR restrictions, noting that the financial stability report (page 35) pointed out that “regulatory leakage” could undermine the effectiveness of the measure. The report also suggests that the resilience of the financial system could be affected if lenders not subject to the restrictions significantly increased their lending. The Reserve Bank said it would be watching the position closely, but the LVR policy had been designed to reduce the scope for such avoidance, and in its discussions with banks the Reserve Bank had emphasised its expectation that banks would adhere to the spirit of the policy, not just the mechanics, when making lending decisions.

**Economic growth and rebalancing**

The Reserve Bank will be updating its forecasts for New Zealand’s economic growth in its next monetary policy statement, due for release on 12 December. Currently it estimates that the economy is growing at about 3 percent per annum, faster than nearly all the other OECD economies, and expects this to continue. The main drivers of this growth are New Zealand’s strong terms of trade, which are 25 percent above the average for the 1990s, increases in consumption, investment, and migration, and improving consumer and business confidence. It notes that GDP is growing faster than the 2.25–2.5 percent growth in New Zealand’s “potential output”, the rate at which an economy can grow at full employment without inflationary pressure, and it is starting to see such pressure building. The bank has signalled that it is likely to increase the official cash rate in 2014 in response.

New Zealand appears to be ahead of other developed economies in recovering from recession. While this is encouraging, it is also problematic as far as the exchange rate is concerned. With other developed economies unlikely to raise interest rates over the next 12 months, an increase here could lead to further appreciation of the New Zealand dollar, putting our traded goods sector under more pressure. We asked the Reserve Bank what this will mean for efforts to rebalance New Zealand’s economy and reduce external debt. The governor told us that higher interest rates tend to put upward pressure on the exchange rate, but they also slow the rate of demand growth; the net result depends on the balance between the two effects. He added that the high exchange rate is also because of very strong commodity prices for New Zealand’s exports, particularly dairy, with New Zealand’s terms of trade at present close to a 40-year high.

New Zealand’s current account deficit remains a concern; it is currently the second highest in the OECD. The Reserve Bank notes that the current account deficit has been a persistent problem for three decades, reflecting the long-standing imbalance between the country’s rates of savings and investment. It is projecting further deterioration in the current account deficit over the next few years because of the sizeable investment needed for reconstruction in Canterbury, and the planned investment in house construction under
the Auckland housing accord. The financial stability report says this situation underscores the need for the improvement in private savings over recent years to continue, along with continued restraint in Government spending.

**External risks**

We note that the measures being taken by the Reserve Bank to cool the housing market are designed to protect against the risks to financial stability that could be precipitated by an economic shock. We explored with the Reserve Bank what it perceives to be the main external risks. We heard that the bank sees the biggest risk as the potential for disorderly slowing of the economy of China, which is now New Zealand’s largest trading partner. Its growth has recently abated from the 10 percent average of the past 30 years to about 7 percent; the bank hopes this rate can be sustained. After such a period of rapid growth, issues to do with bad debts in the banking system, rapid growth in house prices, and the quality of regulation could cause disruption in China’s economy.

Other potential triggers which could cause financial stress for New Zealand include further instability in Europe, a sharp increase in interest rates as many economies move to tighten monetary policy, or disruption resulting from negotiations in the United States over the public debt ceiling.

**The insurance market**

The Reserve Bank is responsible for prudential supervision of the insurance industry. Following the enactment of a new prudential regime in 2010, it has been working with insurers to ensure they comply with the requirements; the three-year process for full licensing was completed on schedule in September 2013, with 99 companies now licensed.

We asked the Reserve Bank whether it considers the efficiency of insurance companies in its scrutiny of them, as we are aware of concern, particularly among Canterbury residents, that insurance companies are gouging the victims of the earthquakes. We were told that the bank’s prime concerns are the safety, solvency, and risk of insurance companies, but it also considers their efficiency; in its view the key is to ensure the industry remains open to competition and new entrants. Claims in Canterbury have been especially complex because of the need to apportion damage among multiple earthquakes, and between two assessors: the Earthquake Commission and private insurers.

**Changes resulting from the earthquakes**

Given this country’s reliance on overseas companies for reinsurance, we are interested in changes the Canterbury earthquakes have brought about in the insurance market, and in New Zealand’s perceived risk profile. We heard that after some initial reluctance from reinsurers to write new policies, most companies have come back into the market. The main result of the earthquakes has been a large increase in the cost of reinsurance, which has flowed through to higher premiums for households generally.

It seems to us that the earthquakes have caused a structural shift in the insurance market, with higher premiums likely to persist. We would be concerned if this led people to opt not to insure, or to under-insure as home replacement cover is replaced by sum-insured policies. As well as increasing the risk borne by householders, we consider that such developments may also affect the riskiness of banks’ mortgage portfolios. The Reserve Bank told us it is watching the situation closely and consulting banks. It noted that New Zealanders have traditionally had a high level of insurance cover compared with other
countries. It may diminish somewhat, but it is still too soon to gauge the extent of any change. We see it as reassuring that the Reserve Bank is monitoring the competitiveness of the industry.

**The banking sector**

New Zealand’s banks are performing well; their profitability has recovered nearly to the levels prevailing before the global financial crisis, thanks to a reduction in non-performing loans, and stable interest margins. Credit growth has been increasing gradually, but banks have been able to meet this demand without increasing their reliance on overseas funding, as retail deposits have continued to grow strongly, boosted by earthquake insurance payouts.

**Exposure to fossil fuel industry**

We asked about the exposure of Australasian banks to the oil and gas industry. Some of us are concerned about the risk that banks exposed to investments in fossil fuel industries could be put under stress if climate change resulted in oil and coal fields being shut down, forcing assets to be written off. The Reserve Bank said New Zealand’s major banks have little exposure to the oil and gas industry. Most such investment in New Zealand has been funded through project financing, generally by overseas syndicates, rather than through domestic banks. While Australian banks are more exposed to the industry, the Reserve Bank does not see cause for concern about such risks.
Appendix A

Committee procedure
We met on 13 November and 12 December 2013 to consider the financial review of the Reserve Bank of New Zealand, and the Reserve Bank of New Zealand’s Financial Stability Report, November 2013. We heard evidence from the Governor of the Reserve Bank, and received advice from the Office of the Auditor-General and from our independent specialist adviser, Brendan O’Donovan.

Committee members
Paul Goldsmith (Chairperson)
Maggie Barry
David Bennett
Dr David Clark
John Hayes
Hon Shane Jones
Dr Russel Norman
Hon David Parker
Rt Hon Winston Peters
Jami-Lee Ross
Hon Kate Wilkinson

Evidence and advice received
Memorandum from Brendan O’Donovan, Committee Adviser, dated 13 November 2013.
Office of the Auditor-General, Briefing on Reserve Bank of New Zealand, dated 13 November 2013.
Organisation briefing paper, prepared by committee staff, dated 11 November 2013.
Reserve Bank of New Zealand, responses to committee questions.
All right, thank you. Welcome to the committee, Governor, and to your team. We’re very pleased to have you. We’ve got kind of a double header this morning, with the financial review and the financial stability report. Inevitably, there will be a lot of overlap between the two discussions, so I won’t be too officious in trying to separate the two. But, in general, if we can devote the first hour to a review of last year’s performance, and then you can talk a little bit about the report today in the second hour. So maybe if you could summarise the financial review aspects first, that’d be great.

Well, thanks very much indeed, chairman. I must say we did anticipate quite a lot of overlap. [Introductions] In many respects, the outlook for the economy is positive. The economy is growing faster than nearly all the 34 OECD economies. The expansion looks sustainable. It’s driven by high terms of trade, strong consumption and investment, increased migration, and rising consumer and business confidence.

Two of the major concerns relating to the economy are the strength of the New Zealand dollar, which creates difficult headwinds for export and import substitution industries, and the housing market, which is the main threat to the financial system—risks associated with the growing imbalances in the housing market, in particular. The Reserve Bank board met nine times during the year and provided valuable insight into the bank’s
activities. The board concluded that monetary policy is being operated within the requirements set out in the policy targets agreement and that it is comfortable with the bank’s processes in relation to developments relating to financial stability.

The annual report discusses the main goals of the bank, the measures of success, and the main priorities for 2012-13 and the outcomes. The bank’s current 5-year funding agreement extends through to June 2015. Spending for the last financial year involved an increase of $1.2 million, or 2 percent, over the previous year, and this helped to finance new responsibilities, which included the licensing of insurance companies and the implementation of measures for anti-money-laundering. The bank reported an annual profit of $308 million for the financial year and paid a dividend to the Crown of $175 million. So thanks very much, chair.

Goldsmith  Who are we going to start with?

Clark  Can I just start off, because I’m unable to stay. The question of the—I just want to go straight to the LVRs and the restrictions you’ve put in place. I’ve had concerns raised with me by people fairly close to the action in Auckland, saying that they have some significant equity concerns in respect of the changes that have been made. They say that without a capital gains tax and other measures, the observable behaviour is that, yes, there is some impact on housing prices, but they’re also noticing that while first-home buyers are being shut out of the market in increasing numbers, speculators are effectively coming in and buying properties cheaper than they otherwise could, further entrenching inequalities and essentially putting out of reach housing for New Zealanders who, a generation ago, might have considered that they could have a chance to own their own home and have a stake in society. Have you done measurement around that? Have you got a view on where that’s heading? I guess that’s my first question.

Wheeler  Can I just get clarity on what the question is? Because you’ve talked about capital gains tax, you talked about speculators, so—

Clark  The point is that the impact of the policy is that it shuts some people out of the market. It’s been called by some commentators a pretty crude tool, and the Opposition parties, for their part, I think, have been clear that they think that the Reserve Bank’s been put in a corner and forced to take some measures because the Government hasn’t been willing to tackle issues in the housing sector. I’m trying not to put a political overlay on that—that’s quite hard to do in that situation. But, essentially, I want to get to the equity issues that are coming out of that policy and get a sense of your take on that. Are there equity issues arising, and would [Interruption]—sorry, I was asked for clarification. Would other measures be able to address those, potentially?

Wheeler  Well, we can understand why some borrowers are disappointed, but our responsibility in the central bank is to look at the risks to the financial system and to the broader economy. What we have is a housing market which is very buoyant in many parts of the country. Many people would say, including the IMF and the OECD and the three international rating
agencies—they would say, and we would agree with them, that house prices are overvalued, and this poses a systemic risk to the financial system. So we felt in the Reserve Bank that we needed to address this.

If you look at the experience of other advanced economies, and many of them have got higher per capita incomes than New Zealand, and if you look at the experience over the last three decades, then you’ve seen significant house price adjustments in many of those economies. And, you know, that’s caused often very considerable damage to the financial sector. It’s caused huge damage at times to household balance sheets, because households basically—you’re sitting there with negative equity. Let’s say you’re a low-equity borrower, and your equity is wiped out, then it can take years of cutting back consumption to build the savings up in terms of your household equity. But these adjustments have enormous cost to the economy, and we became concerned that New Zealand is sitting there with high levels of household debt—currently around 146 percent of disposable income. In essence, this just created too many risks for the New Zealand economy to have house prices taking off again, if you like.

We saw what happened in 2003-07—it was the most rapid house price appreciation in the OECD. We didn’t want to see that happen again. So we know the damage that house price adjustments, when they occur, can cause the financial system, can cause the economy, and what it can do to the balance sheets of those who are most exposed, which is first home owners. What we had was a situation where the banks were competing very aggressively for first-home buyer lending, if you like, and high LV lending was comprising about a third of their lending. We felt that we really needed to try and address this problem. Part of the problem—a big part of the problem—is housing shortages. We felt that it would just take years, potentially, for this equilibrium to be corrected through supply side measures alone. So we felt we had to do something on the demand side to try and reduce the—

Clark Can I just ask what measures have you got for the success or otherwise of the policy you’ve implemented, as opposed to, I mean, other trends, such as, say, more overseas buyers coming into the market and so on, which will also have a different impact. You know, if there’s an impression that housing becomes cheaper, relatively, to buy as an investment for an overseas speculator, for want of a better term, that can have a different impact on the whole market. How are you measuring the effectiveness of the LVR policy?

I mean, I know that bank lending is significantly down, and, you know, the reports we’re getting back is they’re being very conservative first off because they don’t want to lose their licence, and there are a whole lot of equity issues arising from that, as well. People have previously been homeowners who are now divorced, and, because their equity’s lower than it was, despite a regular job and a history of paying, they can no longer get into a home. Those hard-luck stories come to MPs in their offices, I’m sure, around the country. I wonder if you can comment on that—measures.
Spencer Can I just say about the issue of investors versus first-home buyers—there was this proposition that first-home buyers moved out, or high LVR borrowers moved out, and that investors would come in. You know, there’s not a lot of strong evidence as yet, but certainly the anecdotes we’ve had have not supported that hypothesis, and it’s also not being supported by the BNZ survey which was taken in October, which showed a reduction of interest of all buyers, including first-home buyers but also including investors. So I don’t think there’s any strong evidence that somehow—

Clark What evidence do you have, because I’m certainly getting lots of strong messages that that is the case, and I guess I’m asking what evidence and measures you’ve got to back up the story.

Spencer Well, the evidence we have so far does not support the proposition of investors effectively taking over the market. That does not appear to be what’s happening. But you are right. It’s early days and there’s still experience to come in.

Ross Thank you, governor. I just want to continue with the LVR topic. You mentioned supply a bit earlier, and you highlighted the fact that the tools that you have are demand-based and you’re tackling demand. But can you talk us through the concerns you have with the supply of housing and land supply. How big of an issue do you believe the land supply problem is? What are your views on policies that are being implemented to try to address land supply?

Wheeler Well, I think the supply side issue, particularly housing shortages and the availability of land, is a big part of the story. I mean, if you take Christchurch, the shortage of housing seems to be of the order of 10,000 houses. If you listen to the Auckland regional authorities, then they would say the housing shortage is somewhere between 20,000 and 30,000 houses. So that’s a huge part of the story. Given that you’ve got an economy with strong growth at this point in time, and you have low interest rates, there is very significant demand for housing. But you then have coupled with this the considerable shortage of housing that’s been built up for many, many years, often because of regulatory issues and particularly in terms of zoning of land, and also there are issues around the cost of building compared with, say, the cost of building in other advanced economies in particularly Australia, for example.

Moving on those supply issues is extremely important. The measure that was introduced just recently, in terms of the 6,000 sections coming in under the recently announced move by the Auckland authorities, I think is extremely important, but we need a lot—

Ross This is the housing accord between the Government and the council?

Wheeler Well, the housing accord is for 39,000 houses over 3 years, and that has a big step up of 17,000 houses in the third year. So releasing these sections to make them available for building is enormously important. Looking at the issues of why the cost of building in New Zealand is more expensive than it is across the Tasman, for example, is also extremely important.
Ross Can I make the assumption that your bank would have done a range of analysis of local government plans and what’s going to be available in terms of land supply in the future? The Auckland Council, just touching on Auckland because that’s where my electorate is, is going through quite a long-term process of looking at land availability. Are you confident that enough work and enough land are proposed to be opened up to address some of the land supply problems in the Auckland region?

Wheeler I am not an expert on that issue, but what I would note is that the accord has an objective of 39,000 houses. It’s a big step up, as I say, in the third year in particular. New building consents in Auckland are running, at this point, at around 5,600 to 5,700 so there’s still quite a lot of work to be done there. But let me ask Grant.

Spencer I would say that we’re quite impressed with the efforts that have been made in Auckland to accelerate the planning, consenting process, with the establishment of the special housing areas and the reorganisation within the council to bring disparate parts of the council involved in the planning process together, to try to streamline the approval process, working with developers. So I think concrete actions are being taken. It remains to be seen how quick the response will be to that. But it’s very clear that action is being taken and I think it’s looking promising to get some response, or an improved response, over what we’ve seen in the past.

Ross Moving slightly to the side, in terms of the whole housing and land supply issue, I accept the comments that Mr Clark raised. There are some concerns up there about LVRs and what impact they can have on people. But a bigger concern would be if we were to be one of the first nations in the world to start raising interest rates. Can you talk us through the wider economic problems we would face as a country if you had to start using some of the other demand-related tools, such as raising interest rates? How would that have an impact on our economy, in the context of other nations having very low interest rates as well?

Wheeler As I mentioned in the opening comments, the economy is growing pretty strongly and our forecasts that we prepared for the Monetary Policy Statement in September suggest that the economy might grow at around 3 percent or thereabouts next year. We will be reviewing those forecasts in the next couple of weeks, as part of the preparation for the December Monetary Policy Statement.

But given that potential output growth, which is essentially the rate at which an economy can grow at full employment without inflationary pressures, for example, we think that potential output growth is probably somewhere around 2.25 or maybe 2.5 percent—so if you’re growing faster than potential output growth, then you will tend to generate inflation pressures, and we’re starting to see inflation pressures starting to pick up, in terms of the last quarterly increase in the CPI. But a lot of that was seasonal factors, in terms of vegetables and oil prices and things like that.

But it does mean that we’re likely to be putting up interest rates, starting sometime next year, and the concern would be that the interest deferential
between New Zealand and many of the other advanced economies will widen because it's quite likely that most of the advanced economies, or certainly the major economies, are unlikely to raise short-term rates over the next 12 months and the concern is that that could increase pressure on the exchange rate and put the traded goods sector under more pressure.

But you can also say that we've signalled that in our Monetary Policy Statements, and how much of that is simply anticipated and built into expectations. But the risk would be mainly on the exchange rate side.

Ross You have also signalled that if you did not undertake the LVR restrictions that you've put in place, for a range of reasons, some of which are political—if you didn't put those in place, then you would be raising interest rates a lot sooner than you are now expecting to. Is that right? And all of those problems associated with that could come about sooner.

Wheeler Well, we have said that there's a relationship, if you like, between LV ratios, in terms of constraining demand, and what would be the same impact of an increase in interest rates in constraining demand in the housing sector, so we've done some analysis on that, and that's been important work.

But in essence we're moving on the LV front because we have responsibilities under the Act, in terms of financial stability, and we believe that there really are systemic risks to the financial sector associated with these increases in house prices, particularly at a time when there are these supply shortages and it's going to take time for that supply side to work its way through.

Goldsmith OK. We'll come to Shane Jones.

Jones Kia ora. Firstly, from time to time a number of us pop over and get briefings, and I would like to thank you, Mr Governor—

Wheeler Thank you.

Jones —for allowing MPs to come over and get briefings about rather obscure matters, such as insurance. But I am on page 7 of your document here.

Goldsmith You're on the next hour’s document, but that's all right.

Jones It's in the context of what we're talking about. Basically you point out that demand is well ahead of supply, and we've got house price inflation, and presumably part of what you're doing is not only increasing the robustness of our banking system, but you're trying to get your hand around the throat of house price inflation. By what percentage do you want house prices in Auckland to drop?

Wheeler I wouldn't put an exact number on it, in that sense. But what I would say is as follows: as I mentioned in my comments before, house price inflation in New Zealand was the most rapid amongst the 34 OECD countries from 2003 to 2007. House prices in Auckland, the median house price in Auckland is currently 26 percent above the peak of 2007 and the house prices are increasing currently at an annual rate of 16 percent. Now, inflation is around 1 percent. So that's the major concern.
Jones So can you give me a figure, though, because I think you’re being very bold and your decision about LVRs has obviously been influenced by your experience of seeing the meltdown in the United States of America, quite apart from your statutory role in New Zealand, and your boldness has created quite a lot of white water. But you are the independent Governor of the Reserve Bank, so having made this decision, what level of house price reduction would you like to see to improve the robustness of banking and to draw off the fears you have and the anxieties you talk about every week—too much priciness in house prices in Auckland.

Wheeler As I say, I wouldn’t put an exact number on it, but what I would say is that the analytical work that we did around these LV ratios basically suggested that—

Jones Well, if you can’t have a number, how will we ever a sense as to when the LVR has achieved the objective which naturally you’ve determined, and because you’re not responsible to the public—politicians are responsible to the public—how will we ever know you have arrived at the point where this intervention has kicked a goal for you, if you can’t give us a sense as to: “This is the house inflation figure at the moment, and this is what I, as the independent Governor, not responsible to the public, would like to see it come down to.”?

Wheeler Let me put it this way. If we have inflation currently around 1.2 percent at an annual rate, then we have an objective under the policy targets agreement of maintaining inflation over the medium term of the order of 2 percent, then you wouldn’t want to see house prices for the county as a whole growing at around 10 percent, as they are at present. You would want to see a figure much closer over time, much closer to the level of consumer price inflation.

Jones OK. The other question—it is also in the document, and it is very, very good. Basically on page 35 you’ve talked about regulatory creep or leakage, should I say. What I love about reading these documents—I’ve got three degrees and I still need to turn to the new version of the English language when I hear you guys and read you guys. But anyhow, on page 35, Mr Governor, it says: “In respect of LVR restrictions, leakage could involve avoidance activity by the regulated banks.” Which banks do you fear are going to try and game you on LVR?

Wheeler When we’re talking about regulatory leakage, it’s the risk of financial disintermediation that could occur.

Jones I’m reading out what you put out here, and this is the only public forum we have. I have got a right to ask this question, Mr Chairman. In respect of LVR restrictions, regulatory leakage could involve avoidance activity by the regulated banks, including activities designed to game.” Now, which banks do you fear are gaming you?

Spencer This is a concern with any policy, a concern that we don’t want to see leakage that would undermine the policy. We’ve put various conditions in the handbook standards in the regulation to try and minimise that leakage,
and so far we think that has been quite effective. One of the things we put in there was a requirement that the banks not only enter into the letter of the restriction, but also the spirit. We’ve had various discussions with them about, you know, products or activities that might be regarded as inconsistent with the spirit of the regulation. I must say that to date we’ve been encouraged by the response of the banks in terms of entering into the spirit of the restrictions, and not trying to game them. So we’ve been happy with the banks’ response to this point.

Jones OK. Thank you for the answer. I was just surprised to see it so overtly stated. We assume that you have a problem—that the banks are beginning to game you, or you wouldn’t have put that in here.

Spencer No, it was more in terms of a risk that that might happen.

Jones My final point, and then I will hand it over to others, is that recently there has been a lot of talk about a potential default if the Congress, Mr Governor, don’t get their affairs in order, etc. Could you share with us what effect you might see that having on New Zealand, in the event that the American Congress have another bout of instability—it’s referred to in your document—and have a punt at what you think it might mean for us here in New Zealand if it did go pear-shaped.

Wheeler If the US Government did default, it would be an extraordinary situation and so I don’t believe there is a major risk at all that the US Government would default. The Government got shut down, as you know, for the best part of 2 weeks or more and there’s a lot of sensitivities on the GOP and the Democrats side in the House about the level of debt in the economy, particularly the level of public sector debt. But for an administration to actually default on its liabilities would be an extraordinary situation for a country which is 20 percent of world output. If that did happen, and it wasn’t rectified basically immediately, and I couldn’t envisage it happening, then the consequences would be pretty well what you would expect.

Jones So when I see on page 15 you’re just warning us that it represents just one of the risks that you have to be mindful of, in the sense that a default on Treasury bonds represents, on page 15, a significant tail risk if the debt ceiling is not increased permanently. Basically you’re saying you don’t see that debt ceiling being either static or decreasing.

Wheeler I think we could see some quite rocky times in the run-up to the next presidential election and perhaps with the Senate elections in mid-term, you know, it’s unclear to me that having been through what happened with the shutdown of the Government that there would be an appetite to go through that again in January or February.

Jones OK. Thank you very much.

Goldsmith We will come to Russel Norman first.

Norman I have some questions that are probably more related to the annual report, but seeing as we are on the LVR thing, maybe we should just continue down that path, for continuity’s sake, so I do have a few questions about the LVR.
Just following up on Mr Jones’ question, the answer that you gave essentially was that let’s say a 2 percent growth in housing prices would be a reasonable one if the target is one of 3 percent, so the mid-point is 2 percent, so growth in house prices around 2 percent might be a reasonable one, rather than 10 percent.

Wheeler I don’t think I said that, chairman.

Goldsmith Closer to.

Wheeler I said something closer to the 2 percent.

Norman But what you didn’t address in Mr Jones’ question was that he was asking to what extent house prices should come back. That was actually his question. A lot of what you talk about is the problem of the growth in the past and the imbalances that that has produced, which suggests that you think they should come back to some degree, and you didn’t address that part of his question, I don’t believe.

Wheeler Well, part of the issue is whether we have a housing sector which is overvalued in terms of historic experience and international experience. And the sorts of measures you might look at would be household debt relative to household disposable income, or it might be house prices relative to rents, those sorts of things. When people have done that analysis, we in the bank, but also the international institutions, they’ve found that house prices are significantly overvalued.

Now the OECD, for example, in a recent publication in essence said that, if you take house prices relative to disposable income—and that ratio’s around about 4½ at the moment, but in the early 90s that was around 2½. The OECD did some analysis and said that the current ratio, which is 4½ or thereabouts, relative to the historic average in New Zealand is 20 percent higher. So one doesn’t want to see a significant adjustment in house prices happening quickly because that would be—by that I mean just simply house prices falling. That would pose significant—

Norman Nominal terms, you mean?

Wheeler Nominal and real, in nominal terms, yes. Then that would pose significant risks to the financial sector, etc. What one wants to do is to slow down the rate of house price appreciation, and our measures are basically trying to affect the demand for housing while the supply side can come into balance, into much better balance.

Norman So, just to be clear on that, what you would like is to see house price rises slower than rises in income in order to change the ratio of income versus house prices. Is that correct?

Wheeler Well, we’re saying that that measure is too high at the moment, house prices relative to disposable income, that that multiple of 4½ is a high one by historic standards and by international standards. And over time we would like to see that lower.

Norman OK. Just on another issue related to the LVRs. I have the minutes from your May meeting in Whangarei. You may remember the May meeting up in
Whangarei. In it you talk about the LVR and the board discussed issues relating to elements of the housing market that may not be affected by LVR limits, such as foreign buyers. So, what the minutes appear to be saying here is that the LVR limits won’t affect the foreign buyers. Can you explain to me why that’s the case, if this is correct? I’m happy to pass the minutes over to you to have a look at.

Spencer Well, that comment, I guess—the implicit assumption there and their understanding is that a lot of foreign buyers in the Auckland market are not particularly highly geared. In other words, a lot of them have quite a lot of cash and therefore LVR restrictions may have less of an impact upon that group. But there’s still a lot of uncertainty as to how significant that group is in terms of putting pressure on the market.

Norman So, according to the BNZ study, 11 percent of buyers are offshore in the Auckland market. And that study probably under-reports because it relies on real estate agents self-reporting, who have a vested interest in under-reporting because it’s such a sensitive issue. But if that’s an accurate number it means that that 11 percent of demand won’t be affected by the LVRs. Is that the fair conclusion to be drawn from that?

Spencer I would think that’s a reasonable assumption, yes.

Norman Can you see that from the point of view of the average person, that they may think that a measure which is introduced which is having significant effect on first-home buyers’ access to the housing market but has no effect on foreign buyers in the housing market may seem to have elements of inequity around it?

Spencer Firstly I’d say that foreign doesn’t equate to investor. So there’s still an investor segment that’s domestic that will be influenced by the LVR restrictions, albeit they take up a smaller proportion of first-home buyers. As we know, first-home buyers we estimate 40 percent by LVR lending, but the other 60 percent is all those other groups.

Norman So if you were to say, well, that one of your objectives is to deal with the demand side, your argument is, in the short term, while the supply side is sorted out in the medium term. I think that’s a fair characterisation of your argument. Another way to affect the demand side would be to place some constraints on the foreign buyers if they are, say, 11 percent of the market. It is a significant proportion. And yet so far you’ve been unable to apply any constraints on the foreign buyers into the housing market, because the LVRs don’t impact the foreign part of demand. Is that correct?

Wheeler I think whether the 11 percent is right or wrong, I’m not sure. If you look at the analysis that I saw, albeit it was a while back, looking at to what extent do people living offshore own the housing stock as opposed to flows, that percentage was much, much lower. But on the flows, you would expect, given the buoyancy in the market, that the flows percentage would be higher than the stock percentage. I think that would be a fair assumption.

I think it’s probably a fair assumption that people buying from overseas, be it Australia or be it Europe or in Asia, many of them probably don’t have to
go through the banking system to the same extent. But that’s true for the bulk of people buying houses in New Zealand; they don’t, in essence, get caught by the LV restrictions because at its peak it was affecting basically about 30 percent of bank lending.

Norman  But the LV restrictions apply to flows rather than stock, so a like-with-like comparison should be with flows, not stock.

Wheeler  The flows will be higher than the stocks. I agree with that.

Norman  So, if we are looking at demand from offshore it is the current demand and the current flow that we should be looking at in order to compare like with like.

Wheeler  Correct. And we don’t know whether the 11 percent is the right figure or not, as we say.

Spencer  The key factor here is that our aim is not just to reduce demand for housing in Auckland. I mean, the aim is to reduce risk in the system, and that’s why these restrictions are based on loan-to-value ratios. If we do have an incident or a shock in the market, those are the loans that are going to be damaged the most, and they’re going to damage the system the most.

Wheeler  There was a debate. The central bankers in many countries get together for a conference in Jackson Hole every year. There was quite a significant debate, I think it was in 2005, about the buoyancy of house prices in many economies, especially the US. The Federal Reserve System had a view that—and this was Chairman Greenspan’s view—in essence, central banks can do very little about emerging asset bubbles, in essence. That view, I think, got substantially reconsidered in the aftermath of the global financial crisis. That damage associated with rapid build-up in housing market or house prices, substantial overvaluations, and considerable leverage in the financial system—that when the correction comes, it can do massive damage to people’s lives, to the financial sector, and to the broader economy.

The debate intensified about what are potential measures that central banks can do to try and address some of these risks to the financial system and to the broader economy associated with these rapidly rising asset prices, in particular housing markets. That is when an increased focus went on the macro-prudential tools. Things like loan-to-value ratios have been around
for a long time. I mean, there are 25 countries that have used loan-to-value ratios in some way that we are aware of, but amongst central bankers the belief developed that, really, central banks just couldn’t sit by and let these risks to the financial system and the broad economy just intensify and have all the potential outcomes if they collapsed.

Goldsmith When we talk about equity, who were the primary losers out of the situation that we saw in the United States, where there was a bubble, there was a massive correction, and the economy as a whole was thrown into serious problems? My sense is—and it’s a leading question—that it is the lower income and the poorer part of society that suffered most from that happening. Is that right?

Wheeler Yeah, and it’s not just the United States. You’ve seen major house price corrections over 30 or 40 years in advanced economies. In fact, we have a table listing a number of the countries where that has occurred in the past three decades. Yeah, the greatest adjustment and effect on people’s balance sheets and their lives are those that are the most highly leveraged in the economy. In California, for example—I mean, house prices in America were adjusted in five states in a huge way. One was California, another was Florida, another was Michigan, Arizona, and Colorado. You saw house price corrections of the order of up to 60 percent in a lot of those states. A lot of the lending that had been taking place in California was interest only lending. You know, what it did was when the crunch came, you had basically 25 percent of America’s 45 million mortgage holders basically having negative equity. A number of them walked away from their houses and gave the keys to the banks, but others just simply had to cut back their consumption, cut their living standards dramatically, and this lasted for several years and is still carrying on to try and build up their equity in their houses.

Bennett Just following on from what Russel was going on about with his questions—I think he effectively was looking at some kind of restriction on overseas buyers. I think that’s where he was getting to. I think the point you raised was that it’s actually to protect the purchaser as well from the difficulties that can come in if you’re on an interest only or you don’t have enough equity to hit it downtime. What do other countries like—I understand Australia has a limit, doesn’t it, on overseas buyers. Has that achieved the purpose that Mr Norman was talking about— that he was inferring that such a policy would achieve? Have they had a slowing of their property markets in places like Sydney and that, which are comparable to Auckland?

Wheeler In terms of the measures in Australia—perhaps maybe Grant does or someone else knows the details. The challenge we have got in the housing market to supply-side and demand-side imbalances, etc. is that if you look at the Sydney market or the Melbourne market or the market in London, you start seeing house price increases that are starting to become quite significant compared with the underlying rates of inflation. In many respects, we’re sort of ahead of them in the financial cycle and in the economic cycle. As I say, the economy is growing faster than economies in...
those countries—faster than the UK, faster than Australia. By and large, my
guess is they will face increasing house price pressures in those economies,
irrespective of what they might have done by way of a capital control.

Bennett So the things like capital gains tax, limiting overseas buyers—they are not
working or stopping or changing the flow? It is a natural flow that really the
economy goes through in those sorts of cities and modern, world-class cities.
You’re going to have that pressure, and really what you’re saying is what you
try to do with your LVRs was actually protect the buyer in a situation where
they could get themselves into difficulty by overstretches
to get into the market. Is that sort of fair?

Spencer Yeah, I think in Australia, the view there is that capital gains have not really
had a big impact on property cycles over time, nor have the restrictions on
foreign purchase of properties, which were essentially in the nature that
foreigners have to buy off the plan. You can’t buy existing houses, or you
have to get approval for existing houses, so there’s a lot of ways they can get
around that. The view is that those restrictions make very little difference.

Bennett And also, with net migration—one of the things we talked about earlier—
coming in our favour, it would be very difficult to identify a migrant from
an investor in that situation as well, wouldn’t it?

Spencer Yes, well, particularly with the increase in net migration, a lot of it is fewer
Kwis leaving and more Kwis actually coming home who have been away,
so they have obviously all the rights.

Bennett Just with the LVR, is there anything, when you brought that in, that was
unusual or different or something that was unexpected that was unexpected or to that level? Are there any lessons that you would
learn out of that process that you think could be tweaked, or some things
you need to be aware of that are pitfalls in the system going forward?

Spencer Not as yet. I mean, it is early days, because they only started on 1 October.
There’s a lot of adjustments that we’ve yet to see. So it’s probably too early
to make that call. There may well be events that happen over the coming
months that are unexpected but at this point, we haven’t really seen any
surprises, as such.

Wheeler Just on that, perhaps, if I could elaborate, we telegraphed these moves in
many respects in the on-the-record speaking that we had been doing in the
lead up to the introduction of these measures. We’d given a number of
speeches. We’d also been talking with the bankers association. We’d been
talking with the chief executives of the banks—also with the chairs of the
boards of a number of the banks, so these were pretty well telegraphed
within the industry and I do not think at this point we have had any real
surprises.

Goldsmith OK, we’ll go to Andrew Williams and then we’ll come back to Russel
Norman.
Williams Governor, in your earlier introduction you referred to the Auckland and Canterbury markets being somewhat overheated and the need to move on the LVRs to try and contain that. What is your response, though, to the fact that outside of the 1.9 million - odd people who live in Canterbury and Auckland, there are in excess of 2 million other New Zealanders who live in the likes of the Waikato and Bay of Plenty, where house prices increased by 2.3 percent in the last year; in Manawatū and Wanganui at 2.2 percent; Hawkes Bay at 2 percent; Northland at 1.25 percent; and Southland at 0.5 percent?

In those areas, you will agree, the real estate chain is very dependent on people entering the market so that others can move along the chain and move up to their next level of house and that sort of thing. If in areas such as Southland, Northland, Hawkes Bay the market is affected to such an extent that there is no level of entry—affordable entry—for many people on low to middle incomes, do you feel that you are taking a sledgehammer to clobber an Auckland and Canterbury problem and maybe to a lesser extent perhaps Queenstown and Nelson, but other areas of New Zealand are going to significantly suffer?

And when you look at a situation where the average house price in New Zealand is now at $385,000—a little bit less in many of those provinces—but where people now on average in New Zealand will be required not just to raise $38,500, a 10 percent deposit, but $77,000, can young people moving into the workforce with young families honestly in many of these provinces think that they can start raising $50,000, $60,000, or $70,000 to try to get entry into the market? And if you feel in the next number of months that this is really adversely affecting the likes of Gore, the likes of Timaru, the likes of Hastings, the likes of Gisborne, will you move quickly to address it?

Wheeler We thought about whether we should introduce regional LVR ratios, if you like, and we decided not to, partly because of the administrative difficulties associated with that, but also because wherever you draw the ring-fence, wherever you put the border’s edge or the boundary, the pressures will spill over outside that boundary. You’re right, that there are parts of the country, and significant parts of the country, where house prices are either flat or they have been declining, even. But there are other parts of the country outside of Auckland and Christchurch where house prices are increasing somewhere between 5 and 8 percent on the data that I have been looking at recently. And they are in a number of areas in the North Island, in particular, Taranaki, Hamilton, Hawkes Bay, even, Nelson-Marlborough, Otago Lakes. So it’s not just Auckland and Christchurch. I mean the housing pressures in terms of price increases have spread outside those regions.

Now where will most of the LV impact likely take place? We think it’ll be where demand for housing has been the strongest. We think it’ll affect mainly—but surely not at all completely, but mainly—the Auckland region. That will be where its primary effect is. People in other parts of the country, in some of the areas that you describe, may well be able to benefit from the
exemptions that we have provided. We haven’t stopped LV lending as, in fact, most regulatory authorities that have introduced LV ratios have introduced moratoria. They just simply said no, you cannot borrow unless you have a deposit of X percent, whatever X might be.

We didn’t want to go to that extent. We wanted to introduce a reduction in the amount of high LV lending and therefore we introduced the speed limit. But we also introduced exemptions around that, so the speed limit’s 10 percent, but the exemptions add another 5 percent. So for example it’s quite possible that some of the first-home buyers in the regions you talk about may well benefit from Welcome Home Loans, for example. But most of this effect, we believe, will be hitting the Auckland market.

Norman If we’ve moved on from LVRs, I wanted to ask about the non-bank deposit takers review. I have a particular interest in the credit unions and the building societies, and, as I understand it, there has been support from that review that the trustee arrangement isn’t necessary for the credit unions and the building societies, because that is one of the problems with the credit unions is that they have got these layers of bureaucracy on top of them, including the trustee arrangement. I’m just wondering whether the Reserve Bank has formed a view about that.

Spencer Well, we did consider that and there were submissions along those lines, but you can’t differentiate across the non-bank deposit takers. We want a model that works reasonably well across the sector, even though that’s made of finance companies, building societies, credit unions. So, you know, there are pros and cons of the different models. We looked at the current model that we have and essentially our recommendation is that the broad structure—the current structure—would be retained, but that it would be improved and made more targeted, streamlined, more efficient in light of the experience we’ve had over the past 5 years.

Yeah, we acknowledge that there are some groups, such as the credit unions who would prefer a different model. They would prefer, say, just to be supervised by the Reserve Bank and not have the trustees involved. But our broad conclusion was to modify the existing regime, which retains the trustees in the front-line supervisor role with ourselves as regulator.

Norman Just following up on that, the credit unions and building societies have a very different risk profile to the finance companies. So it seems to me a bit unfair to dump them all in the same pot, non-bank deposit takers, and say we’re going to regulate them all the same. Surely they should be regulated on the basis of their prudential risk rather than on the basis that they’re just the odd ones on the side, because, as I understand it, your review did describe the credit unions and building societies as bank-like in many respects, so there is a logic to regulating them direct from the Reserve Bank rather than having the trustee approach, which applies to the finance companies. Aside from the issue about whether that worked with the finance companies, why not just regulate them in a bank-like manner?

Spencer Well, actually, you know, as things have panned out in recent years with the demise of so many finance companies, most of that sector is now building
societies and credit unions. So there’s less disparity in that sense between the risky finance companies; you know, there’s only one or two finance companies in the overall net. But, yeah, they’re financial institutions, so they’re bank-like in a sense, but there is this alternative model, which uses elements of the past structure that was in place in terms of many of the deposit-type instruments, essentially being debenture been raised, where funds are being raised under a trust deed, which brought the trustees into this game in the first place.

So that’s our on-balance assessment. But let me ask Mr Fiennes if he has anything to add in this regard.

Fiennes

Not much to add there. I think one reason we came to that conclusion is that credit unions, building societies, and finance companies essentially do the same sort of business in that they take deposits from the public and lend it out and there’s nothing that could give principle to distinguish between the different business models. But in practice credit unions do this quite differently, in that they provide transaction-type services, but there still needs to be a certain type of protection and a certain type of prudential supervision regulation of financial deposit takers. That was the on-balance reading we took.

Norman

Isn’t it the case that credit unions and building societies went through the GFC pretty much intact, whereas the finance companies all fell over and so there is a quite different kind of business structure that we’re talking about. They actually operate under different legislation as well, so that does change the risk profile and hence shouldn’t that be the criterion for how you regulate their risk profile?

Spencer

Well, it’s true that if you have a riskier institution, they will tend to get more attention and they will be more affected by the capital requirements, etc. that are required under the prudential regime. But, you know, credit unions and building societies do carry risk; they are not risk-free institutions. They need to be within the net. In particular, those types of institutions do tend to have quite a significant maturity mismatch on their books in terms of the maturity of their funding—a lot of on-call deposits versus term lending, mortgages, etc. So these institutions do carry risks and they need to be within the net, the prudential net.

Goldsmith

Can I follow up with a supplementary on that. Are you confident that you have beefed up the prudential regime and non-bank deposit takers in insurance? There’s always the risk that you make the regulatory burden too high. You make it difficult for new entrants and smaller players. Are you confident you’ve got the line right there, so that we still have the ability to have new competition, new people bubbling up, and keeping both of those areas competitive?

Norman

Less red tape. Sorry, I was trying to clarify. I’m sure Paul was concerned about red tape constraining competition.

Goldsmith

You’re always balancing those two things.
Spencer  It’s true to some extent, that sort of soundness efficiency type trade-off. In the insurance sector you had some small operators, some potentially risky small operators, some who were using New Zealand as a base to service the Australian market and other markets, and as a result of our new regime basically they have dropped out of the system, closed down, moved off, and I would not say that’s a bad thing.

So, from a soundness point of view, that’s been a plus. But potentially there’s a bigger, initial hurdle to get into the industry if you’re a new player, and that’s, I guess, to some extent unavoidable, but in the insurance sector we have 99 companies, so there’s some pretty good competition there. But that’s a trade-off that we face.

Wheeler  What you’re looking for is an efficient sector and also a market, in essence, that’s contestable and competitive. So in the insurance sector you had, I think, from memory, about mergers, acquisitions, exits from the industry, they probably totalled about 50 to 60 organisations. If you look in recent years, particularly since 2007, we’ve introduced four new banks into New Zealand, in terms of Heartland, Co-op, the Bank of India, and the Bank of Baroda. So you will get these adjustments in terms of efficiencies, shake-outs, but so long as you have a contestable market, that’s tremendously important.

Hayes  At the outset you said, as I recall, the bank ran a profit of $308 million, presumably on the back of currency trading. You gave the Government $175 million. What happens to the other $133 million?

Norman  TAB.

Spencer  Retained earnings, so, building capital.

Goldsmith  Very good.

Twyford  Governor, you’ve talked about the risk of a future sharp correction, and that seems to me to be quite an upping of the ante, from the language that we’ve heard from you more recently, and I wondered if you could explain what you mean by that. What is the risk? How much is the risk? What do you mean by sharp pressure? And are you saying that people are at risk of losing their shirts?

Goldsmith  We’ve had a long discussion over the LVRs in the previous hour.

Twyford  But have you discussed this particular aspect?

Goldsmith  Indeed. But if you could maybe just briefly address that question, because we would like to cover some other areas as well.

Norman  I reckon we tire him out, and in the last half an hour we ask the really hard questions.

Wheeler  It’s a bit of a Colombo act, isn’t it. I was just looking for it. It’s figure 2.4 on page 7, which has corrections in house prices since 1970 that have occurred in advanced economies. If you look at most of those economies, per capita income is higher than New Zealand’s, certainly for the advanced economies,
and these have taken place over the last 30 years. In some of these cases there have been more than one incident within these economies.

What could cause an adjustment here? What could do great damage to the economy and to the financial sector and to the housing sector? The biggest risk, my guess, would be around China. China’s growth has slowed from 10 percent on average, which is what it has been for the last 30 years, and the issue is can it continue to grow at 7 percent or thereabouts. That’s a long discussion and I’m happy to have it outside the room at some point or unless people are interested; I have a number of thoughts on China.

But one of the things that I was reading recently was a report by Fitch, which is one of the rating agencies, which in essence said that if you look at the housing exposure, or the lending exposure if you like, in the US banking system, it totals roughly around US$15 trillion and it has taken the American banking system 235 years to get there.

The Chinese banking system, which includes the formal banking system and the shadow banking system, has got to a delta of US$14 trillion in 5 years.

So there are significant risks around, I think, the Chinese banking system in terms of the bad debts in the banking system—potentially the quality of regulation. You have seen rapid house price increases in China, over several years. You’ve seen several bursts of it. At the moment the monetary authorities are trying to bring it in. But China is now our biggest trading partner. So the biggest potential risk, I think, is probably around China.

Twyford Can I just ask a follow-up to that. You’ve talked about being willing to consider an exemption around new builds if the data justifies that. Warwick Quinn from the Registered Master Builders Federation was this morning talking about unintended consequences of LVRs, basically saying that one of the things that is putting the frighteners on new builds at the moment is that every decision to do a new build is based on kind of a chain of transactions, and all you need is one first-home buyer or one high LVR borrower in the chain somewhere to withdraw, and that has a knock-on effect down the line. He was putting that up as an argument for the fact that actually the consequences of LVRs on new builds could be much greater than was previously thought.

Wheeler There may be some immediate impact from the LVR restrictions, and we are watching the situation quite closely. But if you take high LVR lending on new house construction, it’s roughly $60 million to $80 million a month. Now that’s about 2 to 3 percent of our total banking system lending on housing, which is around $3 billion a month, so it’s 2 to 3 percent.

We expect the demand for new housing to remain strong, for several reasons. The market price of housing is running ahead of the building costs in Auckland and Christchurch. So that’s one reason.

The second, if you look at annual consents for new building, they’re running at 50 percent higher on an annual basis than when they were in the trough in 2011. If you take the month of October, the new building
consents were amongst the highest for the year—in fact, it was the third-highest month.

So there is strong demand for new housing. The LVR restrictions could have some immediate impact while banks make their adjustments to get to within the 10 percent. We will watch the situation closely, but at this point we think demand for new building is still very strong.

Goldsmith Committee members, we have a report from our committee adviser, Brendan O’Donovan, in relation to the Financial Stability Report. We could break for 10 minutes and clear everybody out and have 10 minutes with Brendan. We have got a hard copy and we could just continue. My preference would be just to continue, but if there is a strong desire to—[Interruption] We’ll carry on.

Jones I want to change tack and get a sense from Grant or yourself, Mr Governor, how does the Reserve Bank feel about—and I’m talking about insurance here. Is there anything that we should know or intelligence that you’ve picked up in relation to the reinsurance market? I’m sure they now look at New Zealand with a different risk profile. You’re supervising, which I’ll come to in a moment, existing players. What observations would you share with us, after all, we ourselves as a nation State are reliant on reinsurers, the Zurich Res of this world.

Spencer I think that after the Canterbury earthquakes there were some reinsurers who felt a bit hurt at large claims and backed off the New Zealand market to some extent, which involved unwillingness to back new policies with new customers with some companies. This partly reflected the higher reinsurance premiums. But we did see some reinsurers coming in to fill the gaps. That was the initial period of 2011. More recently, I think, most of the main companies have adjusted and come back into the market, and most of those players who were there pre-Canterbury are still there, in terms of the big, global reinsurers. But one thing that has changed for sure is the cost of reinsurance, which has increased substantially and that’s the main driver of the increase in insurance premiums for housing generally.

Jones The sense that I certainly get is that there’s obviously been a structural shift to a higher level of cost. What are the implications if more and more Kiwis decide not to insure?

Spencer Well, New Zealand is starting from a pretty high rate of insurance. Comparing internationally, we’re up there in terms of being a highly insured country. You’re right, the possibility of that is that this may diminish somewhat—I think it’s a bit too early to tell. The other complicating factor is the fact that it’s the shift that we now have from replacement insurance to sum insured as policies roll over. That may affect it as well.

Jones Just as an anecdote, I’ve been doing quite a lot of visits around the regions, and these are old buildings that I’m referring to. But it struck me as quite worrying the number of people who have basically told me “To hell with it, because I just don’t have the cash-flow to meet the $50,000 insurance bill
and I’ll take my chances, etc.” That strikes me as quite worrying, for us as a country, doesn’t it? Or each fool to their own desserts?

Spencer Well, it’s a choice that companies and individuals make about whether they self-insure or insure in the market, and how much risk they want to take on themselves. You’re right—people make those choices. But at this point, I think it’s a bit too early to say that there’s going to be any significant reduction in the level of insurance in the country.

Jones Has there been much static between the cost of insurance and, obviously, the requirement by the banks on borrowers to make sure that you’re insuring to cover the mortgage that I’m giving you at an increasingly expensive rate, for a house that’s vastly inflated which, according to the governor, is going to come down to somewhere around 2 percent inflation growth each year? We need a bit more in Kaitaia than that, Mr Governor. It might be right for these fullas in Kohimārama.

Spencer With the move to sum insured, the banks have been asked questions—OK, are people really going to have enough insurance, or are they going to become under-insured and therefore affect the bank’s risk?

Jones That is my point, yes.

Spencer That is something they’re watching closely. But I don’t think there’s been any significant increase in that risk to date.

Hayes So how do you decide if there’s market value failure in the insurance sector?

Spencer Well, at the end of the day, different countries do have different levels of insurance cover. We want to see a sound insurance system and an efficient insurance sector. I think we have that at present—

Jones It can be improved, and help is on its way.

Goldsmith Presumably no Government department or Reserve Bank can change the effects of large earthquakes, which have fundamentally changed the cost structures of what we’ve had to do.

Wheeler Chairman, let me introduce Toby Fiennes, who’s the head of Prudential Supervision, and Bernard Hodgetts who is the head of the macro-financial department, who have joined us.

Goldsmith Thank you. Are there any further questions?

Jones Yes, I just want to finish off insurance before we move on, if you don’t mind. I would say that—and I’ll repeat it again—it was a very good briefing that we did have, but when we’re dealing with the public, there’s a sense that the insurers, and they may have failed to convey the right messages, but there’s a sense that the insurers have gouged the victims, etc., of Christchurch. That’s No. 1, and No. 2 is, rather than recover their losses, they’ve ramped everything up to an increasingly high and unrealistic level. When you’re doing your prudential work, are you looking for evidence that a competitor’s not as competitive as it should be, that it’s not as efficient as it should be, or are you looking at just issues to do with solvency, and that kind of statistical indicator regime?
Spencer Safety, solvency, and risk are our prime concerns for the banks and for insurance companies. That is our main game. But we do have an eye to efficiency, and efficiency is our mandate, as well. As Graeme said, the key is to ensure that the sector continues to be contestable, that new entrants are coming and going. So that’s a factor, as well. But in Christchurch, you know, there’s definitely been a hugely complex claims process going on. The unusual things are the multiple quakes and the involvement of two assessors, being the EQC and the insurance company, and trying to apportion between EQC and the company, trying to apportion between the four, five, six different events, has just added hugely to that complexity, particularly in those areas where there’s been ground damage, the TC3 areas, etc.

Jones Well, it is reassuring to hear that you are going to look at efficiency and competitiveness, because if the solvency thing is so burdensome, it actually obstructs new players coming into the market, and I’d hate to see a sort of ossification or hardening up of the current players. Perhaps it is just our curse. We live in the shaky isles. Every one and a half to two generations, the taxpayer is going to have to meet the costs of rebuilding a major part of New Zealand’s infrastructure.

Goldsmith Indeed.

Norman Just going back to the issue of rebalancing, which we’ve canvassed a bit before. But it’s particularly in light of your comments that we’re leading the financial cycle—I understand what you’re saying there—which means we’re most likely to lead the tightening phase of the cycle, as well. If we’ve already got the second-worst current account deficit in the OECD and a seriously overvalued dollar, which is one of the contributors to it, by leading the cycle in terms of interest rates, the effect will be to make that problem worse, will it not?

Wheeler The current account deficit and the level of external debt, which is, I think, behind your question, is something that has been a significant problem for New Zealand for the past 30 years, at least. If you look back over the last three decades, the current deficit has been in the order of 5 percent of GDP. So it’s very significant. That current account deficit basically reflects the difference between the level of savings in the economy and the level of investment. If you look out over the next 2 years, you see, based on our forecasts, at least, strong investment growth. A lot of that is tied up with the reconstruction of Canterbury, which peaks in calendar 2015 and 2016, but also you’ll see strong investment if the numbers in the accords start to eventuate. You’ll see that on the housing side. And you’ve got an economy where consumer and business confidence is at very high levels. So you’re likely to see strong investment. The issue is what happens to savings. In household savings, the data’s often pretty ropey, but household savings have been increasing since the global financial crisis, but the issue is will they continue to increase? So our projections—and the other issue is what happens to the Government’s fiscal position, what happens to dissaving by the Government? Our projections suggest that the current account deficit is
likely to deteriorate over the next 2 years, mainly because the improvement in savings won’t be sufficient to finance the improvement in investment.

Norman But if you’re leading, or New Zealand’s leading, the world in terms of tightening, won’t that—I mean, we’ve discussed this before—add pressure on the exchange rate, which deals with the problem of the imbalances in the New Zealand economy that we’ve talked about—a systemic problem—that it will make it worse if we’re tightening ahead of the rest of the world into next year?

Wheeler It has two effects, really. One is if you increase interest rates, then it might put further upward pressure on the exchange rate, and, therefore, affect the traded goods sector—your exports and your imports substitution. But increasing interest rates also slows down the rate of demand growth in the economy, and potentially the demand for imports to some degree. So there’s a price effect and there’s an absorption effect, if you like.

Goldsmith I’ll just throw in a supplementary on that. When we’re looking in that context of leading into an area of potential tightening, how big a factor is Government fiscal policy? We’ve currently got a Government that’s committed to getting back to surplus and constraining Government spending. Contrast would be another Government that decided this was the time for a significant spend up—

Jones Keynesian.

Goldsmith A Keynesian approach of postponing a return to surplus for, you know, a longer period. How much of a difference would that make to the overall mix?

Wheeler Well, if you saw a strong burst—that’s if you saw a strong burst—in Government spending or an expansion of the fiscal deficit, you’d be saying to yourself: “Well, look, the economy”—to take our forecast for next year—“is growing at 3 percent.” We’ll be revising those, as I say, in the next 2 weeks or so. But if you say that the rate of potential output growth, which I talked about before, might be of the order of, say, 2¼ or 2½, and if you find the Government sector is increasing demand in the economy by running a bigger deficit, then it will put further pressure on the central bank in terms of its interest rate response and potentially will put further upward pressure on the exchange rate.

Goldsmith So the best thing we can do in terms of potential interest rates for next year is to hold the current course, which is to return to surplus, as has been indicated by the Government?

Wheeler I think reducing the level of Government dissaving—so, therefore, moving into, say, surpluses, if that’s the outcome—would be helpful for our current account deficit and would be helpful for interest rates, in a sense.

Bennett Just with the exchange rate that’s been talked about as well, hasn’t that sort of in recent times been a factor of commodity prices, as well? So, you know, it’s easier to say the exchange rate’s going to go up if we do this and the exchange rate’s going to go down if we do that. The reality is that the
exchange rate’s really tracked our commodity prices and what people view our biggest exports are worth on the world market at the moment, isn’t it?

Wheeler Yeah, it’s a very good point. You know, if you take the terms of trade, they’re close to a 40-year high. They’re basically 25 percent above the average of the 1990s. So the terms of trade and a demand particularly for agriculture and especially dairy products is an important part of the story—a very important part of the story, in fact.

Norman So in spite of record terms of trade, we’re still running a record current account deficit. Does that concern you?

Wheeler It’s not a record current account deficit. We’ve been in some pretty tough territory in about 2006 and 2007.

Norman In terms of the rest of the world, we’re second-worst in the OECD.

Wheeler Yeah, we’re second to Turkey at the moment. But, you know, if you ask me whether this is a perpetual problem and say that it would be far better if New Zealand could overcome its current account deficits and reduce its level of external debt, then I would agree with you.

Robertson The issue of money laundering—I am sure you’ve heard anecdotal complaints, as I have as a constituency member of Parliament. Looking at the bank’s supervisory role under the anti-money-laundering regime, I’m just wondering how you will undertake your supervisory role, because we have an international reputation, something that we wish to protect. I’m wondering how you’ll undertake your role, what are the areas that you will focus on, and which other nations should New Zealand be wary of?

Wheeler Let me ask Toby to offer some comment.

Fiennes Sure. You’re absolutely right. One of the prime reasons for doing the AML job is to maintain our international reputation. How we do that? The key thing we do is we go on-site, we visit banks, we visit non-banks and insurance companies, and we verify, basically, that they have good systems in place so that they can detect and report money laundering when they see it. They are fairly detailed inspections. Key things we look for are that they know their customers, that they know their customers’ business, and that they can detect when any activity on a customer’s account is out of line with what would be expected.

Robertson You haven’t answered the last part of the question.

Fiennes Which countries should we be wary of?

Robertson Yes.

Fiennes Well, there’s a list that the Financial Action Task Force maintains of countries whose money-laundering controls are inadequate and don’t come up to the international mark. I can’t give you the full list here, but we can provide it to you.

Robertson Yes, I think that’d be most appropriate.
Back to LVRs, if you don’t mind. The Real Estate Institute said a few days ago that there’s been a noticeable fall-off in interest from first-home buyers, with investors taking advantage of less competition to purchase properties—

We have covered all these questions in the last hour.

I just wondered, governor, whether or not you would—I know that the distributional consequences of LVRs are not your prime concern; it’s properly a matter for the Government. But would you acknowledge that there are distributional effects specifically that more space in the market’s being made available to speculators and investors, as opposed to first-home buyers?

We have covered all these questions in the last hour.

Goldsmith

Twyford

We have covered all these questions in the last hour.

Twyford

I just wondered, governor, whether or not you would—I know that the distributional consequences of LVRs are not your prime concern; it’s properly a matter for the Government. But would you acknowledge that there are distributional effects specifically that more space in the market’s being made available to speculators and investors, as opposed to first-home buyers?

When I answered this question previously, I referred to the evidence we have, which is not very solid. But what we do have suggests that the participation of investors in the market—in the Auckland market is diminished, as well as participation of first-home buyers. So it hasn’t been a matter of simple substitution with investors coming in to take place of the first-home buyer. That evidence was from the BNZ survey taken a couple of weeks after the beginning of the restriction.

Jonno Ingerson from QV last week was saying that they believe, looking at the data that they’ve got, that, in fact, LVRs may have more impact proportionately in the provinces than in Auckland and Canterbury, where almost all the house price inflation is taking place. His rationale was that the demand is so pent up and so intense in Auckland and Canterbury that pulling high LVR borrowers out of the market won’t have much effect because there’s so many other people ready to step into the holes that they leave. Do you have any comments on that?

Well, I would tend to disagree with that because the high LVR lending has been more concentrated in Auckland. We don’t have exact numbers on that. That’s essentially the story we get from the banks. Because house prices are more pressured in Auckland, relative to income—so buyers tend to be harder pressed, so they stretch further. They tend to run higher debt service ratios, higher LVRs. Therefore, we expect that the restriction will have a greater impact in Auckland than in other parts of the country—even though, of course, you’re starting from a higher rate of house price inflation in Auckland than in other parts. But we think there will be a greater impact there because that’s where there’s more pressure.

And in relation to the comments you make and the report on pressure on homeowners in relation to their mortgage payments, are you talking specifically about a risk of negative equity for homeowners?

That is the worst case. If you get a very high LVR borrower who’s up, you know, 95 percent or so, then if you have anything more than a 5 percent reduction in house prices, they get into negative equity. So our action will reduce the likelihood of borrowers getting into that situation.

You are saying it’s a real risk currently, is how I read your work—
Spencer: Well, we’ve not said we don’t think that there’s an imminent likelihood of the housing market falling. We think, you know, it’d take a significant shock that something that we’re protecting against—the potential for shock, say, an international shock, say, with China turning down, the impact that that might have on our export prices and on our asset prices generally in New Zealand, which would then potentially generate the situation you’re talking about. But we don’t see it as an imminent threat. We’re trying to head off or reduce the risk of that possibility in the face of an external shock down the track.

Wheeler: Debt servicing costs will increase, one would expect, just given the fact that interest rates are likely to increase.

Norman: So this is a slightly different issue. So Angel Gurria gave a climate change speech a few weeks ago at the London School of Economics. He talked about stranded assets. So because you can’t burn all the oil and carbon that the reserves that we’ve currently found, if we could take the climate science seriously, the result is that we’re going to end up with a bunch of stranded assets—these oilfields and coalfields that can’t be burnt. And then there’s the issue about what will be the impact on those companies that are exposed to it. So AMP Capital has done an analysis of the ASX 200 and the NZX 250, and said about 15 percent of the companies in those indexes are highly exposed to the problem of stranded assets and unburnable carbon, as it’s called, with the AMP Capital analysis. Has the Reserve Bank looked at what will be the exposure of the Australasian banks if we run into a situation where a lot of the investments in fossil fuels become unburnable because, as Angel Gurria says, it’s better to have stranded assets than a stranded planet was his language, which means that a lot of these oil and coal companies, the real value of them is significantly less than they are currently listed at. That will help have a kind of cascading effect on those that are investing in them. Have you given any consideration to the exposure of the Australasian banks to that kind of problem?

Spencer: Well, we haven’t really looked at that issue. But I would say, I mean, there’s not a huge exposure of New Zealand banks to the oil and gas industry. I mean, even thinking about the Australian banks and you think about the major investment projects that are going on at present or actually have been going on in recent years, most of those have been funded by project financers, through project financing, through syndicated deals, etc., largely from offshore, rather than being funded by the Australian big four domestic banks. In that sense, if that theory has substance then I wouldn’t be too concerned that the Australian banks have a massive exposure to that industry, even though that industry is a major part of the Australian economy.

Wheeler: It sounds an interesting speech. We’ll certainly look at it.

Norman: It’s a great speech. So it’s a kind of quantity issue. You’re saying how exposed are they to these fossil fuel companies, and then what is the genuine risk in terms of them suffering some kind of depreciation or writing down of the value of their underlying assets.
Goldsmith  Members, we’ve had a pretty full discussion. I think we’ve covered most of the bases.

Jones   It’s been like cricket. We tried to bowl, but the governor, following in the footsteps of earlier governors, has been belting it all over the place.

Wheeler   I believe we won with three balls to go today.

Goldsmith   Thank you very much for coming and for your time. We appreciate it immensely.

**Conclusion of evidence**
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Retirement Commissioner

Recommendation

The Social Services Committee has conducted the financial review of the 2012/13 performance and current operations of the Retirement Commissioner, and recommends that the House take note of its report.

Introduction

The Retirement Commissioner is a Crown entity created by the New Zealand Superannuation and Retirement Income Act 2001, but the commission itself was established in 1993. Its official name is the Retirement Commission, but it operates as the Commission for Financial Literacy and Retirement Income.

The Retirement Commissioner and her office seek to improve people’s financial literacy and financial preparedness for retirement. The commissioner also has a responsibility to review retirement income policy, and monitor the legislation governing retirement villages.

Performance

In 2012/13 the commission’s total revenue was $6.233 million and its total expenditure was $7.137 million, resulting in a deficit of $904,780. Although the commission operated within baseline funding levels, it intentionally increased its expenditure to reduce its accumulated reserves. The Ministry of Business, Innovation and Employment expected the commission to do this.

The Office of the Auditor-General rated the commission’s management control environment, and financial information systems and controls as “very good”. The commission’s service performance information and associated systems and controls were rated as “good”, and several recommendations for improvement were made. The office recommended reviewing performance measures to ensure they are sufficiently defined and adequately cover its outputs, and including historical or comparative trend data in annual reports to allow more accurate assessment of the commission’s performance.

National Strategy for Financial Literacy

The commission provides the secretariat for the National Strategy for Financial Literacy, which sets the direction for improving financial literacy in New Zealand, and coordinates various financial education initiatives. It defines financial literacy as the ability to make informed judgements and effective decisions about financial matters.

The commissioner told us that improving the financial literacy of New Zealanders is the commission’s main focus. To this end, it increased its expenditure on marketing and education in 2012/13, rolling out new phases of the Sorted marketing campaign, Thinking, Shrinking, Growing, and developing a KiwiSaver Fund-Finder tool for the Sorted website. In September 2012, it also hosted the first ever “Money Week”, which included more than 100 financial education events throughout the country. We queried the commission’s ability to manage expectations of it as a leader in the sector, since these initiatives were funded out of reserves and it is not in a financial position to continue making such large investments. We were told that some investments were one-off expenses to produce material the
commission can continue to use. Others, such as the Fund-Finder tool, are expected to incur only maintenance costs after initial development. We were also told that the commission engages with private-sector stakeholders, developing pilot initiatives to promote financial literacy, while employers and other stakeholders will sponsor their expansion.

**Effectiveness of programmes**

We asked how the commission evaluates its effectiveness. Clearly it is difficult to measure the quality of peoples’ financial decisions, and many factors influence them, including circumstances such as the global financial crisis. That said, the commission examines five or six indicators to evaluate its initiatives.

The commission assesses the effectiveness of the Sorted website by evaluating data on the number of people accessing the site, the amount of time they spend on it, and the number of times each of its online tools is used. A December 2012 survey of 500 site users found that 50 percent of them had taken positive financial action as a result of Sorted’s messages, most often by controlling unnecessary spending, managing debt, and creating a budget or other plan.

The commission also evaluates the tangible outcomes of its pilot initiatives. An independent evaluator was employed to assess the effectiveness of a pilot which aimed to improve the financial literacy, wellbeing, and education of 2,000 Pasifika families in Tāmaki. We heard that the outcomes of the pilot at eighteen months were encouraging. For example, three of the families involved had saved $10,000, a number of people had stopped smoking, and there were reports of changed eating habits leading to savings for households.

In addition, the commission measures financial literacy every four years by administering the Financial Knowledge and Behaviour Survey. The 2013 survey of a national sample of 852 adults indicated that New Zealanders rank well among OECD countries in terms of financial knowledge, and that their management of debt, budgeting and planning ability have improved. The results of the survey allow the commission to target the areas of financial knowledge in which New Zealanders could benefit from further education.

**Educating vulnerable groups**

Although the 2013 Financial Knowledge and Behaviour Survey showed an increase in the financial literacy of Māori and Pasifika people, these groups remained less financially literate than other ethnic groups in New Zealand, and particularly vulnerable to predatory lenders. We asked what the commission was doing to address this vulnerability, and were pleased to learn that a Māori and Pasifika Education Adviser role was created in 2012/13. The commission works with Māori and Pasifika people in existing pilot projects, and is discussing future initiatives for working with Pasifika people with the Ministry of Pacific Island Affairs. We also heard that the commission is carrying out work to improve its effectiveness with other ethnic groups.

**Monitoring retirement villages**

The Retirement Villages Act 2003 requires the Retirement Commissioner to monitor retirement villages. The commissioner said this is an important area of work, particularly as New Zealand has an ageing population and the number of people living in retirement villages is forecast to rise.
At the financial review hearing in 2011/12 we were told that the legislation governing retirement villages needed to be reviewed, and that there were a number of persistent issues in this area: communication between retirement village operators and residents, the disputes process, transparency regarding fees, service charges and maintenance, and the quality of the available information. We raised once again the desirability of legislative reform. The commissioner said she considers certain aspects of the legislation could be improved. The commissioner told us, however, that she is not convinced of the necessity for legislative reform, and questions whether there are systemic issues in the sector, or whether the issues that arise are par for the course and can be resolved via already available avenues. We were pleased to hear that the commissioner liaises with key stakeholders, such as the CEOs of facility operators, and is seeking a better understanding of issues in the sector.
Appendix

Approach to this financial review
We met on 19 March and 14 May 2014 to consider the financial review of the Retirement Commissioner. We heard evidence from the Retirement Commissioner and received advice from the Office of the Auditor-General.

Committee members
Melissa Lee (Chairperson)
Hon Phil Heatley
Jan Logie
Le’aufa’amulia Asenati Lole-Taylor
Hon Peseta Sam Lotu-Iiga
Sue Moroney
Alfred Ngaro
Dr Rajen Prasad
Mike Sabin
Hon Chris Tremain
Louisa Wall

Evidence and advice received

Commission for Financial Literacy and Retirement Income, Responses to written questions, dated 11 April 2014.
2012/13 financial review of the
Social Workers Registration Board

Report of the Social Services Committee

The Social Services Committee has conducted the financial review of the 2012/13 performance and current operations of the Social Workers Registration Board, and has no matters to bring to the attention of the House. The committee recommends that the House take note of its report.

Melissa Lee
Chairperson
2012/13 financial review of Solid Energy New Zealand Limited

Report of the Commerce Committee

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Solid Energy New Zealand Limited

Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 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, a state enterprise, 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 for the steel, dairy, and cement industries. Solid Energy has mines in Huntly, the West Coast, and Southland.

The interim chief executive of Solid Energy was Garry Diack. Since our hearing a permanent chief executive, Dan Clifford, has been appointed. Mark Ford stepped down as chairperson of the board in early March 2014; we thank him for his service. The interim chairperson is Pip Dunphy.

On 1 October 2013 the Minister for State Owned Enterprises announced that Solid Energy would receive $100 million of Crown funding, with the aim of returning the company to a viable financial position.

Financial and service performance

In 2012/13 Solid Energy generated total revenue of $631.1 million, a significant decrease from $978.4 million in 2011/12. The fall in revenue can be attributed to a strong New Zealand dollar, and international coal prices continuing to fall. The company recorded a net loss of $335.4 million (compared with -$40.2 million in 2011/12). Profits were reduced by asset write-downs and one-off costs relating to restructuring and closures.

The Office of the Auditor-General graded Solid Energy’s management control environment as “good”. The grade fell from “very good” in 2011/12, which was mainly attributed to the loss of some corporate knowledge as a result of restructuring.

Coal prices

We asked Solid Energy how it plans for changes in coal prices. We were concerned that a lack of risk management had led to Solid Energy’s recent financial struggles, and we hoped that steps had been taken to avoid similar problems in future. Solid Energy acknowledged that it had been overly optimistic in the past, but it now takes a more conservative position based on external advice and market information. It is also subject to monitoring by the Crown and its banks. We were told that Solid Energy has a “constant dialogue” with the responsible Minister about the low price trend for coal and its consequences.

We asked why Solid Energy uses hard coking coal prices as a benchmark when it produces semi-hard coking coal. We heard that hard coking coal still accounts for 66 percent of its export volumes and therefore forms the basis of its planning, but it is trying to move in favour of semi-hard coking coal. It believes that its business can be sustainable with a hard coking coal price of US$140 to $150 a tonne, but the current price is only US$119.
We asked Solid Energy to elaborate on the processes it uses to ensure its forecasts of prices are reliable. It told us that it relies on external advice for forecasting, thus avoiding internal bias. It monitors the forecasts to stay as up-to-date as possible. Forecasts are compared with previous prices to determine the variance between forecast and actual prices.

Current forecasts indicate that it will be some time before coal prices reach levels sustainable for Solid Energy, and it forecasts operating losses for the next two to five years. We asked whether Solid Energy had planned for the possibility that coal prices might not recover to pre-2012 levels. Ms Dunphy told us that the board would be looking at a low-price scenario in their next round of budgeting, and mining plans would be altered where necessary.

Effect of the price downturn on the mining industry

We were interested in the effect of the price downturn on the coal mining industry as a whole. Mr Diack said the entire industry had felt a prolonged negative impact; Solid Energy’s major competitors in Australia and the United States had shed several thousand jobs. We heard that some Australian companies were mining coal at pre-2012 rates because the exit costs of their rail and port contracts were too high to lower production. The resultant oversupply of coal has had the effect of further lowering the price. It was said that other mining companies appeared to have reacted more quickly to the downturn than Solid Energy. Mr Diack said he did not have sufficient information to comment but believed all industry players were forced to move quickly.

Forecast price path

We noted that Solid Energy’s forecast price trend from 2008 to 2012 appeared optimistic compared with the cited consensus path of brokers.1 We were told that the main considerations that affected Solid Energy’s forecast were the price of crude oil and China’s steel industry. In 2006/07 it appeared that the prices for crude oil and coking coal were linked, but these markets have since diverged. From 2006 to 2008 China was developing its steel industry rapidly and had a huge capacity for coal. Although demand for coal remained high, China’s domestic coal production also increased. Supply from Australia also increased significantly, which resulted in a lower coal price than forecast. Solid Energy maintains that there is a risk of insufficient supply in the future as investment in coal production has temporarily halted.

International markets

We asked about the state of the international market and the competitiveness of Solid Energy’s product. Its coal is very low in ash and phosphorus, which makes it desirable for steel-making. Solid Energy therefore has a “niche” position in India, Japan, and China, which are its biggest markets. Ms Dunphy said that the board and management believe Solid Energy remains a viable business.

Alternative energy sources

We asked Solid Energy what consideration it gives to the prices of alternative energy sources. We heard that about 90 percent of Solid Energy’s export trade is in the coking coal market, which is less affected by alternative energy sources than softer coals and remains strong. Solid Energy is gaining a lot of new business in Asia, and demand from current customers continues to grow. However, it acknowledges that shale gas and other

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alternatives are making a large impact on the market for softer coal and this trend is expected to continue.

**Company culture**

We asked Ms Dunphy if she had confidence in the current Solid Energy management, despite the unsuccessful diversification strategy. Ms Dunphy said she has confidence in management. We were told that most of the executives responsible for the failed strategy are no longer with the company and the culture of the business had changed significantly since the downturn, with cost management to the fore.

**Staff remuneration**

We asked Solid Energy about salaries and bonuses, particularly those paid to senior executives. Just over $22 million was paid in performance payments over the 2011/12 and 2012/13 financial years. Following the organisation’s large financial losses over several years, we asked if its spending had become more conservative. Solid Energy has reviewed all staff salaries, and senior executive and corporate staff contracts have been renegotiated. General individual contracts no longer have a bonus component, but a small number of executives may earn a bonus of between $40,000 and $50,000, at the discretion of the board. Staff on collective employment agreements can earn bonuses of 8 to 10 percent, based on the performance of particular sites.

**Corporate headquarters**

Solid Energy’s head office is in Christchurch; Mr Diack acknowledged that both the office space and the street were renowned for being “showy”. We heard that the lease runs for another six years and commercial real estate rates in Christchurch are relatively expensive. Solid Energy has sublet half of the office space after reducing the number of corporate staff. Some health and safety and planning positions have been moved to the West Coast but Solid Energy does not intend to move its head office there, for strategic reasons.

**Asset sales**

We asked if former staff had acquired large assets from Solid Energy. We were told that the sale of assets related to Biodiesel New Zealand was managed independently by Deloitte. Solid Energy said that one former manager acquired assets, but had previously declared the potential conflict and was not involved in the sale process. Two other employees formed part of a larger group that purchased fuel division assets in 2012.

**Community sponsorship**

We asked if Solid Energy had continued to provide sponsorship for communities. We were told that almost all sponsorship had been halted because of limited cash flow; Ms Dunphy said that Solid Energy was still conscious of its obligations to communities.

**Gearing**

We asked whether the company would be in a better position today if gearing in July 2012 had been lower than 10 percent (the same as other mining companies at the time). Gearing is the ratio of a company’s long-term debt to its equity. Ms Dunphy acknowledged that for a commodity-based company high gearing levels represented high risk because commodity prices and currency are variable. We were told that if debt had been lower in 2012, Solid Energy would have been more resilient to the price drop and would be in a stronger position today. However, Solid Energy said that typical gearing currently ranges between 20...
and 50 percent in the mining sector. We noted it has forecast gearing in excess of 70 percent from 2014/15 onwards. When Solid Energy negotiated with banks in 2013 they had forecast a significant reduction in debt within two years; this may not be achieved if coal prices remain at current levels.

**Accountability**

We asked Solid Energy who should be held accountable for the financial and job losses. Ms Dunphy said that she was aware the previous chief executive, Dr Elder, had apologised during the organisation’s financial review hearing last year. As acting chairperson she and the board take responsibility for decisions made since they joined Solid Energy. However, Ms Dunphy could not assure us that if she had been a member of Solid Energy’s board in July 2012 the end result would have been different.

**Pike River mine**

We requested further information about Pike River; Solid Energy has responsibility for the mine and recovery of the 2.4-kilometre coal drift. Solid Energy said that their first priority was to stabilise the mine’s atmosphere, which has been partially achieved by placing a temporary seal in the drift and the ventilation shaft. Once this seal has been concreted, recovery of the drift will be possible. This work is expected to be completed within two months. Funding from the Government will cease upon recovery of the drift; Solid Energy reports its progress weekly.

Ms Dunphy said that the decision on whether to enter the drift had not yet been determined by the board. The licence for the coal is held by Solid Energy but developing the Pike River mine would not be economically favourable until the coal price increased to US$200 per tonne, which is not expected until 2021. We heard that the costs of accessing the coal at Pike River are very high.

**Investment in mining**

We noted the high level of investment in mining in Stockton and Huntly East and asked if this had affected Solid Energy’s continued viability. Mr Diack said that without this investment Solid Energy would not have been able to remain competitive in the coal export market throughout the downturn. However, he acknowledged that the company had taken on a high level of debt.

**Spring Creek mine**

We noted that Spring Creek mine ceased production in 2012. Solid Energy is undertaking a feasibility study for resuming mining at Spring Creek because the ash content of its coal is extremely low, making it desirable for the manufacture of silicon and ferroalloy. This creates an opportunity to enter a high-value market, which could be worth up to US$100 more per tonne than coking coal. However its potential will be limited until coal prices increase internationally.

**Indian coal interests**

Mr Diack confirmed that he and another senior executive had met the Indian Minister of Steel during his recent visit to New Zealand. We heard that it is common for Solid Energy to discuss coal supply and mine investment with stakeholders. We were told that the meeting with the Minister of Steel was an informal lunch and no minutes were taken.
Asset impairment
We noted that Solid Energy is divesting a number of projects unrelated to its core coal-mining business, and asked if further impairment to assets was expected. At the end of the 2012/13 financial year Solid Energy reviewed the carrying value of their assets; it does not expect its Southland briquetting plant and underground coal gasification project to sell for more than scrap and land value. However, the company believes its wood pellet plant and related land may receive a reasonable offer. Solid Energy does not expect any impairment against its land assets.

Auditor-General’s assessment of certain governance and management issues
We sought specific information from the Office of the Auditor-General on Solid Energy’s governance and management to augment its advice to us on this financial review. Our areas of interest covered

- Solid Energy’s investment in the Stockton mine of $128 million for the coal handling and processing plant and in the Taupō wood pellet plant
- coal prices adopted by Solid Energy
- Solid Energy’s response to drops in the price of coal.

We note the office found that the Stockton mine project was handled well. Solid Energy senior management had provided the board with adequate information to assess the project (including its risks), approve funding, and monitor progress. It is a concern that the office’s review of the Taupō wood pellet project found that Solid Energy’s risk assessment was insufficient, and calculations of the continuing operational costs of the plant were deficient.

The Auditor-General told us that Solid Energy’s forecasts of coal prices in the five years the office reviewed were found to be generally higher than those of other analysts; however the company’s estimated price often proved more accurate. We understand this was because coal prices had been declining since the beginning of 2011 and whilst Solid Energy had a forecast range, its low base did not take into account a “worst case” scenario. We agree with the Auditor-General that factoring a worst-case price into risk assessment would have been prudent.

We note the Auditor-General’s view that Solid Energy could not recover from the coal price downturn in July 2012 because of its high level of debt. Although some action was taken by Solid Energy’s senior management and board in response to the price drop, this was not wholly apparent to other parties, including the Treasury.

We asked the Auditor-General who should be held accountable for Solid Energy’s financial losses and consequent job cuts. The Auditor-General said that in a company the board of directors is responsible for its commercial strategy and performance. Senior management is responsible for the implementation of the board’s strategy. It was noted that many Solid Energy board members and senior executives present in mid-2012 had since left.

We asked whether government monitoring agencies received adequate information from Solid Energy. We were told the Office of the Auditor-General did not scrutinise this area, as Deloitte had already undertaken a review of the Treasury’s monitoring. However, the report found that although coal prices were being debated, there was little planning for a sudden drop on the scale of which occurred in July 2012.
We questioned how Solid Energy could have been expected to plan for a worst-case scenario when many in the industry were surprised by the downturn. We heard that the coal price has been volatile for decades, and therefore companies exporting coal should have exercised prudence when assessing risk.

We asked the Auditor-General if Solid Energy’s gearing was too high. We note the comments of the Auditor-General that in terms of risk management gearing should allow room for a drop in profit, which Solid Energy did not have in July 2012.

To conclude, we agree with the Auditor-General that the impact of declining international coal prices on Solid Energy’s performance could have been mitigated had there been

- clear communication between the shareholder, senior management, and the board
- industry expertise at the senior management and board level
- more prudent investment in core assets
- better scoping and management of projects
- scepticism when assessing risk.

**Labour Party minority view**

Labour members thank the Auditor-General for initiating an inquiry into the near collapse of Solid Energy. We note that her inquiry addressed decisions and possible failures at a board and management level but did not address any issues pertaining to the accountability and lack of action taken by shareholding Ministers. We note that shareholding Ministers were, at all times, well informed of all actions taken by the then board, and this is evidenced by the extensive information which the Government has released from its advisers including the Treasury and UBS (the consultants who conducted the scope of the study to initiate the sell-off of Solid Energy). We note further that shareholding Ministers had the power at all times to intervene in Solid Energy’s activities and decisions by changing the scope of corporate intent, and/or removing the then board. At no time did shareholding Ministers take any action, as noted above.

It is distressing that taxpayers will never gain a full and factual account of the events and decisions which led to the near collapse of this state owned enterprise, a near collapse which has led to over 800 employees losing their jobs to date and losses of approximately $400 million. In the view of Labour members the Government should have initiated a full and open inquiry to establish what went wrong and who is responsible. However, the Government, and Government members, chose not to hold an independent inquiry, nor to refer any matters to the Auditor-General. It is the strong view of Labour members that the Government blocked the Commerce Committee at all stages from enquiring into these matters. Labour members hold the view that it is grossly irresponsible of the Government as they owe a duty of care to the taxpayers of New Zealand for assets for which they are responsible.
Appendix A

Approach to this financial review
We met on 6 March, 20 March, and 8 April 2014 to consider the financial review of Solid Energy New Zealand Limited. We heard evidence from Solid Energy New Zealand Limited, received advice from the Office of the Auditor-General, and heard evidence from the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Evidence and advice received

Organisation briefing paper, prepared by committee staff, dated 23 December 2013.

Solid Energy New Zealand Limited, clarifications to questions, received 17 March 2014.

Solid Energy New Zealand Limited, handout for hearing, received 5 March 2014.

Solid Energy New Zealand Limited, responses to written questions, received 11 February and 17 March 2014.
Appendix B

Corrected transcript of hearing of evidence 6 March 2014

Members
Jonathan Young (Chair)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Catherine Delahunty
Kris Faafoi
Mark Mitchell
Hon Damien O'Connor
Hon Chris Tremain
Jian Yang

Witnesses
Pip Dunphy, interim chair to the board, Solid Energy
Andy Coupe, director to the board, Solid Energy
Garry Diack, interim chief executive, Solid Energy
Bill Luff, chief strategy and marketing officer, Solid Energy

Young I'd like to welcome you to the Commerce Committee, and thank you very much, Ms Dunphy, for your appearance, and just acknowledge that Mr Ford can't be here. We'd like you to introduce your team and then we will quickly introduce the committee to you.

Dunphy Thank you. I'm here in my—

Cosgrove Sorry, this presentation will be how long?

Dunphy It's not very long. I'm here in my capacity as interim chair. Beside me I have Andy Coupe, who has recently joined the board late last year and chairs our finance and risk committee, audit and risk committee. To my right is our interim chief executive, Garry Diack, and Bill Luff, who is chief strategy and marketing officer.

Young Right, thank you. We'll just go quickly around the table to introduce ourselves. [Introductions] Welcome, and look, if we could ask you to do your initial presentation for 5 minutes, that would be great. Thank you.

Dunphy As I mentioned, I joined the board in December 2012 and Mr Coupe joined the board in November 2013. For the last 12 months the board’s main focus has been agreeing the refinancing arrangements and restructuring the business to ensure our ongoing viability. We would like to acknowledge and thank all those involved.

We understand you have just received the Auditor-General’s report. Should you wish to look back, we will attempt to answer or provide an answer. I
hope you will understand that the directors here today have limited capacity to discuss decisions made prior to our joining the board.

Cosgrove
Sorry, could I just ask a procedural question. Presumably you have officials with you—Mr Diack and co.—who can provide information, given that they were there at the time.

Dunphy
That is possible. Mark Ford is not with us today. He stepped down as chair last week for health reasons. I’m sure he would have been here had he been able because he and the rest of us on the board believe the company has made substantial progress towards securing a future for Solid Energy. Mark’s leadership since he was appointed chair in August 2012 has been critical to laying the foundation for achieving this goal.

On Friday we announced our results for the first 6 months of the year. Weak global coal markets have impacted our revenue. However, as we increased our export tonnage by 180,000 tonnes, export revenue was down only $7.6 million. Domestic customers purchased 600,000 tonnes less than last year, resulting in $80 million less revenue. These declines in revenue were offset by operating cost being approximately $40 million less. The net result was an NPAT loss of $40.9 million for the half-year to December 2013. We almost broke even on our operating cash flows, an improvement of almost $55 million over the comparable period. In June 2012 the cash cost per saleable tonne of coal was NZ$179 a tonne. By December 2013 this had reduced to NZ$125 a tonne. This is a significant achievement, but we may need to dig deeper if prices remain weak or fall further.

Solid Energy has changed significantly since the committee reviewed us a year ago. The business is now almost exclusively refocused on its area of core expertise: developing, mining, and marketing coal to customers in New Zealand and overseas. I say “almost” because we’re still in the process of exiting the investments which are no longer part of the core company strategy. Selling the surplus land in Southland is an example of this. Since Solid Energy last appeared before the committee, we have concluded an agreement with the Crown and our major lenders based on this strategy.

We appreciate the support received from Government and our banks and bond holders to enable us the opportunity to turn the business around. We are subject to a high level of reporting and scrutiny from our banking group and the Crown. We provide monthly financial updates to both parties by KordaMentha to ensure we stay within our agreed parameter. We have a clear set of financial and non-financial requirements to enable us to retain the support of our banks and the Crown.

Our result for the half-year was better than expected. In other words, it was better than we had anticipated at the time the refinancing package was agreed. That is because the company has made good progress in reducing cost and has responded to the falling coal price by not spending our budgeted capital expenditure, and taking advantage of our lower-cost resources. We are conscious there is still more work to do to improve margins in order that the company can survive this low-priced environment.
On the revenue side, global coking coal prices determine about 60 percent of the company’s revenue. We export approximately 2 million tonnes annually. The international seaborne market is estimated to be 278 million tonnes, so Solid Energy represents a mere 0.7 percent of the market. We therefore have no capacity to influence pricing. Today the market is oversupplied with excess coal, particularly in China, the largest import market. In the middle of 2012 the market dropped suddenly from about US$224 a tonne to US$142 a tonne by October. Today the spot price for hard coking coal is US$119 a tonne. The average benchmark price for hard coking coal we have agreed for our exports up to the end of December averaged US$148.5 a tonne. That is equivalent to NZ$182, and this is slightly lower than our budgeted benchmark rate of NZ$184.

Our major customer base has remained loyal, and we are still able to get firm ongoing commitments for future shipments. This allows us to plan our production with confidence, knowing we can fix export tonnage. However, we are exposed to changes in market prices.

Domestic sales make up the other 40 percent of our revenues. The 600,000 tonne downturn in sales in the half-year was due to reduced off-take from our domestic customers, reflecting the transition of our long-term contracts with our major North Island customers. Since the committee last reviewed us, we have renewed about 1.1 million tonnes of business, primarily as a result of concluding 4-year supply agreements with our two major North Island customers: Genesis Energy and New Zealand Steel. In addition, we have written nearly 150,000 tonnes a year of new domestic business. We are actively seeking new business as we expand two of our South Island mines.

At an operational level, all mining operations are being reviewed to ensure we can supply our customers to their specification at the best possible prices. Our mines are continually looking at how they can work more efficiently. The company continues to improve its health and safety performance, despite the uncertainty and the distraction that restructuring and redundancies inevitably cause.

Lastly, the outlook: on Friday again we noted that our plans anticipate that any improvement in international pricing for our coal could be some time away and likely to be slow when it begins. The board and management is using a reputable international market analyst as a source of our forward-looking coal pricing. At the same time we are testing the reasonableness of this advice.

Similarly, for forward-looking currency forecasts we are using an average of New Zealand bank providers for the first 2 years, then applying a more conservative judgment for the longer term. In addition to adopting this approach we will also be testing the downside scenario in the event the timing of, or speed of, the recovery differs from our forecast.

Finally, to date Solid Energy has not needed to call on either of the two $50 million secured facilities or the $30 million working capital facility made available by the Crown as part of the refinancing agreement. We will be continually monitoring the markets and will continue to restructure to give
us the best chance to ride out this dip in coal prices and relative strength of
the New Zealand dollar to return us to a sustainable business. In the event
coal prices do not improve, a further review of our costs and carrying value
of our assets is likely.

Thank you for this opportunity to outline where the business is. I now look
forward to answering your questions.

Young Thank you very much, Ms Dunphy, and we have got a number of
questions, of course.

Cosgrove Just before I start, could I just acknowledge Mr Ford, and if you can pass
on our thanks. For the record, I note—am I correct—that Mr Ford has not
taken any board fees for his chairmanship at the helm of Solid Energy? Is
that correct? He hasn’t received any personal remuneration?

Dunphy No—

Cosgrove He hasn’t received any board fees, as I read it here. Is that right?

Dunphy I think not personally.

Cosgrove Not personally.

Dunphy Not personally—that’s correct.

Cosgrove Well, I’m just staggered. I think we should thank him for services. It’s quite
unusual that that would happen. Could I just ask, just for the record, have
we got any lobbyists or any other ancillary people in the room from Solid
Energy? Anybody on $48 grand an hour, just like we did last time? No?
Great. Mr Diack, I’m going to ask you—

Tremain What’s the purpose of that question?

Cosgrove Well, we had Saunders and Unsworth on $48K an hour to give these boys
select committee advice. The question is this, and it’s a very pointed
question. Will you be telling us the truth today in all matters that we
discuss?

Diack I will.

Cosgrove The reason I ask for that is your conduct over Mr Eldler’s appearance was
less than truthful at the last meeting. So you’re giving us that commitment.

Young I think that’s a very strong allegation.

Cosgrove It’s not an allegation.

Diack Yes it is.

Cosgrove It’s on the record. I’m just asking—

Young And he answered you.

Cosgrove Can I ask you, Ms Dunphy, and I acknowledge that you weren’t in the
position, but you have been on the board for a period of time, and this is a
financial review. And whilst you are not, and your colleague is not,
responsible for what went before, we do need to seek your advice and your
insight as to what happened. You will be aware that the Auditor-General—
it’s public information—has done an additional set of inquiries over and above what is the norm regarding this organisation given the serious state that it is, 800 jobs gone, the loss of $136 and $270 million respectively. I’d like to ask you: has the culture in Solid Energy changed in terms of what I would term extravagant expenditure that went before?

Dunphy Well, I can answer, and I might also ask Garry to answer. But, in my view, we have put in place a series of policies and procedures that will not allow that to happen. The environment in the company—everyone understands the predicament that the company is in and is responding accordingly.

Cosgrove Given that, I appreciate that, but could I refer to the annual report, page 68, where, looking at salary scale, the highest salary in 2012—well, there are 13 people earning, currently, as I understand it, on the 2013 figures, over $500K, and in 2012 there was one individual earning between $1.42 and $1.43 million. This year there’s one individual getting, or maybe has got, $1.45 to $1.46 million—and I think we might guess who that might have been—and the next highest salary is around $1.3 million. Now, without being crass, one can only conclude that’s the acting chief executive. My question would be: why is an acting chief executive on that level of salary when a permanent position hasn’t been found, and will the permanent position’s salary be reduced?

Dunphy Well, I can answer this. This does not reflect the acting chief executive’s salary.

Cosgrove Which one doesn’t? Which of the three figures?

Dunphy Well, as you’ve correctly identified, these all reflect payments in the prior period because of the bonus payment that was made at the end of 2012.

Cosgrove Which bonus payment was that?

Dunphy There were bonus payments made to staff according to their contracts.

Cosgrove That’s the $23 million—

Dunphy That was the one at the end of 2012 year.

Cosgrove Was that the $23 million one?

Dunphy I’m sorry, I don’t know the amount.

Diack I’m not sure of the figure, but I can address a couple of these issues for you.

Cosgrove No, no—Ms Dunphy’s raised an interesting point. You outlined a bonus regime—as I recall there was a large bonus of $23 million. Are we talking about the same one, or are we talking about additional?

Diack I believe we’re talking about the same one. These are the bonus payments that were paid for the 2012 year. They were paid at the conclusion of the year, so they fall into the 2013 accounts.

Cosgrove And the salary issue?

Dunphy All the salaries in the company have been reviewed, and all the senior executive team and the corporate office team have had their individual employment contracts renegotiated.
Cosgrove: And, without again breaching anyone’s privacy, what’s the average percentage reduction?

Dunphy: I don’t have that number. I think what the numbers reflect is an entitlement to a bonus payment that was in the previous contract, which is not in the current contracts.

Cosgrove: So is there still a bonus component, or is there no bonus?

Diack: There’s no bonus component in the general individual contracts anymore. There’s the opportunity for three or four executives to earn a small bonus based on the discretion of the board. So the bonuses have essentially been taken out of all the employment contracts.

O’Connor: What would be a small bonus, because it might be viewed differently for a coal miner.

Diack: There’s the opportunity to earn up to $40,000 to $50,000 for about five people.

O’Connor: Small bonus: $40,000 to $50,000.

Cosgrove: And presumably those five people are executive people, or are they people in the pit?

Diack: They’re executive people. And as we stand now there’s still the opportunity for collective employment staff to earn bonuses on site performance.

Cosgrove: And what sort of scale are the bonuses for the people who are actually doing the work in the pit?

Diack: They’re about 10 percent, 8 to 10 percent, depending on—there’s no definitive view that you can run across everybody, because they’re all different. But it’s in that order.

Cosgrove: Could I ask you about the coal price issues that you faced previously, because in the report that we’ve received the analysis is that you guys refused to accept the worst case scenario and plan and risk manage around that in terms of the coal price heading west. In fact, the advice that we’ve received is that the emphasis that Solid Energy had was a debate about what the price will be, not a debate about trying to manage the path of that price if it was to go up or down. To a large extent, that lack of risk management and oversight has led you to where you are. Can you comment on that?

Diack: I’m going to refer this on to my colleague Bill, who was involved in these things.

Luff: I think that the comments are fair. I think we had an optimistic view of forward coal prices. I think as the report from the Auditor-General does indicate, we did have a range of forward prices, including a low one. One could argue in hindsight that low one was, in itself, optimistic. I think we recalibrated our view going forward. We’re relying on external advice, both in terms of describing the top and the bottom of a range, and our short-term planning is very much focused on where the market is going.
Tremaine: I want a couple of supplementaries in this area, please. Price is obviously clearly very important going forward. What is a sustainable price for coking coal going forward?

Dunphy: For our business?

Tremaine: For your business.

Dunphy: I’ll just ask Bill to answer that question.

Luff: As a result of the cost efficiencies that the chairman talked about, we believe that we have got a sustainable business with the hard coking coal price now around US$140 to US$150.

Tremaine: US$140 to US$150. And at the moment it’s at $118? Did I hear that correctly?

Luff: It’s at $119.

Tremaine: What is that down from? So if your sustainable price, for US dollars, for hard coking coal now is $140, what did it used to be?

Luff: If you take the cash cost comparisons with the end of FY12, that number is about NZ$50 a tonne less.

Tremaine: So you’ve made efficiency savings in your business of US$50—

Luff: New Zealand dollars, per tonne.

Cosgrove: In fact, in 2010 our advice is that Treasury considered your projections “bullish”—likewise Macquarie, likewise Forsyth Barr. And that was a key consideration in Treasury—who reported that bullish view to Ministers. Again, Ministers pulling back from—apart from the lignite and the unconventional gas operation—pulling back from the so-called national resources strategy. So you had a clear number of analysts, including the UBS study, who said you should have stuck to your knitting; you didn’t. That was all reported back to Ministers, and life sort of trundled on. Do you regret that?

Luff: Certainly, with the benefit of hindsight, as I said, managing that downside would’ve been done very differently, and is now being done very differently.

Cosgrove: Well, the thing that we struggle with, and I know it’s sort of a (inaudible), is that with all the information and debates that were happening through Treasury through Forsyth Barr, through the UBS study, we know, and it’s undisputed, that Ministers were well informed. I think Mr Diack alluded to that. Presumably you don’t resile from the fact that the company at the time provided all information that was required through the then chair Mr Palmer. I presume that’s the case?

Diack: No, I don’t.

Cosgrove: OK, and nothing happened. Can I ask the deputy chair: is the Minister taking a more active role in terms of within his legal parameters, in terms of oversight? Is he asking any questions? Is he asking, for instance, if the coal price keeps moving south how you’re going to sustain your operations? Are there going to be more job losses? What’s going to happen to debt?
Dunphy: We have very intensive monitoring, both from the Crown and by the banks, and the tolerance around any variation to our forecast is very small.

Cosgrove: With respect, you were put—not you personally but the organisation was put under a 6-month close watch by the Minister and things trundled on before your time, so it doesn’t fill us full of confidence. Is the Minister actively asking you, for instance, if the coal price keeps moving south—more job losses, more cost-cutting—how will you sustain the business?

Dunphy: Well, I’d expect that we would be going to him with an outline of that risk.

Cosgrove: And are you?

Dunphy: We are. We’re about to head into our budget round, which will look at the low price scenario and the consequences of being on that price path, and advise him what we think the remedies are.

Cosgrove: Forgive me—to go back to my original question, though, has he approached you people to take an active interest in these matters? I accept that it’s responsibility to be reported up, but we had 3 years of people reporting up to the Minister and he didn’t do anything. Is he taking an active interest in approaching you and asking the questions around this key issue?

Dunphy: We have constant dialogue.

Tremain: I want to continue down this price path. Obviously you’ve given me that information about where we break even now—is it 140 down from 190? The price is currently $114 that you’ve indicated to me today.

There were issues historically in terms of a consensus position reached by analysts and where the company itself sat. What I want to understand is what processes you have in place to be on top of that price as much as possible. Secondly, I really want to understand what consideration you’ve taken into those price considerations of alternative energy sources now, particularly, I guess, all the shale gas that’s coming in to America, replacing the need for coal.

Dunphy: Firstly, just to talk about the pricing approach, what the board has been keen to do is seek an external source for pricing information and forecasts, so that we take out any management or board judgment as to where the price is going to be. So we’ve adopted that as a policy, and the analyst forecast that we’ve chosen for the purposes of completing our half-yearly accounts, we back-tested the reasonableness of that forecast and compared the variance of their forecast against the consensus path.

At the time that we signed our half-yearly accounts, we also went back to the forecast house and asked them had they updated their forecasts. So we’re continually monitoring. It’s an iterative process and it continues to change but we try and stay on top of those changes.

In terms of the answer to your second question, Bill would you—

Luff: There are always two aspects to commodity pricing. One is the fundamentals and one is the short-term dynamic. The underlying
fundamentals of this market, because we are firmly in 90 percent of our
export trade placed in the coking coal market. This is not thermal. So the
extent to which it has been affected by alternatives is very limited for that
reason.

Tremain So that gives you more confidence than the impacts that the thermal market
is having a real massive reduction in softer coals.

Luff That’s right. The thermal market has dropped much more than the coking
coal market and there are structural issues at play, not least of which is the
replacement particularly of US coal by shale gas and other alternative
means. And that’s the beginning of a trend that we simply don’t think will
do anything but continue, and we are not in that market.

The coking coal market, however, is extremely strong. We’re looking at a
tripling of capacity in India. We are delighted to hold the prospect of getting
a new customer who is just starting up a steel-making business in Viet Nam,
which will be New Zealand’s biggest single foray into a new market, a
developing market. We obviously have very solid customers in China and
Japan.

External analysis that we are using on the fundamentals is indicating to us
on the supply and demand, if you take all the noise out of the short term,
that the coking coal price should be somewhere about US$200 by 2021.
That’s in today’s dollars. So we believe there is some firmness. Right at the
moment the dynamics are that there is excess volume coming out of
Australia, there is excess volume coming out of the US, and demand is quite
weak, particularly in China in the short term.

Tremain Just one last question in this area. When is it forecast to get to a sustainable
break-even level of $140? In 2021, with all respect, is some time away yet.

Luff That’s the $64,000 question, and I’d be a much richer man if I could answer
that. We are basically forecasting a little or no upward change in the next 12
to 15 to 18 months, and, thereafter, as the short-term oversupply is taken
out of the system by firm demand, we’re expecting an uplift towards that
$200 over the next 5 or 6 years.

Tremain OK. So the next 2 to 5 years, operating losses forecast into the future. I’ll
come back and ask some questions later about this.

Delahunty This is again about your international relationships—

Young Catherine, is this a supplementary?

Delahunty No, this is my question.

Young No, can we just—a couple of supplementaries on this line, if that’s all right,
and then we’ll come to you. Just regarding the $200 US per tonne, I think
you made a comment that you were testing the reasonableness of your
advice. Can you just explain a little bit how you’re doing that?

Dunphy We took the previous forecast from this house, this forecasting house, and
went and back-tested their forecast curve against what actually happened to
see what the variance was between their forecast numbers and where the
market actually traded to at that point in time. And so those variance numbers were the point of difference between—well, we just want to see that their variance numbers were not outside of what a consensus variance might look like.

O’Connor Just perhaps a minor technical matter, but understanding the importance of scrutiny, you are quoting hard coking coal prices, yet you are producing semi-hard coking coal for the market. And I’m guessing there’s a difference in the price. So while you come to the committee quoting—and all the reports are indicating world trends in hard coking—if it’s $10 or $20 less per tonne, that’s quite a significant overall income drop. So I’m just wary that perhaps again there might be some optimism that may not be justified.

Dunphy Can I just explain, firstly, why we use that as a reference pricing and then I’ll pass on to Bill to explain the difference. But when we went into our restructuring round last year with the banks, we use that as our benchmark pricing and so that when we set and agreed those forecasts last year we had that number, which was the $184, as our benchmark price, and then when it comes to working out the revenue and the actual operational side of the business, there’s some adjustments to that price, but it brings us back to one referenced market price. So I’ll now ask Bill to explain the difference.

O’Connor And I appreciate Mr Luff did refer to coking coal, but I think we have every right to scrutinise every bit of your accounting performance.

Luff It’s a very good point, and just to reinforce it, in the first half of this financial year, still 66 percent of our export volumes are hard coking coal. We take discounts for quality on some aspects of that. We are trying to move towards a semi-hard, but all our prices that are being planned in the business are on ratios to our hard coking coal. For example, semi-hard we use a number of 85 percent, semi-soft a number of 60 percent. They’re all predicated off that hard coking coal.

Delahunty In terms of the international relationships, did anyone from Solid Energy meet with the Indian steel Minister and his delegation in January?

Cosgrove Who?

Delahunty The Indian steel Minister came in January.

Dunphy I’ll ask Garry to answer.

Diack Yes, Bill Luff and I did.

Delahunty Did you discuss the potential sale of any of your West Coast coking coal permits to those Indian coal and steel interests?

Diack It was discussed, yes.

Delahunty It was discussed. Are you aware that the Indian media is reporting that there could be an allocation of mineral assets from the Government of New Zealand for public sector coal companies on a Government-to-Government basis, including the joint development of coal mines? Is this what’s on the table?
Diack: No. These things are always discussed, and our Indian partners are very, very keen to ensure that they get long-term access to the type of coal that we produce, so in the discussions that they bring to us, they bring all sorts of options, from localised mine investment all the way through to major investment in Solid Energy itself.

Delahunty: And have any commitments been made to them?

Diack: There have been no commitments made; it is not our place to do that.

Delahunty: However, on the coast, the Cypress mine, which is now being developed despite the vulnerable coal price, is that operation for sale, or are you committed to that?

Diack: No, no. I mean, Bill can answer these questions better than I can, but the Cypress coal mine development—we need that coal to blend with our other coal so that we can meet our specifications that are taken in to our international customers.

Delahunty: Did you discuss that permit with the Indian delegation?

Diack: No, we didn’t.

Delahunty: You didn’t. So that one is related to the Stockton project overall?

Diack: Mmm.

Delahunty: OK, so when you met with the steel Minister, and they were very, very keen to have a Government-Government relationship and to own some of our coal mines, you made—I just want to make this really clear—you are continuing the conversation?

Diack: We continue the conversation with them around ongoing supply, but the ownership issues, we do not engage in actively. We receive their requests and their desires, but we don’t engage in it.

Delahunty: So it would be up to the Minister of Energy and Resources should he wish to, say, sell some more Solid Energy permits, rather than you?

Diack: It’s certainly not up to us.

Delahunty: OK. Thank you.

Mitchell: Yeah, it’s pretty obvious that you’ve certainly taken some major steps towards getting the risk management around the worst case scenario, but I’m really interested to know what happened when you saw that massive drop in the commodity price. How did your competitors react, and what have they done since then? I mean, did it hit the industry as a whole? I know you’re a very small part of it, but what did you see happen within the sector?

Diack: Well, we did prepare just an aide memoire that’s on the table in front of you, and if you go to the back page, you can see that massive drop has affected the entire industry—Australia, New Zealand, US, anybody who’s involved in it, and there’s been a massive drop of productivity through that. We regard the Australian and American exporters as our competitors in the export market, and they are all suffering like we are—taking jobs out. There
are a number of contractual relationships in place, particularly in Australia
where they have take-or-pay relationships with their rail and port, so they
have to keep producing coal, otherwise the cost of breaching those is worse
than not mining coal.

Tremain So, is it stockpiled?
Diack Pardon?
Tremain Is it being stockpiled?
Diack I’m sorry, I missed the first part.
Members Is it being stockpiled?
Diack Stockpiled? They’re pouring it into the market. That’s part of our dilemma.
Mitchell Is that what’s driven the price down?
Diack And that’s what’s driving prices down. But we think that the correction has
inevitably got to come because there’s not a lot of margin in any of that sort
of behaviour.
Mitchell So it’s pretty fair to say that, really, most of your competitors got caught out
as well.
Diack Oh, I think this has been an industry downturn that wasn’t foreseen to the
extent that it has emerged.
Cosgrove It would be also fair to say that your competitors didn’t spend a lot of time
arguing on valuations with shareholders, valuers, and arguing about price—
that they moved a damn sight more swiftly than you did to arrest the
bleeding. That would be a fair—most of your competitors moved far faster
than you did.
Diack I don’t have the information to answer that accurately, but all I know is
everybody has had to move very, very quickly, and some are moving faster
than others.
Cosgrove But in November 2008 when it moved south rapidly, your international
competitors moved swiftly. You guys didn’t. In fact, you were static. You
were caught with your feet in the mud. That’s one of my theses—it simply
didn’t have to be this bad.
Diack Look, in retrospect, there’s little answer to that—
Cosgrove Well, with respect, you were there at the time. So was Mr Luff. This is a
financial review, and the people deserve some insight as to what went
wrong. So it’s a simple question. Your competitors moved swiftly—
Diack 2008 we weren’t there. We didn’t arrive (inaudible) till 2010 and 2011.
Yang Focusing on coal price—lot of other factors we’d consider. One is the
quality of your product; the other is the market itself. I understand you have
secured a 5-year contract with New Zealand Steel and Genesis Energy
domestically. How about overseas market? And also, how competitive your
product is compared with other products of other companies or
competitors?
Dunphy I’ll ask Bill to answer that question.

Luff We have a very, very selective niche in the markets that we deal with. These are India and China and Japan. Best example I can give you is India. We’ve referenced SAIL, who are our biggest customer—the Steel Authority of India—but also private company Tata. Indian coal typically has ash between 15 and 20 percent. New Zealand ash is around 3 or 4. The less ash, the less coal you have to buy, the less ash you’ve got to clear from your furnaces. We also have very low phosphorous, which is damaging in the steel making process, and very high vitrinite. So in the case of our two major Indian customers, ironically, although it’s only 3 or 5 percent of the total blend, our coal goes into the blend first, and then they build the blend around that so that they can maximise the amount of indigenous coal that is higher ash. So we have some real structural advantages, and while some of our newer customers are just understanding what we call the value and use of our coal, in the case of SAIL, we’ve been dealing with them for 26 years, so we have grown with them. They know our coal very well. Same with the Japanese customers.

Delahunty Would that be one of the reasons why the Indian people that came over recently would be so keen on a relationship and so keen on possibly purchasing coal mines?

Luff I’m sure you’re right.

Delahunty So that’s a really strong practical reason.

Diack Our relationship with the Indians goes back many years. They’ve been a customer for 23 years, for those reasons.

Delahunty Have they ever before expressed an interest in buying up our permits?

Luff Always.


Yang Where is your main overseas market?

Luff Our biggest single market is India, followed by Japan and China.

Chair OK. Just a question and then we’ll come to you, Damien. In terms of the price path that you were looking at compared to the consensus path, your price path was a bit more optimistic. Can you give us the rationale behind that?

Dunphy Sorry, can I just check the period that you’re referring to?

Young We’re looking back around about from 2008 through to—actually, when it started to significantly drop. So, actually, it might be before your time.

Cosgrove Treasury described it as bullish.

Luff I think there were two effects. One was that at the time our analysis tied coal and oil prices together, there was a point in time in 2006-07 when the coal price was probably around $50 a barrel—it is currently $100 a barrel—and there had been quite a tight relationship between coking coal prices and oil prices. There was a view that that may continue and had it done so—
obviously, oil’s at $110 a barrel now in today’s dollars. That relationship broke down simply because those two markets diverged.

The other aspect of our view was simply on supply and demand in that period, and if you look at the graph on the handout, you will see there was a huge blip in 2008-09 followed by another one in 2011, which was caused by some issues in Australia with cyclones locking in production. But what happened in 2006 to 2008 was the Chinese started to develop their steel industry and put a huge amount of effort and investment in, and didn’t have enough coking coal of a quality to sustain it. So they came quite dramatically on the market and have built up a huge capacity, to the point where it’s nearly 950 million tonnes. And that’s happened over a very short period of time. What happened with those price spikes was that Chinese indigenous production became much, much more profitable compared with the import option, and that’s been serving to keep a lid on the price, and one of the structural reasons why the coal price has remained lower than was anticipated by Solid Energy in 2007-08 has been that effect.

Also the high prices have encouraged Australian production to increase. So the spike we’re seeing now in oversupply from Australia is very much a function of decisions that were taken when the price spike occurred in 2011-12. It takes 3 years at least, or more, to bring on a coalmine. Right now with the prices where they are, there is no investment in new production going on almost anywhere in the world that I know of, and that is really worrying because you know what happens when people stop investing in new production. Demand is still going to increase. We’re worried about more of these spikes appearing.

Young So with the shale gas, it’s essentially a phenomena that happened, which was gas was probably originally locked into oil prices, but that’s seen a substantial drop in costs around that, which would have affected the thermal coal productions around the world. In USA, I think the last figure I heard is that 16-plus percent of coal fired power stations have gone offline.

Luff What makes it worse for the coking coal market is there’s about 10 million to 15 million tonnes of production of coking coal in the US that can go into thermal that’s at the top end of thermal and at the bottom end of coking. Well, that’s finding its way on to the international market now.

O’Connor Just moving on to another issue and that is Pike River—you currently have responsibility for Pike River—you currently have responsibility for Pike River and the recovery of the drift. So two questions: a brief update on how that is going, and then what are your plans for the mine once you have reached the rockfall?

Diack So in terms of an update of where it’s at, the first priority was to stabilise the atmosphere inside the mine workings. To do that, there is a seal in the drift now. It’s a temporary seal and we needed to seal the ventilation shaft that goes to the surface above the mine. That activity has taken some months, but the seal is in place, and we’re just finalising putting the concrete collar around the top to completely finish that part of the operation. We’re now in the process of preparing to put a more substantial seal in the drift right at the end of the 2.4 kilometres before the rockfall, and the drill holes
that need to go in to allow that seal to be put in place are being undertaken right now. So within, we think, probably 2 months it’s likely that we’ll be able to enter the drift and recover the 2.4 kilometre drift. At that point the arrangements in place for the funding for this come to an end and the next stage would need to be discussed and reviewed. We are the host of this activity. It’s being funded by the Government and those discussions would need to take place.

O’Connor: Who currently owns the licence, or who’s got control of the licence?

Diack: Solid Energy has the licence for the coal.

O’Connor: And are you going to do any more drilling or exploratory work of that resource?

Diack: We don’t have any plans at this stage to do any more development of that resource, and the current pricing environment means that will be some way off before we even think about that.

O’Connor: Is there a valuation being put on that asset on your books at all?

Luff: We have a small resource value given the current prices, which is not much. We also have a value for the equipment and plant that were required along with the mines, which we’re obviously looking to divest.

O’Connor: So you’ve put a quantum on the resource and a valuation related to the coal price on that?

Luff: Yes.

O’Connor: What’s that?

Luff: We would have to get back to you on that but it’s a matter of cents per tonne. It’s small, very small.

O’Connor: Do you think that there will a point in the medium-term outlook that a business case might be put up to redevelop that mine?

Luff: At $US200 a tonne it would start to look interesting from a prospecting point of view.

O’Connor: And the long-run projected price for the coking coal, given your earlier statements, is that it will get up to that level and that value again in the medium term. So that could then lead to consideration of the reopening of Pike.

Dunphy: Can I just clarify that point? First of all our forecast currently has us recovering to $200 a tonne in 2021.

O’Connor: 2021?

Dunphy: So that’s our current forecast, so that’s quite some time away. Can I also just, for clarity’s sake, make it clear that the decision to re-enter the drift has yet to be determined by the board. That is the content of a special board meeting that will be held to specifically look at that issue and to take into account the risks associated with that.
And are you working very closely with the Government—given that the Government gave the money for the recovery of the drift, are you having to report on a very regular basis in working closely with the Government on this?

Yes, we are. We report through almost weekly on progress.

So it’s been a very close working relationship—

A very close working relationship, and working very, very well.

Thank you.

Supplementary to that. Pike’s not economic at the moment. Is the difference—this is just for my learning—between Pike and the Happy Valley Cypress mine the difference between open-cast and underground in terms of cost, or is it related to the type of coal, why one is economic at the moment to open up and the other is not?

It’s primarily related to the type of coal as well as the cost of getting access to that coal. The costs of getting access to the Pike River coal are very, very large.

Whereas with Cypress it’s—

The Cypress mine is an extension of a site. There’s infrastructure there—

Ah, you’re just carrying on, so you don’t have to invest the same amount.

OK, thank you.

I just want to get on to the gearing levels. I notice from your statement of corporate intent that your forecast gearing levels for 2014-15 are still obviously very high at 72 percent. Can I ask you, in hindsight if you’d had a level of debt gearing, which was consistent with almost all overseas mining companies—say 0 percent to 10 percent, which is the recommended amount as you’d know—when the price collapse happened in 2012, would Solid Energy have been the position, the drastic position, it is in now?

I’d say most unlikely. I share your views that, for a commodity company the risk level we have is extremely high because we can’t control our commodity price and we can’t control our currency. So those are the two key factors that drive our company. What I’d consider to be a prudent balance sheet for a commodity-based company would be very low gearing.

So, the fact that your gearing went from 11.2 percent in 2008 with no dividend paid to 14.7 percent with $60 million paid in 2009, 33.7 percent with a $54 million dividend paid in 2010, 31.3 percent with a $20 million dividend and 42.5 with a $30 million dividend in 2012—you’re saying that if your gearing ratios had been on par with most industry players, then we wouldn’t be anywhere near the situation we are in now?

I’d say most unlikely.

Most unlikely. Have you expressed that view, as the acting chair, to the Minister?

I haven’t really had the opportunity.
O’Connor Could I summarise that as perhaps the Government mining Solid Energy while you were mining the coal, which inevitably led to an unsustainable situation?

Dunphy Sorry, I didn’t understand your question.

Young He’s trying to put words in your mouth. He’s trying to get you to make a comment..

O’Connor Well, I guess the Government was mining revenue from you while you were mining the coal—

Young It was a statement rather than a question.

Dunphy I was just checking.

Young Can I, as a supplementary to this, to Clayton’s question, in terms of other resource companies around the world that have seen considerable losses and shed considerable jobs, in terms of their gearing have you been able to have a look at how they are operating and how they’ve been set up?

Coupe First, I’d agree with Mr Cosgrove’s comments about the gearing and I think the UBS report suggested that there should be no debt if it was going to be taken to market.

Cosgrove And that went to the Minister’s desk as well.

Coupe Correct. But I think it’s also fair to comment that industry gearing has risen markedly since that time. So, average industry gearing, I can’t give the exact figure but if you look across the sector you’ll frequently find gearing ranging from below 20 percent in some cases through to up to 50 percent in other cases. So gearing in the current market environment is much higher. Nevertheless I think the actual point you made, and I’d agree with the chairman—

Young —in a perfect world—

Cosgrove Well, no, no, not the perfect world. They didn’t say that. They said that, as I understand it, had your gearing been on par with industry at the time—it’s all right to talk about it now but at the time—the bleeding could have been arrested and we wouldn’t be as bad as we are in terms of Solid Energy. Can I just remind you that, I think it was in December 2008, it was the Minister of State Owned Enterprises at the time who wrote to all State-owned enterprises requiring greater dividends and suggesting that that could be actioned through gearing. Can I ask you—

Young Can I—

Cosgrove No you can’t. I’m about to ask a question. Can I ask you, as acting chair, do you have full confidence in the advice you receive from your current management team? And I ask you that because, with respect, there are a number of people who were there at the time and who are now there at the time. Given that, if you look at the advice we’ve received about the investment in the Taupō wood pellet plant, the advice talks about that the board did not receive information about a financial operating model for the wood pellet plant, or a funding model, setting out the potential effects on
Solid Energy’s existing business; that there was no mention of the risks associated with developing a new product for sale into overseas markets; that a total CAPEX of $33.9 million was committed by the then board based on inadequate advice and that, if you recall the history that the post-investment review of the project basically showed that was a disaster, effectively. Given that a number of those individuals who provided that advice still remain with the company, are you confident going forward that you’re getting the best possible advice to enable decisions?

Dunphy

Firstly, just to correct one of your statements there, I think the projects you’re referring to are the investments that we’re divesting and the personnel in the company who were responsible for those I would say are no longer with the company. Am I correct Garry?

Diack

That’s right.

Cosgrove

No one on the executive team who formed—

Dunphy

—who were part of that team. So, to answer your first question, in terms of confidence, I have every confidence in management.

Cosgrove

You’ve participated, I believe—or the organisation has—in the Auditor-General’s inquiry?

Dunphy

We’ve had interviews. I’ve been interviewed. Garry’s been interviewed.

Cosgrove

And you’ll note that the Auditor-General has concluded, I think, that there was a lack of scepticism—I think is the term that has been put to us—in the mind-set of management and the then-board, to be fair. Has that culture changed with the new board and the management team you have now?

Dunphy

Well, perhaps I could ask Garry to answer and I’ll answer from my perspective. I think that my view is that there’s a high level of challenge around the current board table. I’ll ask Garry to give his opinion as to his views.

Diack

I think there’s been a very significant change in the culture in the business, not only in the way it is operating, but in the way it’s being led and managed by management around down-side risk, the issues of largesse, cost management, and a realisation that we’re a business that’s here and trading in a situation where we’ve essentially got our backs against the wall and we do everything we can to try and ride that period out.

Cosgrove

Could you tell me how you define the issues of largesse that you quote, given that you were one, along with Mr Luff, who was there at the time of largesse?

Diack

Well, we had a long discussion around some of these things last year, but the remuneration policy at the time—2 years ago—was established for a business that had a growth strategy in mind. It was a highly competitive industry for key talent around those projects, and it was designed to attract and retain people in a very competitive environment. We don’t need that remuneration policy now. We’ve changed it significantly. So that’s an example of how what was right or utilised at that time is no longer in place.
And we work our way through all of those organisational policies and approaches through the business and are progressively addressing them.

Tremain We’ve been talking about the move away from some of those projects and the focus back on core business. Can you just give me a summary of progress that’s been made there, what you still have to back out of, any further impairment that may be necessary, or write-offs around exiting those projects? So, just a summary of the progress and where we’re at with that, please.

Dunphy Well I’ll just update you on the balance sheet values for those assets. When we did the financial statements to the year-end 2013 we did an extensive review of the carrying values of all those assets. Where we thought there was not a viable market, for instance the briquetting plant in Southland, or in fact the UCG, we wrote those down to basically scrap value or what we could realise through sale of just the existing plant. In terms of the operating businesses, and I think the wood pellet plant falls into the category, we had another close look at that business. The carrying value of that is ostensibly its land value plus a bit of value for plant. The carrying values of our surplus land assets—we suspect we won’t be facing any impairment on the sale of those assets.

Tremain So there could be some upside on the land sale?

Dunphy There’s a potential.

Tremain So, just in summary, you don’t believe there’s any further impairment to those non-core assets going forward?

Young So in regard to, and this is really going back to some further lines of questions regarding the indebtedness and the borrowing that you’ve undertaken, according to our reports a lot of investment was made in Stockton, Spring Creek, and Huntly East, which were your core mining activities. So in terms of that investment, particularly in Spring Creek, now that’s in care and maintenance, what’s the prospect around its future viability?

Dunphy I’ll pass that on to Bill.

Luff At current prices, not a lot. But we are working very hard on a feasibility exercise, looking closely at Spring Creek for one very, very important reason. The coal quality at Spring Creek, in terms of its ash content, is as low as any in the world, particularly after it’s processed or washed. And this coal is very much sought after by silicon and ferroalloy makers, but it’s completely another market from the coking coal market. It has its own challenges in that it has to be a very, very tight specification on ash. It has a very tight specification on sizing. But we have identified about half a dozen international manufacturers of silicon and ferroalloy for whom finding low-ash sources of carbon is very, very difficult. The amount of this sort of fuel—reductive, sorry—is limited.

But the interesting thing about that is that the prices are not floated in the open market but we have anecdotal evidence to suggest that they are at least $US100 or maybe more a tonne more than coking coal. If we can verify
that, then on a very limited basis—because this is a low-volume, high-value business—there could be a feasibility plan put together for a limited return to the operation of Spring Creek. It’s early days but what it would mean is that not all the current investment, which is effectively written down, would be necessarily wasted.

Young Right. So without these investments in these mining resources, which I think totalled about $397 million in terms of our report we’ve received, where would Solid Energy be today in terms of its future prospects in the market?

Luff We’d be out of the export business entirely.

Young So you would say that these investments that supported the borrowing were absolutely critical for the development of the company? Because, I guess this is in terms of the gearing issue, the fact that if you could stay low gearing, you might not actually have a resource that you could actually utilise.

Dunphy Well, I think the other way to look at as well is if the money wasn’t spent on alternative investments, we wouldn’t have had so much debt.

O’Connor But the single biggest investment on Stockton was paid back within 15 months.

Diack That’s right. I think the answer, Mr Young, is that all of that capital investment doesn’t fall into that category, but large tranches of it does.

Tremain In terms of the alternative investments, where did the policy initiate? It was clearly before this board’s time. Was that before 2008?

Cosgrove I’ll read you the quote, if you like, from when you fellas got into Government.

Diack All of those things go back before the tenure of anybody on the panel here, but it’s tied to the vision that the company had back in those days.

O’Connor Maintaining relationships through some testing times, I guess, is not easy. But one of the really important ones is with community, and most other mining operations around the world—and I say generally—have to build the infrastructure. You’ve always had the luxury of relying on local communities for your housing, for your water, all of that. So as a company you have never had to invest in that, and the communities have borne the brunt of your fluctuating fortunes. Can I ask what the current situation with sponsorship is, and with investment into those communities from your company?

Diack From a sponsorship point of view, given the parlous cash position we’re in, we’ve stemmed all sponsorship.

O’Connor So you’ve stopped all sponsorship?

Diack There is one sponsorship we do, which is an outreach programme for children, which is a contracted sponsorship. The benefits of that do find their way to the likes of Westport and Greymouth.
Are you still sponsorship Christchurch or Canterbury opera, or something? I think you had a deal there. Did you chop that?

No, that’s gone.

So, in the communities, such as Huntly and the West Coast, where you’re relying on the workforce to be cared for, there is no sponsorship other than the one you referred to?

Yes. There is none.

Do you think that’s a good way to maintain community relationships?

Can I answer that question? That was a need. We just did not have the resources to continue that investment at this point in time.

Well, no. I contest that. It’s a prioritisation.

We didn’t have the money.

Well, you’ve spent a lot of money on other consultants and you’ve maintained salaries at very high levels. I don’t want to prolong this, other than to suggest to you that as a company, going through the 1990s, you have taken a very arrogant attitude towards the communities that provide the core infrastructure for your workforce and for the operation of your mines. Can I ask that the new board take a fresh look at that and compare what burden there would be on a mining company around the world to maintain and support the workforce?

I think we’re very conscious of working with our communities. We’re certainly not—or I hope we’re not—portraying the arrogance that you referred to.

Chopping all sponsorship was not working with your communities.

Can I ask a supplementary question to that? Would the board maintain a job over a sponsorship? Because I think, in that instance, it’s more likely that that’s more beneficial to the community than a sponsorship.

Well, no, it’s not. I guess that’s the kind of attitude that—

That a job is less important that a sponsorship? Good luck with that.

Just on spend, have you guys cut out purchasing branded items such as beanies, umbrellas, and, my personal favourite, branded Solid Energy peppermints, and for some reason—I don’t know why guys down in the pit need sunscreen. Those have been the purchases you’ve made, all branded in the past. Has that ceased?

That’s ceased.

No peppermints left?

I haven’t seen any peppermints. We haven’t signed off on a purchase for any peppermints.

He wants a packet.
Delahunty  Just going back to your original question about your future and your investments—and it does affect the people of the West Coast because they have a right to some kind of certainty in their lives. What if the coal price does not recover? The global approach towards climate change is that coal is a significant contributor to climate change. The world is changing. People are less likely to invest in what they perceive as dirty industries. So what planning have you done to recognise that the world is actually changing very rapidly on this issue?

Dunphy  I hope that we’re testing the downside adequately. Certainly, as we go into this next round of budgeting, we’ll be looking at a low-case scenario. The consequences of that scenario will be a change to our mine plans. But until we’ve actually done the numbers and agreed what those parameters should be it would be speculative to indicate.

Delahunty  Sure, but you do acknowledge that there is a shift going on away from coal for very good reasons.

Dunphy  Yes.

Cosgrove  Could you tell me—and you may not be able to provide this information today so if you could get back to us—have any former or current staff purchased assets at Solid Energy; and if so, what and whom? I’m not talking about one you’ve got on TradeMe here, which is a doorknob. You’re selling off the doorknobs and the kitchen sink for a dollar when the TradeMe fee is 50c. I presume there’s a better strategy for getting some dough than that. I’m talking about substantial company assets.

Diack  We would need to get back to you on that because—I think biodiesel went to a former employee.

Cosgrove  How was that—this is the one near Mataura?

Diack  Sorry?

Cosgrove  This is the one near Mataura, is it?

Diack  The biodiesel plant? No, it’s in Christchurch.

Cosgrove  How was that process conducted? So it went to a staff member, did it?

Diack  Yes, ultimately it did. You are correct.

Luff  It was an open process that was run by an outside agency—

Cosgrove  Which agency?

Luff  Pardon?

Cosgrove  Which agency?

Luff  Deloitte. I am aware that there was potentially a staff member who was part of a syndicate that acquired some of the assets. But I would have to check and get back to you on the details.

Cosgrove  Are you aware of an allegation that a person bidding—not a staff member—for that asset was told: “No, don’t put a bid in. It’s a done deal.”? Are there any former staff or current staff who have an interest still in that
Can you get back to us on it? I’d be interested to have a list of what other assets, if any, former or current staff have purchased.

Diack Yes. We’ll come back to you on that. We continue to be aware that—coming back to the doorknob, which surprises me, unfortunately—anything that—

Cosgrove —knee-pads, plastic boxes, ventilation tubing, a washing machine, a freezer, a 32-inch TV, and something called—forgive my ignorance—a Dan Rutherford sculpture. So I don’t know if you’re sort of selling off, if this is a sort of recapitalisation plan, but my advice is if you’re going to sell something for a dollar and take 50c, it might need a review.

Diack Look, we are unashamedly of the view that anything that we have, and we have a vast array of things, that is of no value to us over the next 1 to 3 years, we do need to realise it for cash. That’s the position we’re in.

Cosgrove Indeed. Are you still occupying the corporate headquarters commonly known as “The Palace”?

Diack Yes and I heard the other day that it was on “Showy Place”, so it has quite a reputation. We are there; we have been actively looking to move from there for all sorts of reasons.

O’Connor There’s plenty of real estate in Westport and Greymouth.

Tremain What’s the lease period on that?

Diack The lease period goes for another 6 years.

Cosgrove What’s the annual lease cost?

Diack It’ll be in the papers here somewhere, in part of the questions. Comparatively to the way the real estate industry is going in Christchurch for commercial real estate, it’s turning out to be a relatively cheap option from an annual rent point of view.

Cosgrove Have you sublet any of it, given the vast reduction in corporate staff?

Diack We have. We have retreated to one and a half floors and we have one and a half floors sublet.

O’Connor Have you considered, given the reduction in focus on alternative industries and the focus back on core coalmining, have you considered the shifting of many of those jobs back on to the West Coast closer to the point of action?

Diack We have. We’ve looked at it and we’ve had these conversations at length with some of the business leaders in Westport. The reality is that the export part of our market that comes from coal on the West Coast is only half of our business. We have two other businesses in the North Island and South Island, and the big part of our business around export is the marketing side of things, and we just have to be close to airports and those sorts of things. But where we can, we’re looking to get functions back and located on the West Coast—things like environmental management and health and safety.

O’Connor Surveying and planning—stuff like that?

Diack Many of the technical people we have are located on the West Coast, yep.
Cosgrove Ms Dunphy, can I ask you a question that I think most New Zealanders would like answered. Retrospectively, looking back at this mess, who should be held accountable? You’ve got three areas of accountability. You’ve got the Minister, or Ministers, you’ve got the then board, and the then and current management. I think that most people looking at this are wondering, you know, no heads have rolled, no one got sacked, apart from, sadly, 800 workers who lost their jobs. They weren’t accountable for this. Who should pay the price and who should be accountable?

Dunphy Well, when I accepted the role to go on this board, I accept the point that I’m acting in the shareholders’ best interests, and that’s the reason I’m there, and to do whatever I can to retrieve this company from its current predicament. So I see that as my responsibility, and I’m presuming if the corporate governance model works, then everyone who sits around the board table shares that view.

Cosgrove I accept that, and for the record I think the current board and the former chair, Mr Ford, have said you’re the guys with the shovel behind the elephant—you’ve cleaned it up. You’ve saved some jobs, but I come back to it: you’re a very experienced businesswoman. You’ve seen the internals of this company. You’ve been in place. You’re moving to try to restructure it. No one’s head has rolled apart from 800 workers who weren’t responsible apart from trying to keep the show on the road—you know, nearly $400 million worth of losses over 2 years. One person received a big payout on gardening leave, as we know, or was. Who is accountable for this? People actually have a right to know.

Dunphy I think it’s a very fair question. I don’t know that I’m well placed to answer it, because had I been a member of that board, sitting round that board table, I couldn’t give you an assurance that I could have stopped happening what happened. So it’s very difficult for me to answer your question.

Cosgrove Mr Diack, then, you’re acting CEO.

Diack Yes.

Cosgrove You were there at the time, but not in that role. Can you answer the question?

Diack I can’t answer it directly. All I can say is that there are decisions that were made back then that are not being made now and won’t be made while we take the current focus that we’ve got with the business.

Cosgrove Mr Luff, can you offer us any?

Luff I think Mr Diack summed it up very well.

Cosgrove Well, you might from your point of view. We’re sitting here, and I take your point, Ms Dunphy, but we’re sitting here and no one can give us an answer. For $400 million worth of losses down the kazoo, 800 jobs gone—you two were there at the time; this board wasn’t. The former CEO has taken a dive and a golden parachute, and no one’s accountable. The Minister ain’t here; he won’t front up. These boys won’t have an inquiry, and if it hadn’t been
for the Auditor-General, we’d be no further ahead. So no one can give us an answer.

Tremain

How much of the losses are due to the fall in coal price?

Cosgrove

Excuse me—can you give us an answer? Anybody resign, or be sacked?

Dunphy

Well, I think the issue that I think you have currently is that the current board, albeit with two members from the previous board and current management—it is really hard to isolate a person out of all of that, and say that they’re responsible.

Cosgrove

Or persons?

Young

We’ve been told that in terms of the drop in coal price that analysts were taken by surprise, the business community was taken by surprise, and Solid Energy were taken by surprise. So to what degree has that contributed? If there wasn’t that severe reduction for all those sorts of reasons, what sort of shape would Solid Energy be in today?

Dunphy

Well, I think the key difference I would sum up in saying is that had we not made the alternative investments, we would have had sufficient banking lines to continue our business through the downturn. What caused us to go to our banks last year was that we had insufficient resources to continue our business.

Cosgrove

Do you believe the core assets of Solid Energy are still viable because the—do you?

Dunphy

Well, I wouldn’t be here if I didn’t.

Cosgrove

So you disagree with the Deputy Prime Minister who has waxed eloquently from time to time as to the lack of liability and speculated about, prior to the deal being done with the banks, letting you guys tip over.

Dunphy

Can I just understand—was your word “viability”?

Cosgrove

Sustainable—the core assets, the coal assets.

Dunphy

We believe we can make a sustainable business here. We wouldn’t be here otherwise.

Cosgrove

Turning to my former point, the thing I still struggle with to this day is that people, as this ship was sinking, one, knew about it from the Minister down, and two, got remunerated handsomely in the form of salaries, golden parachutes, and $23 million worth of bonuses—bonuses that were made for presumably the KPIs of that company—and no one at this table, acknowledging the current board was not responsible, can tell the people of New Zealand who should put their hand up. It’s a pretty sick situation.

Dunphy

I do recall at the last select committee, Mr Elder apologising. Was that not what you’re referring to?

Cosgrove

Well, yeah, but, you know, is there anybody else? Should Mr Palmer have apologised? Should Mr Palmer have taken responsibility? Should the former board have taken responsibility? Should the Minister?

Dunphy

I believe Mr Palmer attended the committee.
Cosgrove  He did.

Young  So in regard to going forward, certainly in the short term it is very difficult. The medium to long term you’re having some good confidence, particularly around as the coking coal price increases. When do you expect that you’re going to be in a position where you’re confident, and your gearing is going to reduce?

Dunphy  I think that when we negotiated with our banks last year, we did a set of forecasts based on what we knew at the time, and we were optimistic that we would have been able to reduce debt over the next 2 years. I think if the coal price remains at its current level or lower, there is some prospect that the debt reduction that we had forecast may not happen.

O’Connor  Thank you. Ms Dunphy, you said that you probably weren’t confident that had you been there yourself, you could have stopped it. So the question is do you think there are any lessons in this whole sorry saga for the people like yourself who are in governance positions across a whole lot of corporations and Government agencies?

Dunphy  There’s always lessons.

O’Connor  What would they be for this? How would you summarise them?

Dunphy  Well, I’m always learning. I’ve never stopped learning. From my perspective when you look at the opportunity to come and work in a company in the state that Solid Energy is in, it’s a tremendous opportunity to learn about how to get a company back on its feet. So, similarly, had you been there through the process of the demise of the company, you might have learnt something as well.

Delahunty  Mr Chair, can I make a request? Can I have a copy of the minutes of that meeting that was held with the steel Minister from India? Could the committee have an opportunity to see what was discussed?

Cosgrove  It’d save putting in a whole lot of OIAs in.

Delahunty  I’m just asking.

Diack  It wasn’t a formal, sit-down meeting; it was done over a lunch.

Delahunty  So no minutes were taken?

Diack  No minutes were taken.

Delahunty  Nothing was written down?

Diack  No.

Young  Well, I want to thank you very much for attending today. I think we’ve had a good opportunity to ask you some good questions. Thank you very much for your answers. All the best for the future.

Cosgrove  Could you pass on our regards to Mr Ford.

Young  Yes, please do so. Thank you.

**conclusion of evidence**
Appendix C

Corrected transcript of hearing of evidence 20 March 2014

Members
Jonathan Young (Chair)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Hon Ruth Dyson
Kris Faafoi
Dr Paul Hutchison
Melissa Lee
Mark Mitchell

Witnesses
Lyn Provost, Controller and Auditor-General
Andrea Neame, Sector Manager, Local Government, Office of the Auditor-General

Young Thank you very much for coming to the Commerce Committee, and we are going to be looking at part 3 of your report, which was the extra work that you commenced. Thank you for that report to this committee. We’ve got 30 minutes with you. If you’d like to just make a few introductory comments, we’ll come to questions. Thank you, Ms Provost.

Provost OK. Thank you very much for this opportunity to present our report—

Cosgrove Sorry, could you just talk —

Provost Is that OK?

Cosgrove Yeah, that’s great. The acoustics are pretty bad—

Provost I’ll start again.

Young Oh, by the way, we are streaming live.

Provost OK. Thank you very much for the opportunity to present our report. I’m going to introduce the scope of what we did and then my colleague is going to talk through the substance of the report, and I’ll conclude with the lessons.

In doing this report we looked at the board minutes of Solid Energy for a 5-year period. We also reviewed the publicly released information from Treasury and we did a number of interviews. It’s important to note this is not a full audit and it is not a full inquiry. It focused on five particular areas. One was the investment in Stockton mine for the coal handling and processing plant, which cost around about $128 million. The second, we looked at one of the other investments, and in that case we looked at the
We then looked at the price path and what Solid Energy did in terms of the drop in the coal price. That was the fourth issue. Finally, we have brought it together in terms of lessons that can be learnt for the public sector. So I now—

Cosgrove Sorry, can I just ask you a process question? Could you just tell us who you interviewed and the respective players in this?

Provost Yes, we interviewed the former chairman, the former chief executive, the current acting chief executive, and the deputy chair of the current board.

Young So who is also the acting chair at this this present time?

Provost At that point in time.

Cosgrove Did you also interact with any Government departments, Treasury—?

Provost We also talked to some Treasury officials.

Cosgrove And COMU?

Provost I can’t—Treasury was being restructured about that time, so the exact location of those people, but they were Treasury officials we talked to.

Cosgrove Any of the independent consultants that Treasury engaged, like UBS or any of those?

Provost No, we didn’t, but we did read their reports.

Cosgrove Thank you very much.

Provost Andrea.

Neame So, as already noted, the report seeks to answer four questions. I think it’s important to note we’ve also included a background section in the report. We thought it was important to provide a high-level timetable and some context around the evolution of Solid Energy’s business strategy as part of the process in answering those questions and for us, ourselves, to get an understanding of what business initiatives were or were not being progressed by the company.

We’ve already outlined the two projects that we looked at, and in both projects we wanted to know whether management had provided the board with the appropriate information to approve the project and authorise the expenditure. We also wanted to know that the board understood the risks associated with the projects and whether they were appropriately monitoring the projects.

In the case of the coal handling and processing plant, we found that the board was provided with the appropriate information to consider, approve, and monitor the project—

Cosgrove The board was?

Neame The board, yes—by management. And that included the project’s risks. The conclusion was also supported by a post-investment review that the company actually undertook on that project, as well.
In the case of the Taupō wood pellet plant, we were not able to draw the same conclusions. The company’s own post-investment review of the project showed that the project itself had underachieved, and that conclusion was echoed by those that we interviewed. The board did spend a lot of time challenging management about the investment, and there was evidence of a high level of scrutiny by the board over the project, but, notably, Solid Energy did not, in our view, carry out significant or enough risk analysis about the wood pallet plant target market. That was both nationally and internationally, and nor did the company sufficiently consider the ongoing operational costs of the plant.

The third query that we sought answers to was why management and the board had adopted a higher price path for coal prices than others in the industry. We also wanted to understand how management and the board considered the risks associated with adopting a higher coal price path. The company itself had a number of reasons for justifying a higher price path than others in the industry, and as the analysts had taken a conservative approach, the company itself felt that it had a better track record than analysts at predicting future coal prices, and through a comparison of actual coal prices with market analysts’ forecasts we found that the analysts’ forecasts were generally lower than Solid Energy’s forecasts, but Solid Energy’s forecasts were generally closer to the actual price path that was achieved in the future.

The company did have a high, a base and a low forecast for its coal prices or projected coal prices, and we were told by those that we interviewed that the board was actively considering where the actual coal price fell within that range. But the low case forecast did not anticipate the worst case scenario, being the significant drop in coal prices that occurred in July 2012 and has been sustained since then.

We accept that others in the industry also didn’t anticipate that type of drop, but in our view it would have been more prudent for Solid Energy to have turned its mind to that worst case scenario. So even if they did consider it unlikely, it should always be factored into your risk assessment—the worst case scenario.

The company was not resilient to that drop in prices in July 2012 because of the level of debt it had and it wasn’t able to react. A big component of that debt was on the core coal infrastructure—so on the Stockton coal handling and processing plant—and during interviews we were told that another large influence was the continued operation of the Spring Creek Mine. However, we haven’t sought to quantify that in our report.

We found that during the period of review, management and the board were responding to a drop in coal prices, so coal prices have been steadily declining since the beginning of 2011. We did see evidence that there was consideration of the declining coal price by management and the board, and they were adapting their business strategy accordingly. However, that wasn’t transparent to all parties, and that included Treasury itself. So I will hand back over to the Auditor-General to discuss lessons learnt.
All right, and then we’ll come to questions as soon as we can. Thanks.

There were five lessons we’ve drawn from this experience. The first is that clear communication is important between the shareholder, the board, and management. We have provided a couple of examples in terms of the coal price and the natural resources strategy.

The second lesson was around risk management, and my colleague has already talked about the worst case scenario. In risk management you always need a sceptical mind-set, and to make sure that you don’t take too much of an optimistic view of what might happen, and that was particularly true in terms of the pellet plant.

The third lesson was in terms of the board and management, including relevant industry expertise. From 2008 to 2012 there was one board member and one senior management person with mining expertise. But they continually, through this period, tried to find additional expertise to add at both levels. It wasn’t from want of trying, but it is certainly a very specialised area, and having specialists on boards and in management, in my opinion, is a sensible thing to do.

The fourth lesson is in terms of scoping a project, getting your scoping right, and your project management is important. Once again, the Taupō pellet plant showed us this. I would like to just put on record that a lesson like that is, with the benefit of hindsight, to work out what all the risks were. It’s always easier with the benefit of hindsight to do that.

The final lesson was it’s right to invest in your core assets. The investment in the wash plant has been critical, from all accounts, by everybody we talked to, to the current performance and future of Solid Energy.

So those are the five lessons.

Can I just ask a question—then we’ll come to Clayton. The scope of date, 1 July 2008, is that where you looked at board minutes and papers and relevant documentation? Is that a direct date or are you looking within that financial year? The reason I ask that question is did you review any of the statement of corporate intent for July 2008?

We reviewed all minutes and agenda papers from 1 July 2008, with the exception—there were a couple of items that we requested outside of that period. I think we’ve incorporated that in the report itself—because we needed to get a full and complete understanding of the history around the Taupō wood pellet plant. That was in 2007 that some of the decisions were made around that.

The reason I asked that is because 2007 and 2008 the valuation of the company, which the company set, was hugely different—$450 million to about $7.8 billion, and then that statement of corporate intent was challenged. They reviewed it back and then it was reviewed back in 2009 as well. My concern is that that valuation became the leverage point for borrowing and for their thinking into the future in terms of the investment programme they had. So did you look at any of that?
Provost  We didn’t go that far back. I think it’s fair to say, Mr Chair, we can comment on what’s in the report, but we’re not the management and governors of Solid Energy, so we will have limited ability to go outside what is written here.

Young  Look, I understand that. It’s just that you’ve chosen a date, 1 July 2008, and the statement of corporate intent for July 2008 I think was absolutely significant in terms of the thinking and the valuations that were put in place.

Provost  We just decided to do 5 years. That was our decision to take the 5 years. That was the decision we made in terms of scope.

Mitchell  So in hindsight now, do you see that it might have been more prudent to go back to 2007, because basically what the chair is saying is that there was a major shift in the way they looked at the business, with the valuation, which then meant the leverage, in terms of financing, changed. So in hindsight, do you think it would have been better to go back, to get a clearer picture?

Provost  I’m comfortable with the scope of the review we’ve done.

Cosgrove  Just on that—for the record, AG—could you confirm that when I met with you in my office and we discussed my request for an inquiry, I did offer, if you like, or suggest to you that you may want to go right back, right into the period of the Government I was a part of. Now, I would have thought that would be absolutely appropriate. You chose to do otherwise, but could you confirm that that was my advice?

Provost  I believe you. I don’t remember specifically, but—Andrea’s got a better memory than me.

Neame  Yeah, I remember that date.

Provost  So yes. You know, we have limited resources, limited time frames, and we wanted to do this in a short time frame so the committee had the benefit of it in a timely way. As I’ve said, it wasn’t a full audit. It wasn’t a full inquiry. It was of limited scope to provide you with some significant questions that had not been answered with other reports.

Cosgrove  And look—can I thank you, because you were the only agency that has conducted any form of inquiry. The Government’s refused to do so, and we did offer Government members the same parameters—that we would agree to go right back to 1999 at the latest. And they rejected that. So my first question is in respect of who should be accountable for this, because you say “clear communication between management board and shareholder”. My question would be—you say from time to time management provided the board with appropriate levels of information. Could you confirm whether the Government agencies that were charged with monitoring Solid Energy were provided with adequate information?

Provost  I think accountability in a company setting is very clear. You appoint a board of directors who have responsibility for setting a strategy and monitoring the performance and determining the investments of that particular company. So my first answer is: the board of directors are
accountable for the performance of that company and for making sure that it sets a strategy in the path forward. Then, senior management—in any company—are responsible for implementing that strategy and ensuring it happens. So that’s where the straight accountability lies.

Treasury is a monitoring agency. They were provided with some information, but, as I’ve said in my lessons learnt, there were some things that everybody could have done better in terms of that communication.

Cosgrove The reason I ask you is because we know about the UBS study, which were the Government consultants to scope the company for sale. There’s been a plethora of Treasury, COMU, and other information literally feet high dumped on journalists and us all. It suggests to me that there was plenty of information—including the newspaper, going back, if you are looking at coal price—provided to those monitoring agencies. Would that be fair? Because there were arguments, you know, three or four times—Forsyth Barr, UBS—about the valuations. There was a whole series of interactions.

Provost There was a lot of information and there’s a lot of information up on Treasury’s website about what they had. We did concentrate this review because there was a separate review by Deloitte about Treasury’s monitoring. So that was incidental to what we did, rather than the focus of our review. So I am reluctant to go too far, when it was incidental.

Cosgrove Because the missing piece in all this—and I know you’re either bound legally or chose not to or whatever—in the accountability tree is the ministerial level, where Ministers have power to intervene and sack boards, power under a section in the SOE Act to change the statement of corporate intent, and that’s the big bit that’s missing, so—

Young Sorry to interrupt. That’s exactly the reason I asked that question about the statement of corporate intent. Carry on.

Cosgrove Thanks for that commentary—I appreciate it. Because when the coal price moved south as early as 2009 and took a big dip, this was information available to everyone, because other coal companies around the world moved swiftly. So you’ve got management, you’ve got the board, and then you’ve got the guy in the Beehive who can drop the axe and make it change.

Provost As I have briefed committees in the past, my mandate goes to the use of public resources and the implementation of policy decisions, not to the policy decisions themselves. So whilst occasionally there is a decision that—Parliament sets legislation and I look at the Minister’s decision, generally they are policy decisions and excluded from my mandate, as I think is appropriate because we democratically elect people to make those decisions. I don’t think it’s appropriate for me to second-guess them.

Cosgrove So in the future, though—because the purpose of your inquiry we hope to get some learnings out of it—my question is who is ultimately accountable? Secondly, do you have any advice in terms of interventions or actions or proactivity or better monitoring that could have occurred? Because the Deloitte report says that Treasury did the job. It says they provided their
Minister with enough information. Everybody knew what was going on. So how would we stop this happening again?

Provost That’s a good question, and that’s why my first one is that the groups need to keep talking, and talking about the right thing. The example I give was that there was a lot of debate about the coal price, rather than—the question which I think was really important was what would happen if the coal price fell significantly. It’s that level of discussion, and from everybody we talked to, people have learnt that lesson—that were involved.

Cosgrove It costs though.

Provost It’s how you then move that lesson to others.

Young Just a supp on that. In your report you stated that none of the private analysts saw that drop in 2012 coming. Solid Energy didn’t see it. So I guess 20/20 hindsight is absolutely fantastic. So in terms of what a worst case scenario would look like, how would they actually know—how would they look into the future and think: this could happen?

Provost The coal price—and there is nothing in this report, but it’s been volatile over decades. So the volatility of the coal price is something everybody agrees about. Coal prices are volatile. So I think there was a reasonable basis—and we didn’t publish those graphs in this report—that there is volatility. We are not critical that nobody picked when it was going to fall or the fact—our point was that when you have a volatile coal price, it is prudent to try and at least have in place “What would we do?” and “Have we got enough resilience in this company if it does fall?”. I accept absolutely—being an auditor often has the benefit of hindsight, and this is a whole report with the benefit of hindsight.

Cosgrove But, AG, could I put this to you—and I’m not disagreeing with you. You’re obviously a charitable soul, as it were. But there were enough flags that the coal price, which other—we’ve got Solid Energy’s own graph here I agree with. But anybody in the minerals industry would know that minerals, by their nature, are very, very volatile. You had two or three disagreements on valuation. You had a UBS scope, the Government’s own consultants going in. There were enough flags—with respect, the local village idiot could’ve opened the newspaper and worked out the coal price is moving up and down—and nothing happened. What I find strange is that the Government’s own monitoring agencies—and independent valuing firms like Forsyth Barr—were having arguments day after day with these guys about where the coal price was going. So you had all this static, and everything just trundled on. You had enough warnings, I would have thought.

Provost It’s not fair to say that nobody did anything. One of the big things in this report that hasn’t been in the public arena is we’ve set out in quite a lot of detail what did happen as a result of the reports and of the coal price, and there was certainly action. You’d have to ask Treasury and Solid Energy for any further detail on that and examine them. But certainly it is not fair to say that nothing was done.
So Solid Energy had a vision of transforming this company into a natural resources company. So what was the opinion of the Minister when they approached the Minister about this?

What we have said in the report is the board was presented by management with the strategy. They considered it at one board meeting, decided that it would be sensible to ask their shareholder whether that was something they were interested in doing or not. They sent it to the Minister or Treasury, I’m not sure—to Treasury. The covering letter said that it was an audacious proposal, both in terms of policy and risk. It was then considered by everybody within the system, presumably the officials, and it was agreed not to proceed with the natural resources company.

That is different from what was agreed in every SCI and between everybody—was that they should have a coal business plus do some diversification. That is different from a natural resources strategy. So there are three bits. There is Solid Energy core business coal. There is diversification of the business—for example, the wood pallet plant. And then there is a more extensive natural resources strategy that had a very short life. One of the things we found in talking to people is that they mixed up the diversification and the natural resources strategy.

You made a comment about the Stockton investment, and that has been essential and integral to their position and their planned recovery. In terms of the borrowing for that plant, how much was that? I think it was a washing plant, wasn’t it? A processing plant?

The total capital expenditure for the plant was $128 million. I don’t know how much of that was borrowed, down to the dollar, but most of it was borrowed.

It’s not possible to match individual project with borrowing because, I mean, it’s all put together and then determined. But it did have an element of it.

They did a feasibility study on this before investing into this project. So when that feasibility study was conducted, who authorised it?

The commissioning of the feasibility study? The board.

The board. And when was it done?

Sorry?

Time period.

The time period was in the beginning of 2008, I believe. I’d have to come back and confirm that. I don’t have the specific date. In December 2008 the board authorised the construction of the mine, so the feasibility study was prior to December 2008.

Can you please confirm the exact date when it was commissioned?

Yes. We can come back to you with that.
Provost  Can I ask, with respect, Mr Chairman, that you ask that to Solid Energy? It's outside the scope of my report.

Young   Fine. OK, we can do that. Thank you.

Cosgrove AG, you’d be aware of the debt levels or the gearing ratios that the company had and the letter, of course, I’m sure you’ve seen from then Minister Simon Power in I think it was 2009. And you may not be aware, but the acting chair, when asked this question: “Basically, if the debt levels hadn’t been this high, would things have been different?”—I think the answer was, yes, substantially different.

Do you have any judgments on the level of gearing, because at that time the industry standard for a minerals company, a coal company, was, I think, close to zero—zero to two or three. And this debt gearing went up to—I can’t remember the exact figure—well into double figures. Do you have any view on that?

Provost  We certainly in our financial audit have considered that in terms of when we expressed our opinion, in particular, about going concern. I’m not an expert in gearing of companies and you’d be better to ask a financial analyst that.

Young   Well, we did ask them—the acting chair.

Provost  Yeah, and the deputy chair does have expertise in this area. I defer to her greater knowledge.

Young   We found out the average gearing is about 40 percent around the world at the moment for these resource companies.

Provost  I don’t have that information.

Cosgrove And the key words there “at the moment”. We’re not talking about at the moment; we’re talking about the time the company came a gutser—

Provost  The technical term.

Cosgrove Because it would seem to me that the logical conclusion would be high debt gearing ratio, large payout in dividends—I think one was $60 million—crash in price, inability to react swiftly as other coal companies around the world did means catastrophe: 400 million bucks and 800 jobs. As the acting chair said to us a week or so ago, it could have been a lot different. These are the comments that the Government in writing put on Solid Energy. You have made no comment about this.

Provost  One of the issues that I talked about in lessons is risk management, and one of your risk management elements is to make sure you’ve got some headroom in your gearing. That is pretty much on the record. It was difficult for them because they didn’t have any more headroom, with the amount of debt they had, to react.

Also, though, to be fair to Solid Energy and the people involved, the drop was dramatic. It wasn’t a small drop in price; it was a dramatic drop in price.

Young   Yeah, well, I understand that 50 percent of companies around the world came under stress and many of them closed, actually, in that time.
Cosgrove  Yeah, but if you look at Solid Energy’s own graph, which you will have seen, I agree, but it had several dramatic drops right through, and I would argue, using your own words, that if you were planning for the worst case scenario, you’d take one big hit. You then say “Right, we’ve got to circle the wagons.” and you’d strategy up on this, because this is going to get wobbly. And they just trundled on over-forecasting, disputing valuation—

Young  Would that be true in 2012, when those drops came?

Cosgrove  —with monitoring agencies reporting back to the ministry, including UBS that was “trouble at mill”, and again nothing happened.

Provost  I keep repeating—things did happen, and there was action happening.

Cosgrove  Well, sorry, from a shareholder point of view.

Provost  There was action happening.

Young  There was an action plan. Well—

Provost  There was an action plan. There were plans of what they were going to do, and they did stop a lot of things. They stopped a significant number of things after that report and when the share price fell.

Cosgrove  A double-barrel question to you—last question: what would have been considered too little too late? And, more importantly, we asked the acting chair—I don’t hold responsible for it, but the executives who are in place—who should be accountable, because the only people who got sacked were 800 workers who weren’t responsible and 400 million bucks worth of debt, and one guy who got a million bucks or whatever for gardening leave and $23 million worth of bonuses for running the company to the ground, and no one’s accountable? We had people sitting at the table looking at each other, going “Well, somebody apologise.” Could I ask any of you who should be accountable?

Provost  The board and the chief executive and the senior management.

Cosgrove  So they all should’ve gone?

Provost  And the majority of them—my understanding is—have.

Young  Thank you very much. Look, we thank you for your time coming in today to the committee, and appreciate the work you’ve done on this. It’s been very informative, given us a broader view of those sorts of events, and we continue to watch Solid Energy with interest. Thank you.

Cosgrove  Could I just commend you as well. If it hadn’t been for your office, we would have had no inquiry also—thank you.

Provost  I would welcome from the committee—this is the first time we’ve done this kind of report, so any feedback you have for us about this kind of approach to this kind of event I’d be very happy to hear.

Young  Thank you very much indeed. Andrea, thank you for your work in particular.

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South Canterbury District Health Board

**Recommendation**

The Health Committee has conducted the financial review of the 2012/13 performance and current operations of the South Canterbury District Health Board and recommends that the House take note of its report.

**Introduction**

The South Canterbury District Health Board is a relatively small DHB, and half of the population it serves lives in rural areas. The area has the highest percentage of people over 65 in New Zealand and relatively low percentages of Māori and Pacific people.

**Financial and service performance management**

In 2012/13 the DHB’s total income was $177.956 million and its total expenditure was $177.22 million, resulting in a surplus of $736,000. The DHB had budgeted for a $0.5-million deficit. The surplus was mainly due to revenue exceeding expectations and the costs of employee benefits being less than budgeted for.

The Office of the Auditor-General issued a modified audit report, with a qualified opinion on the performance information of the DHB. The qualification, regarding DHBs’ limited control over third-party performance information, applied to all DHBs in this audit round.

**Mental health services**

The DHB funds community programmes, called “brief intervention services”, to help and support people with mild to moderate mental illness. Those with more severe mental illness are usually treated at Timaru Hospital. The hospital has a small mental health unit, and the DHB is seeking to provide more early treatment so as to reduce the need to refer people to the unit.

The DHB uses the “Choice and Partnerships Approach” which employs collaboration and demand and capacity theory to deliver efficient, effective timely intervention to the maximum number of people. When we queried the lack of targets for waiting times, the DHB said that the Choice and Partnerships Approach reduces the need for waiting times. It also pointed out that, as a small DHB, it deals with low numbers which can be easily skewed by outliers when reporting performance measures.

**Oral health services**

The DHB has made steady progress in child oral health, with just over 60 percent of five-year-olds and almost 50 percent of Māori five-year-olds free of holes or fillings. We were pleased to note a substantial improvement in the figure for Māori children. We heard that the DHB is trying to improve these figures further by working with parents about their children’s diet. We also note that the DHB is due to undertake a new round of oral health advertising.
Orthopaedic services

On 29 January 2014 the Minister of Health announced an extra $10 million in funding for elective surgery, with a third of the additional operations expected to be orthopaedic. The DHB plans to use the additional funding to perform an extra 80 operations, but has yet to decide what kind.

We are aware of concern about access to orthopaedic services in Timaru. The DHB said that the system is complex and not always understood, and that demand will always exceed capacity. It also said that individual circumstances can influence what constitutes an appropriate pain and disability threshold for intervention.

Services for older people

The DHB’s catchment includes the highest percentage of people over 65 in New Zealand. We were therefore interested in the development of the Centre of Excellence for Older People project. Development of the programme began in 2013 and plans are to be implemented over the next 18 months to two years. We are very interested in the programme and look forward to seeing its progress.
Appendix

Approach to this financial review
We met 19 February and 19 March 2014 to consider the financial review of the South Canterbury District Health Board. We heard evidence from the South Canterbury District Health Board and received advice from the Office of the Auditor-General.

Committee members
Dr Paul Hutchison (Chairperson)
Shane Ardern
Paul Foster-Bell
Kevin Hague
Hon Annette King
Iain Lees-Galloway
Scott Simpson
Barbara Stewart
Poto Williams
Dr Jian Yang

Evidence and advice received
South Canterbury District Health Board, Responses to written questions, received 14 February and 13 March 2014.

Office of the Auditor-General, Briefing on the South Canterbury District Health Board, dated 19 February 2014.

Organisation briefing paper, prepared by committee staff, dated 28 January 2014.
The Government Administration Committee has conducted the financial review of the 2012/13 performance and current operations of 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
2012/13 financial review of the
Takeovers Panel

Report of the Commerce Committee

The Commerce Committee has conducted the financial review of the 2012/13
performance and current operations of the Takeovers Panel 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
2012/13 financial review of Te Reo Whakapuaki Irirangi (Māori Broadcasting Funding Agency)

Report of the Māori Affairs Committee

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Te Reo Whakapuaki Irirangi (Māori Broadcasting Funding Agency)

**Recommendation**

The Māori Affairs Committee has conducted the financial review of the 2012/13 performance and current operations of Te Reo Whakapuaki Irirangi (Māori Broadcasting Funding Agency) and recommends that the House take note of its report.

**Introduction**

Te Reo Whakapuaki Irirangi is a Crown entity funded mainly through Vote Māori Affairs, and is accountable to the Minister of Māori Affairs. It operates under the name Te Māngai Pāho. Its primary function is to promote Te Reo and tikanga Māori by funding the broadcasting, production, and archiving of programmes.

The chief executive of Te Māngai Pāho is John Bishara, who has been in the role since 2004. The chair is Professor Piri Sciascia.

In 2012/13 Te Māngai Pāho’s total revenue was $54.039 million, and its total expenditure was $53.983 million.

**Strategic planning**

We asked if Te Māngai Pāho was making any preparations for expected changes to the funding and planning of Māori language programmes by the Government. Te Puni Kōkiri released a draft national strategy in December 2013. Te Māngai Pāho is meanwhile operating according to the current strategy and has not yet made any changes. However, the agency believes that the proposal is aligned well with its own philosophy and should be compatible if the proposed strategy is implemented. Te Māngai Pāho does not believe that the new strategy would require any changes to its current purchasing and funding framework.

**Digital media**

The agency is finalising a new digital strategy, to focus on better access to and distribution of targeted content, with the goal of achieving measurable language outcomes.

Te Māngai Pāho is soon to launch a new website. This is an important part of its operations, as all contestable television funding applications are made online. This has resulted in lower costs for the agency and applicants.

**Iwi radio**

We asked how the introduction of capability enhancement plans for iwi stations has affected the performance of iwi radio. These plans set 15 key indicators of modern effective broadcasting capability. They have been fully implemented by most stations, with successful results. We asked if iwi radio stations can pay a “living wage” from current funding. Te Māngai Pāho acknowledged that these broadcasters generally pay much less than their mainstream counterparts, but suggested that many of those working in this area do it for the kaupapa, not to make money.
We are concerned that some iwi radio stations must pay large transmission fees, even when transmitting from their own maunga. Fees can vary widely, from a high of $151,003 to a low of $1,543, depending on the location of stations and the number of transmission repeaters they use for terrestrial broadcasting. Funding for transmission from Te Māngai Pāho is the same for every station regardless of their costs. The agency acknowledged that this system is not fair, but said that the move to digital broadcasting will reduce costs, which should remedy this issue.

We asked if frequency holders, rather than frequency users, should cover transmission costs. Te Māngai Pāho says its current strategy is to work towards handing over responsibility for Māori language broadcasting to the licence holders, most of whom are iwi. We asked if the agency had been consulted about the potential for moving the cost of the licences to a new structure, as the Minister is proposing. The agency said it has not contributed to the costing of the proposed new structure, but believe it has been factored into the Minister’s planning.

**Strengthening Te Reo Māori**

We asked how Te Māngai Pāho measured the impact of its funding on the ordinary use of Te Reo Māori. The agency relies mostly on anecdotal evidence, and its own observations.

Te Māngai Pāho said the recent Te Kupenga report by Statistics New Zealand which measured Māori well-being in social, cultural and economic terms, was heartening, and showed that it is important to find effective ways to measure Te Reo Māori that engage Māori people.

Looking to the future, we asked if the agency sees itself as well placed to drive the future of Te Reo Māori, perhaps better than Te Taura Whiri I Te Reo Māori (the Māori Language Commission). It said Te Taura Whiri and New Zealand On Air are its partners, and each organisation brings different strengths to the task of growing the language.

We asked why Television New Zealand does not fund its own Māori language programming. We also asked if Te Māngai Pāho is getting value for money from its spending on TVNZ programming, particularly considering the timing of many of the broadcasts. Te Māngai Pāho said most of its funding goes to Māori Television, but that will only ever reach a limited audience. By funding programming on mainstream broadcasters, it can reach viewers who may not watch Māori Television. It also funds non-traditional Māori programming such as *The G.C.* as a way to introduce Te Reo Māori and tikanga Māori to audiences who do not actively seek it out.

**Staffing**

We asked if Te Māngai Pāho used consultants at the cost of staff development. It said it invests in development training for staff, and is pleased at its retention rate, but as their staff is small, it is sometimes necessary to seek external expertise. It pride itself on its expertise in the field of Māori broadcasting. We encouraged the agency to develop female staff as managers in future. The board said it continues to seek strong women members.
Appendix

Approach to this financial review

We met on 7 and 21 May 2014 to consider the financial review of Te Reo Whakapuaki Irirangi (the Māori Broadcasting Funding Agency). We heard evidence from the agency and received advice from the Office of the Auditor-General.

Committee members

Hon Tau Henare (chairperson)
Te Ururoa Flavell
Hone Harawira
Claudette Hauiti
Joanne Hayes
Brendan Horan
Hon Nanaia Mahuta
Rino Tirikatene
Metiria Turei
Hon Nicky Wagner
Meka Whaitiri
Jonathan Young

Evidence and advice received

Office of the Auditor-General, Briefing on Te Reo Whakapuaki Irirangi, dated 7 May 2014.
Organisation briefing paper, prepared by committee staff, dated 7 May 2014.
Te Reo Whakapuaki Irirangi, Answers to written questions, received 7 and 14 May 2014.
Arotakenga pūtea o Te Reo
Whakapuaki Irirangi mō te tau 2012/13

Te pūrongo a Te Komiti Whiriwhiri Take Māori

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Tūtohutanga
Kua whakahaere e Te Komiti Whiriwhiri Take Māori te arotakenga pūtea e pā ana ki te whakatutukinga mahi me ngā mahi o te wā nei a Te Reo Whakapuaki Irirangi mō te tau 2012/13, ā, ka tūtohu kia aronga e Te Whare tana pūrongo.

Kupu Whakataki
He hinonga Karauna Te Reo Whakapuaki Irirangi. Ko te nuinga o āna pūtea āwhina nō Te Pōti Take Māori, ā, haere ai āna whakamāramatanga mō te whakatutukitanga mahi ki te Minita Take Māori. Mahi ai hoki i raro i te ingoa Te Māngai Pāho. He whakatairanga i Te Reo, i te tikanga Māori tāna mahi matua mā te hoatu pūtea āwhina mō te pāhotanga, whakanaonga me te whakapūranga hōtaka.

Ko John Bishara Te Kaihautū o Te Māngai Pāho, ā, nō mai ai te tau 2004 a ia i roto i te tūranga. Ko Ahorangi Piri Sciascia te heamana.

I te tau 2012/13, e $54.039 miriona te katoa o Te Māngai Pāho, ā, e $53.983 miriona te katoa o āna whakapaunga.

Maherehere rautaki
I pātai mātou mehemea e whakariterite ana Te Māngai Pāho mō ngā whakarerekētanga, tērā tonu pea ka tūpono puta e pā ana ki te pūtea āwhina me te maherehere hōtaka Reo Māori a Te Kāwanatanga. Ka whakaputaina e Te Puni Kōkiri he rautaki hukihuki puta noa te motu, i te mārama o Hakihea i te tau, 2013. I te wā nei, e mahi ana Te Māngai Pāho e ai ki te rautaki kei te whakamahia i nāianei, ā, kua kore anō ētahi whakarerekētanga kia whakaurua mai. Heoi anō rā, whakapono ai te pokapū kei te tū tika pai te kaupapa ki tāna ake rapunga whakaaro, ā, ko te tikanga e rite ana mehemea ka whakatinanatia te rautaki kei te whakaroorhia. Kihai Te Māngai Pāho e whakapono, ka hiahia e te rautaki hou ētahi whakarerekētanga ki tāna ake pou parāwaho hoko mai, pūtea āwhina hoki o te wā nei.

Pāpāho ā-mamati
Kei te whakaotioti haere te pokapū i tētahi rautaki ā-mamati hou, e arotahi ana kia pai kē atu te whai putanga me te whakaratonga o te ihirangi kua ūngia, me te whāinga kia tutuki ngā hua o te Te Reo ka taea te ēne.

Taro ake ne tētahi paeturutukuku hou a Te Māngai Pāho ka whakamānutia. He wāhi nui tēnei o āna mahi matua i te mea, ka tonoa ā-tuhiwhitia ngā pūtea āwhina mō te whakata kairapu katoa. Ko te mutunga mai i hua mai i tērā, ko ngā utu raro ihu mā te pokapū, mā ngā kaitono.

Reo irirangi iwi
Ka pātai mātou, i pēhea te papānga o te whakatutukinga mahi o te reo irirangi iwi i te whakaurunga mai o ngā mahere whakaniko i te pūmanawa ki ngā teihana iwi. E 15 ngā tūtohō matua e pā ana ki te tōtika o te pūmanawa pāhotanga hou i whakatakotoria e ngā mahere nei. Kua whakatinanahia katoatia e te nuinga o ngā teihana ērā, ā, he momoho ngā hua i puta ake. Ka pātai mātou mehemea ka taea e ngā teihana reo irirangi iwi te utu i tētahi
“utu-ā-wiki kia ora tētahi,” mai i te pūtea āwhina o te wā nei. Ka whakae Te Māngai Pāho, ko te tikanga noa, ka iti iho i te utu mā ngā kaipāhō nei i te utu mā o rātou hoa auraki ēngari, ka mea ake anō, ko te maha o tāua hunga e mahi ana i tēnei takiwā, mahi kē ai mō te kaupapa, ēhara mō te moni.

I te māharahara mātou mō ētahi teihana reo irirangi iwi i te teitei rawa ana ngā utu whakaputanga me matua utua e rātou ahakoa, nō rātou ake te maunga e pāpāho mai rā rātou. Arā noa atu te whānui o te rerekētanga, piki atu ki te mea teitei e $151,003, taka iho ki te mea e $1,543 i raro rawa, nā te āhua o te wāhi kei reira te teihana, ā, nā te hia kē o ngā mea tukurua whakaputanga ka whakamahia e rātou mō te pāhotanga mai te mata o te whenua. He rite tonu te pūtea āwhina mai i Te Māngai Pāho mō ngā whakaputanga mā ia teihana, ahakoa te āhua o o rātou whakapauanga utu. Ka whakae te pokapū, kāore te pūnaha nei i te tika ēngari, ka mea mā te neke ki te pāhotanga ā-mamati, e heke ai ngā utu, ā, kei reira pea he rongoā mō tēnei take.

Ka pātai mātou mehemea mā ngā kaipupuri hōnongoingoi, kapā mā ngā kaiwhakamahi hōnongoingoi ngā utu whakaputanga e whakakapia. Ka ki Te Māngai Pāho, ko tāna rautaki i te wā nei, he mahi kē atu ki te wā e taea ai te hoatu i te haepapa mō te pāhotanga i Te Reo Māori ki te hunga papūri raihana. Ko te iwi rā te nuinga o taua hunga. Ka pātai mātou mehemea i rapu whakamaherehere te pokapū mō te pūmanawa nohopuku e pā ana ki te neke i te utu raihana ki tētahi hanga hou, e whaakarotia rā e te Minita. Ka ki mai te pokapū, kāore anō ia kia hoatu āwhina mō te utu i te hanga hou kua whaakarotia ēngari, ki tōna whakapono, kua raua tērā āhuatanga ki roto i te maherehere o te Minita.

Whakapakari ake i Te Reo Māori

Ka pātai mātou, i pēhea te ine a Te Māngai Pāho i te papānga o tāna pūtea āwhina ki te whakamahinga noa o Te Reo Māori. I te nuinga o te wā, whakawhirinaki atu ai te pokapū kī ngā taunakitanga whakaatū kōrero poto me āna ake tirohanga.

I ki mai Te Māngai Pāho, he mea manahau te pūrongo Te Kupenga o nā noa nei a Te Tatauranga Aotearoa, nāna nei ine te oranga Māori mō te taha pāpori, taha ahurea, taha ōhanga, ā, ko tērā i whakaaturia, he mea nui te rapu huarahi tōtika hei ine i Te Reo Māori e whakareware rā i te iwi Māori.

Nā, ka titiro atu ki te wā kei mua i te aroaro me tā mātou pātai ki te pokapū, mehemea māna Te Reo Māori e ē atu ki reira, ā, mehemea rānei he pai kē atu mā Te Taura Whiri i Te Reo Māori. Ko tēnei tāna. He hoa tahi Te Taura Whiri i Te Reo Māori me Irirangi te Motu, ā, haria mai āe i ia rōpū whakahaere ngā pūmanawa wehekē mō te whakatipu i Te Reo.

Ka pātai mātou, he aha te ihe te kore ai Te Reo Tātaki o Aotearoa i tuku pūtea ai mō āna ake hōtaka Reo Māori. Ka pātai anō hoki mehemea kei te eke te ura o te moni e whakapua ana e ia ki te taumata o tōna hiahia mō ngā hōtaka a Te Reo Tātaki o Aotearoa, otiūra, ki te whakaaaroarahia te roa o te wā mō te maha o ngā pāhotanga. Ka ki mai Te Māngai Pāho, haere ai te nuinga o tāna pūtea āwhina ki a Whakataa Māori ēngari, he ititi noa te minenga ka kite. Mā te hoato pūtea āwhina ki ngā kaipāhō auraki, e tae atu ai ki te hunga mātakitaki, a rātou mā e kore noa nei e mātaki ai i a Whakataa Māori. Hoato pūtea āwhina ai hoki mō ngā hōtaka Māori kore-taketake, pērā i The GC, tērā huarahei whakamōhio atu i Te Reo Māori me te tikanga Māori ki ngā minenga kore rawa nei e tino oreore atu ki te rapu i Te Reo Māori, i te tikanga Māori hoki.
AROTAKENGĀ PŪTEA O TE REO WHAKAPUAKI IRIRANGI MŌ TE TAU 2012/13

Taha ki ngā kaimahi

Ka pātai mātou mehemea ka whakamahia e Te Māngai Pāho he mātanga, ka mahara kē te whakawhanake i āna kaimahi. Ko tāna, whakangaotia ai e ia te whakangungu kia pakari ai ngā kaimahi, ā, me tana koa anō ki te pupuri i a rātou ēngari, nā te itiiti noa o āna kaimahi, he wā anō me haere ki waho ki te rapu mātanga. Ka whakahīhī anō hoki a ia ki tōna mātanga i te takiwā pāhotanga Māori. Ka whakatenatena mātou i te pokapū ki te whakawhanake kaimahi wahine hei kaiwhakahaere mō ngā wā kei mua i te aroaro. Ka kī mai Te Poari, ka haere tonu tana māhi rapu kaimahi wāhine pakari.
Tāpiritanga

Ara ki te arotakenga pūtea nei
I hui mātou i te 7 me te 21 o Haratua i te tau, 2014 ki te whakaaroaro i te arotakenga pūtea o Te Reo Whakapuaki Irirangi. I rongo taunakitanga mātou nō mai i te pokapū, ā, i whiwhi whakamaherehere nō mai i Te Tari o Te Tumuaki o Te Mana Arotake.

Ko ngā mema o te komiti, ko
Hōnore Tau Hēnare (heamana)
Te Ururoa Flavell
Hone Harawira
Claudette Hauiti
Joanne Hayes
Brendan Horan
Hōnore Nanaia Mahuta
Rino Tirikātene
Mētīria Tūrei
Hōnore Nicky Wagner
Meka Whaitiri
Jonathan Young

Te taunakitanga me te whakamaherehere i whiwhi
Te whakatakotoranga tohutohu mō Te Reo Whakapuaki Irirangi a Te Tari o Te Tumuaki o Te Mana Arotake i te 7 o Haratua i te tau, 2014.

Te pepa whakatakotoranga tohutohu a te rōpū whakahaere nā ngā kaimahi o te komiti i takatū i te 7 o Haratua, i te tau 2014.

Ngā urupare a Te Reo Whakapuaki Irirangi ki ngā pātai i tuhia. I whiwhi i te 7 me te 14 o Haratua i te tau, 2014.
2012/13 financial review of Te Taura Whiri I Te Reo Māori (Māori Language Commission)

Report of the Māori Affairs Committee

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Appendix 5
The Māori Affairs Committee has conducted the financial review of the 2012/13 performance and current operations of Te Taura Whiri I Te Reo Māori (Māori Language Commission) and recommends that the House take note of its report.

Introduction

Te Taura Whiri I Te Reo Māori (Māori Language Commission) is a Crown entity funded mainly through Vote Māori Affairs, with a small amount from other sources, such as contract income. The commission was set up under the Maori Language Act 1987 to promote the use of Te Reo Māori as a living language and ordinary means of communication. It is an autonomous Crown entity, with a board of five members.

In 2012/13 its total revenue was $5.04 million, and total expenditure was $4.821 million, resulting in a net surplus of $219,000.

While the chief executive of Te Taura Whiri I Te Reo Māori, Glenis Philip-Barbara, is on secondment, the acting chief executive is Pita Paraone. The current chair is Erima Henare.

Research and revitalisation

We asked about the commission’s work strengthening and revitalising Te Reo Māori. A new venture is the establishment of a new business unit, He Puna Whakarauora, tasked with research on Te Reo Māori. The Government has provided the unit with $8 million of funding spread over four years. The unit will measure the impact of language revitalisation programmes, and seek to determine where resources are needed most.

Some of us questioned the value of investing in the research unit; it was suggested that the reasons for the shrinking number of Te Reo speakers are already well known. The commission responded that Government funding decisions must be based on evidence. Pertinent research has not been undertaken since 1975, and anecdotal information is not sufficient. The commission also said that while recent census figures indicate a drop in the number of Te Reo speakers, it believes that the question on census forms was poorly phrased, providing an unhelpful result. The question asks about the use of Te Reo in everyday conversations. The commission believes that while the number of children learning Te Reo in kura is increasing, the use of the language in homes is falling as everyday Te Reo speakers get older. It believes this trend will reverse as kura students become adults. It is heartened by the enthusiasm that younger people have for Te Reo.

The commission also advocated research to measure the economic value and potential of Te Reo Māori, both here and overseas. It believes that it is important to determine the impact of Te Reo on broader New Zealand society, beyond the Māori community. For example, this would take account of the growing support from all New Zealanders for the teaching of Te Reo in all schools. We asked if the commission was concerned about the health of Te Reo; it said Māori immersion schools are doing a good job, but students in
mainstream schools and adult learners need more support. Support for active users of the language was needed while also encouraging new learners.

Research will be done on language revitalisation programmes overseas, to see what can be learned from others’ successes and failures. The commission also pointed out that teaching is distinct from revitalisation. It believes that many iwi are doing well teaching the language, but revitalisation is a different matter. It hopes to develop programmes supporting revitalisation as a result of its research.

**Strategy**

We asked about the commission’s involvement in the development of the Māori Language Strategy. The process has reached the consultation phase, and the board made a submission. We asked if the commission was confident it had a future in the Government’s plans for Te Reo, but it did not wish to comment.

We asked the commission about its long- and short-term goals. The commission is still waiting for the implementation of the strategy to begin, and for any changes that may be made to the Māori Language Act 1987; but for now it has indicated its plans in its statement of intent.

**Funding**

We asked how funding for the language should be targeted. The commission believes it is important to balance supporting active users of the language and encouraging new learners. We asked if funding could be allocated at an iwi level; but the commission doubts that this is the best option. Iwi have access to a number of other funding options, including Ma Te Reo. Their interest in running language programmes varies, which the commission believes might result in uneven support for Te Reo.

**Broadcast of Te Reo**

We asked if the commission felt that there was enough Te Reo content available to a broad range of television and radio consumers. The commission believes that Māori Television’s main channel has become a public broadcaster, and lacks sufficient Te Reo content. It feels that is not the proper role of Māori Television, and it should increase its commitment to the language. The commission would like to see New Zealand on Air and Te Māngai Pāho increase their commitment to funding original, innovative locally-produced Te Reo programming rather than voiced-over overseas content.

We asked if the commission should have a more hands-on role in commission programming under the new strategy. The commission believes the Minister wants to increase iwi control over entities that deliver Te Reo content.

**Relationship with Te Puni Kōkiri**

We asked how the commission works with Te Puni Kōkiri, which is the monitoring agency for the commission under the Māori Language Act. The Act empowers the commission to advise the Government on Māori language policy, leading to some tension with Te Puni Kōkiri, which also advises the Government on Māori issues, of which the language is sometimes a part. The commission acknowledged that the two organisations sometimes provide conflicting advice, but believes that in general the relationship between the two is good. However it would like the agencies’ roles to be more clearly distinguished. We asked whether the commission considered that legislation was necessary to clarify the difference, but the commission believes the governing legislation as it stands is quite clear.
Appendix

Approach to this financial review

We met on 5 March and 9 April 2014 to consider the financial review of Te Taura Whiri I Te Reo Māori (Māori Language Commission). We heard evidence from the commission and received advice from the Office of the Auditor-General.

Committee members

Hon Tau Henare (Chairperson)
Te Ururoa Flavell
Hone Harawira
Claudette Hauti
Joanne Hayes
Brendan Horan
Hon Nanaia Mahuta
Rino Tirikatene
Metiria Turei
Nicky Wagner
Meka Whaitiri
Jonathan Young

Evidence and advice received

Te Taura Whiri I Te Reo Māori, Answers to written questions, received 7 and 18 March 2014.

Office of the Auditor-General, Briefing on Te Taura Whiri I Te Reo Maori, dated 5 March 2014.

Organisation briefing paper, prepared by committee staff, dated 5 March 2014.
Arotakenga pūtea o Te Taura Whiri i Te Reo Māori o te tau 2012/13

Te pūrongo a Te Komiti Whiriwhiri Take Māori

Hirangi

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Ki te whakapono o te taura whiri, ahakoa te piki haere o ngā tamariki e ako ana i Te Reo i ngā kura, e taka haere kē ana te whakamahinga o Te Reo i ngā kāinga, ia rā ka pakeke haere ake ngā tamariki. Ki tōna whakapono, ka taka huria tēnei āhuatanga ka pakeke ana ngā akonga o te kura. Hikaka ana tōna ngākau ki te rawe o Te Reo ki te hunga taitamariki.

Ka āki anō hoki te taura whiri i te rangahau hei mea ine i te wāriu me te pūmanawa nohopuku o Te Reo Māori i te ao āhanga i konei, ā, i tāwāhi. Ko te mea nui ki tōna
whakapono, he whakarite i te papātanga o Te Reo ki te porihanga whānui o Aotearoa, waho atu i te haporan Māori. Anei te tauira. Mā tēnei e whakamārama te tautoko e tipu haere ake ana mai i ngā rātanga katoa o Aotearoa mō te ako i Te Reo i ngā kura katoa. Ka pātai mātou meheamea he anipā tō te taura whiri mō te hauora o Te Reo; ko tāna i ki ake, e pai ana te mahi a ngā kura rumaki āngari, mō ngā ākonga i ngā kura auraki me ngā pākeke kei te ako i Te Reo, me kaha kē atu te tautoko mā rātou. Ka āpirangiitia he tautoko e ngā kaiwhakamahi kakama o te reo i te wā; ka anō hoki e whakatenatena ākonga hou ana.

Ka rangahautia anōtia hoki ngā hōtaka whakarauhora ki te reo i tāwahi kia kitea ai, he aha tērā ka ākonautia mai i ngā āngi, i ngā takanga a ētahi atu. Ka tohu mai anō hoki te taura whiri i te tino rerekētanga o te mahi ako me te mahi whakarauhora. Ki tōna whakapono, e pāi rawa atu ana te mahi ako a te maha o ngā ākonga āngari, mō te mahi whakarauhora, he take kē atu tērā. Nā runga i tāna rangahau, ko te tūmanako ia ka taea te whakahiato hōtaka hei tautoko i te mahi whakarauhora.

Rautaki

Ka uiuitia e mātou te wāhi a te taura whiri i te whanaketanga o Te Rautaki Reo Māori. Nā, kua tae atu te hātepe ki te wāhanga rapu tohutohu, ē, kua whakatakoteara e te poari he tāpae-tanga. Ka pātai mātou meheamea e titikaha kaha ana te taura whiri kei roto a ia i ngā mahere o te Kāwanatanga e pā ana ki Te Reo i ngā wā kei mua i tōna ārama āngari, kāore a ia i hiahia ki te kōrero.

I pātai mātou mō ngā whāinga roa me ngā whāinga poto a te taura whiri. Kei te whanga tonu te taura whiri mō te wā e ūmata ai whakatinanatanga o te raute, ē, mō ētahi whakahouanga, tērā pea ka hangaia mō Te Ture Reo Māori o te tau 1987; ēngari i te wā nei kua whakaaturia āna mahere i roto i tana tauākī whakamaunga atu.

Pūtea āwhina

Ka pātai mātou me pēhea te pūtea āwhina e taea ai. Ko te mea nui ki te whakapono o te taura whiri, ko te whārite o te tautoko mō ngā kaiwhakamahi kakama o te reo me te whārite o te whakatenatanga ākonga hou. Ki te whakapono o te taura whiri, he mea nui kia whārite te tautoko kaiwhakamahi kakama o te reo me te whakatenatanga ākonga hou. Ka pātai mātou meheamea ka tohina e hōtaka āwhina ki te taumata āngi; ēngari, e rangirua ana te taura whiri, ko tēnei te kōwhiringa pai. Whai putanga ai te iwi ki te hia kē e ētahi atu kōwhiringa pūtea āwhina, tae atu ki a Mā Te Reo. He rerekē o rātou pānga e pā ana ki te whakahare hōtaka reo. Ki te whakapono o te taura whiri, ko te kore rite o te tautoko mō Te Reo pea tērā ka hua mai.

Pāhotanga o Te Reo

Ka pātai mātou ki te taura whiri meheamea ki ō rātou whakaaaro, e rawaka ana te wātea atu ki ngā kaiwhakapeto reo irirangi me ngā kaiwhakapeto pouaka whakaata. Ki te whakapono o te taura whiri, kua noho kē kē ai te hongere matua a Whakaata Māori hei kaipāhotanga mā te āngi whānui, ē, taurua kāre Te Reo i roto i rahia rawa. Ko a ia nei, ēhara tērā i te tūranga tika mā Whakaata Māori, ē, te tikanga kia piki kē tāna noho here ki te reo. E hiahia kē te taura whiri ki te kīte i a Irirangi Te Motu me Te Māngai Pāho e whakapiki ana i tō rātou kaiangakau ki te tuku pūtea āwhina mā ngā hōtaka Te Reo taketake, tirohanga hou no konei ake, nō te hau kāinga. He pai kē ake ērā i ngā hōtaka nō tāwahi kē ngā reo o rōto, ē, ka tae mai ana ki konei kua raua atu te reo taketake o konei kia kore ai te reo nō tāwahi e rongohia atu.
Ka pātai mātou mehemea kaha atu te pā o ngā ringaringa o te taura whiri ki te māhi hoko hōtaka mai i raro i te rautaki hou. Ki te whakapono o te o te taura whiri, e hiahia kē ana te Minita ki te whakapiki i te mana o te iwi ki te whakahaere i ngā hinonga e tuku ana i Te Reo o rotong.

Te whanaungatanga me Te Puni Kōkiri

Ka pātai mātou, pēhea ai te mahi a te taura whiri me Te Puni Kōkiri, tērā pokapū aro turuki mō te taura whiri i raro i Te Ture Reo Māori. Whakamana ai Te Ture i te taura whiri kite tuku whakamaherehere ki te Kāwanatanga mō te kaupapa here e pā ana ki Te Reo Māori. Tērā pea ka mānukanua te whanaungatanga me Te Puni Kōkiri i te mea, tuku whakamaherehere ai hoki ki te Kāwanatanga mō ngā take Māori. I ētahi wā, he wāhi tō te reo i roto i aua take Māori. Ka whakaae te taura whiri, ka tūtuki ngā whakamaherehere o ngā rōpū whakahaere e rua ēngari, i te whānui o te wā ki tōna whakapono, he pai te whanaungatanga i waenganui i a rāua tahi. Heoi, ko tana hiahia, kia tino mārama kē atu ngā tūranga i waenganui i a rāua. Ka pātai mātou mehemea i āta whakaaroaro te taura whiri kia whakatakotoria he hanganga ture kia mārama ai ngā rerekētanga. Ēngari, ki te taura whiri, kei te tino mārama te hanganga ture whakahaere e tū nei i tēnei wā.
AROTAKENGA PŪTEA O TE TAURA WHIRI I TE REO MĀORI O TE TAU 2012/13

Tāpiritanga

Te huarahi ki tēnei arotakenga pūtea

I hui mātou i te 5 o Poutū-te-rangi me te 9 o Paengawhāwhā i te tau, 2014 ki te whakaaroaro i te arotakenga pūtea o Te Taura Whiri i Te Reo Māori. I rongo mātou i te taunakitanga a te taura whiri, ā, i whiwhi whakamaherehere mai i Te Tari o Te Tumuaki o Te Mana Arotake.

Ko ngā mema o te komiti, ko

Hōnore Tau Hēnare (Heamana)
Te Ururoa Flavell
Hone Harawira
Claudette Hauiti
Joanne Hayes
Brendan Horan
Hōnore Nanaia Mahuta
Rino Tirikātene
Mētīria Tūrei
Nicky Wagner
Meka Whaitiri
Jonathan Young

Te taunakitanga me te whakamaherehere i whihi

Ngā urupare ki ngā pātai ā-tuhituhi i whiwhi i te 7 me te 18 o Poutū-te-rangi i te tau, 2014, a Te Taura Whiri i Te Reo Māori.

Te tuku tohutohu e pā ana ki Te Taura Whiri i Te Reo Maori i te 5 o Poutū-te-rangi i te tau, 2014, a Te Tari o Te Tumuaki o Te Mana Arotake.

Te pepa tuku tohutohu a te rōpū whakahaere, nā ngā kaimahi a te komiti i whakareri, i te 5 o Poutū-te-rangi i te tau 2014.
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Television New Zealand

Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of Television New Zealand and recommends that the House take note of its report.

Introduction

Television New Zealand Limited is a Crown entity, and New Zealand’s national broadcaster. TVNZ operates six channels, two of which are digital Sky channels. It also operates an online video content site and a news website.

Television New Zealand’s chief executive is Kevin Kenrick; its shareholding ministers are the Minister of Finance and the Minister of Broadcasting. The board of directors is chaired by Wayne Walden. TVNZ is subject to the provisions of the Crown Entities Act 2004, the Companies Act 2003, and the Television New Zealand Act 2003.

For 2012/13 TVNZ generated revenue of $362.1 million (2011/12: $381.84 million). Net profit after tax was recorded at $14.4 million, exceeding the previous year’s result by $0.2 million.

Refurbishment and sales of premises

The central Auckland building that TVNZ currently occupies is undergoing refurbishment, which is expected to take two years, and involves temporarily accommodating 500 people. We asked TVNZ whether the refurbishments were necessary, or required to accommodate technology. It said that it is reducing the number of properties it owns, and consolidating all its office space. The building is 25 years old, and has an inefficient layout, so the refurbishment is necessary, but TVNZ also plans to make more efficient use of the building space, saving maintenance costs in the process.

The refurbishment, along with an upgrade in technology, is forward-looking. TVNZ intends the refurbishment to provide 25 years of accommodation, and an environment flexible enough to deal with new technologies and new methods of distributing content that cannot be predicted yet. It is also planning a more open-plan layout, in the hope of fostering an environment conducive to teamwork and engagement.

Cost of refurbishment

We asked TVNZ how much the refurbishment would cost; it said it could not disclose this information, as some aspects of the refurbishment and the costs were still under negotiation at the time of the review. It expects to be able to make all the information available by the end of this financial year.

Dividend relief

The Government has agreed to dividend relief for TVNZ to help it offset the cost of the refurbishment. We asked TVNZ to explain the rationale for this measure. It said that it had gained some profit from selling some buildings, but still needed to cover the cost of
temporary accommodation, as well as the refurbishment itself. We asked TVNZ how much the dividend would have been without the relief, but it declined to speculate.

**Sale of premises to Skycity**

We asked TVNZ to explain the sale of its premises at two addresses on Hobson Street in Auckland to Skycity, given that we had been told two years earlier that it would be too expensive to move from them. TVNZ explained that in its strategic review, it identified non-core elements of the business, one of which was property, which could go in order to free up funding for content. It had found that it could absorb the staff from these buildings once the refurbishment of its primary building is complete. It has no other property it plans to sell to Skycity.

**Pay-to-view television services**

TVNZ said that, since TiVo was not commercially successful and used out-dated technology, it considers that its decision to launch Igloo was sound. It represents an opportunity to enter a market sector, pay-to-view television, where it was not previously represented.

We queried the soundness of the decision, when there were only about 6,000 current subscriptions to Igloo, against the predicted 15,000. TVNZ said that a subscriber base takes some time to build up, so initially costs exceed profits. TVNZ said it had no plans to reduce its shareholding in Igloo, indicating confidence in its potential; however it may need to reassess this should the capital costs increase.

TVNZ shares the cost of advertising Igloo with Sky Television, and advertising costs nothing when the slot is one for which there is no other buyer. It has invested in the success of Igloo, but cannot guarantee it.

**Online television**

TVNZ told us that it expects its online audience to continue to grow. In the six months preceding the review, the number of streams had grown by 88 percent, but statistics suggest it is unlikely to overtake television viewing in the short term. Revenue from online viewing is also increasing rapidly, up 23 percent in the same period, compared with television’s increase of 2.4 percent. Online television currently accounts for 3 percent of TVNZ’s revenue.

We asked TVNZ about the increasing use of smart televisions, which connect to the internet and to other devices within the household. We were concerned that an exclusive deal with Samsung makes it the only brand of smart television able to use TVNZ’s on demand service. TVNZ confirmed that this was the case, but said there was no exclusive deal; rather that it was prioritising making the service available on devices such as tablets and smartphones because they are a popular way of viewing the on demand service.

**Political bias**

We asked TVNZ to comment on a news story about a former TVNZ news presenter who announced his intention to stand for election, causing TVNZ to say that he would not be able to return to his former role, because of the need for political neutrality in journalism. TVNZ does not believe that this is a widespread issue among its staff. It is conducting a thorough independent review of all the previous editorial content for any evidence of bias, and once it is complete it will be able to comment on the alleged use of TVNZ resources,
and thus public funding, for political campaigning. TVNZ told us it has a number of checks and balances in place to ensure the integrity of its editorial output. The chief executive, as editor in chief, told the committee that he did not notice any political bias in the content from that unit before the issue became public and no instances of allegations of bias came across his desk during the tenure of the person concerned. He does not think its reputation for impartiality will be damaged. TVNZ expressed disappointment in the presenter concerned and told us that it would be expanding its conflict of interest declarations as a result.

**Content**

TVNZ has recently entered into a partnership with the English Premier League, and now distributes its content on air. We asked if there were any plans to enter into similar arrangements with other organisations. TVNZ explained that it acquires content with the aim of providing New Zealanders with what they want to see. Sometimes it creates the content, and sometimes it buys it, and sometimes it gains access to it via partnerships. The opportunity to work with the English Premier League was unexpected, and reflected a growing international trend, especially in sport. TVNZ wants to continue to work with organisations that have the rights to various sorts of content.

**Diversity of programming**

We asked TVNZ if, in the light of the growth in ethnic communities of New Zealand according to a recent census result, it planned to increase the amount and availability of content for these communities. TVNZ said that this depends largely on advertisers. If many advertisers want to target ethnic audiences, it makes sense for TVNZ to invest in the content. Because advertising demand may not offset the cost of content, TVNZ is more likely to partner with content providers than to invest in making content that is unlikely to prove commercially viable.

TVNZ works with NZ On Air on programmes to celebrate the cultural diversity of New Zealand, putting forward programme proposals it receives for funding. It has a programming initiative aimed at minorities, but could not expand on it as it is commercially sensitive. It considers that content that appeals to small audiences is more appropriate online than in primetime television slots, commercial and financial viability being its main criteria.
Appendix A

Approach to this financial review
We met on 6 and 20 March 2014 to consider the financial review of Television New Zealand Limited. We heard evidence from Television New Zealand and received advice from the Office of the Auditor-General.

Committee members
Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Ann Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Evidence and advice received
Office of the Auditor-General, Briefing on Television New Zealand dated 6 March 2014.
Organisation briefing paper, prepared by committee staff, dated 9 January 2014.
Television New Zealand Limited, Responses to written questions received 20 February 2014.
Appendix B

Corrected transcript of hearing of evidence 6 March 2014

Members
Jonathan Young (Chair)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Raymond Huo
Mark Mitchell
Hon Chris Tremain
Jian Yang

Witnesses
Wayne Walden, chairman of the board, Television New Zealand
Kevin Kenrick, chief executive officer, Television New Zealand
Jeff Latch, head of television, Television New Zealand

Young If you’d like to just make introductions, that would be appreciated.
Walden OK. Thank you, Mr Chair, and thank you, members. [Introductions]

So if I could begin by saying that TVNZ is on track to meet its financial goals for the 2014 financial year and produce a result that confirns our position as New Zealand’s leading free-to-air national television and media company in what continues to be a dynamic and extremely competitive market. And given the dynamic nature of the industry, we do need to explore and try new ways to distribute content, and, look, some of those may work and some of those may not. In the 2013 financial year the company exceeded the shareholders’ expectations regarding return on investment. Television New Zealand exceeded the financial result forecast in our statement of intent by $400,000, resulting in a net profit after tax of $14.4 million.

TVNZ has moved from being the leading television broadcaster to being the leading multimedia video content provider. Television New Zealand’s success is dependent on content. This is reflected in the company strategy, which focuses our energies on engaging the hearts and minds of New Zealanders with the most watched content on air and now, increasingly, online. Television New Zealand’s leading content has created richer and more integrated viewing opportunities for viewers and advertisers.

Television New Zealand held 60 percent share of television advertising revenue, delivered strong growth in online advertising revenues, and
materially reduced known content cost during the year as a result of the efforts of our management and staff throughout the company. The board is very satisfied with the company’s performance.

So with those short words, I’ll hand over to Kevin to talk a little more in detail about the business and the 6-monthly result to date.

Kenrick

Thanks, Wayne. In addition to the review of the last fiscal year, we are well progressed in terms of the new financial year. Just last week we released our half-year results, and it shows that the company is really on track to deliver against both our business strategy and our near-term financial outcomes. A principal focus is on delivering year-on-year improvement in all aspects of the business. From a profit perspective at the half year, net profit after tax was $20.8 million, which was up 47 percent on the same period a year ago, and we’ve got a strong balance sheet, which enables us to invest in the future of the business.

So given the dynamic growth and change and evolution that we’re seeing in the industry, the ability to invest in our future is really critical. Right now we’re embarking on pretty fundamental changes and enhancements to our online capability to mirror what we have in the TV environment. Our share of TV advertising revenue and online revenue is strong. We continue to deliver the content that New Zealanders wish to see, with 18 of the top 20 rating programmes screening on either TV1 or TV2.

It’s a very exciting time for us in terms of transformation of the business because we have the physical transformation of our primary working place, being our TV centre in Auckland. We have moved somewhere in the region of 500 people to temporary accommodation as we start the refurbishment programme. This will take an expected 2 years to deliver, and, in tandem with the upgrade we’re putting in place our online technology, we think will enable us to create a future-focused environment so that we can continue to lead in the video content space and continue to deliver great outcomes for viewers.

So that gives you a bit of a flavour of where we’re at for this current fiscal year. Happy to pick up any questions you might have.

Faafoi

Could you explain the rationale behind the dividend relief that you’re going to be having with the Government?

Kenrick

The agreement that we reached with Government was that dividend relief was going to be put in place to offset the net costs associated with the refurbishment. So, obviously, there were some buildings that were sold and there was some profit on disposal of those buildings. There’s some temporary interim costs associated with renting space in an alternative building, and then there’s the cost of the refurbishment.

Faafoi

So there is a direct correlation between the buildings on Hobson Street being sold to Skycity and the fact that you won’t be giving as much dividend back to the Government?

Kenrick

Well, the situation with, you know, the decision around the sale of the building and the refurbishment, we had to look at that in terms of what was
in the best financial interests for TVNZ, and that was the basis the board made the decision. Part of that was looking at: strategically, was it aligned? And then financially, was it something that made sense versus the situation that would have prevailed if we hadn’t progressed with that sale.

Genter Can you just give us an estimate of the total cost of the temporary leasing for the 500 employees who’ve had to move out during the 2-year refurbishment?

Kenrick We’ve avoided disclosing the cost of the refurbishment at this point in time, given that we are still negotiating some aspects of the refurbishment and the costs that we’re incurring, and we feel to disclose them at this stage would prejudice the negotiation that would otherwise take place. We will be disclosing all that information as and when that’s concluded, and we expect to have that by the end of this fiscal year—that all that information would be available.

Bakshi Why is it necessary to refurbish your facilities? Is it because of a technology requirement, or it was due for refurbishment?

Kenrick What we’re doing is reducing the number of properties that we own and consolidating into one primary location. So the building that we are refurbishing has the floor plate space to be able to accommodate the total number of people, but the way that it was formatted and laid out some 25 years ago meant that it was a relatively inefficient layout. So the refurbishment will give us greater utilisation of that space, which will, long term, give us a more productive use of that building.

Bakshi Will there be any cost saving once you have done the refurbishment?

Kenrick Sorry, could you repeat the question?

Bakshi Will there be any cost saving on that?

Kenrick We would expect, once the refurbishment is concluded, that the operations and maintenance costs of a new, contemporary building would be far less than what it would be in an ageing building, and I think there will be some avoided costs that we would otherwise incur as we did progressive repairs and maintenance over a period of time. The current building is in excess of 25 years old and some aspects of it are, you know, a pretty good reflection of its age.

Young OK. So you’ve been appearing before this committee for a number of years that members here have been involved in, and reporting that you’re in major transition, of course—Mr Walden, you talked about new ways to display content. You’re a media company now, not just a broadcaster. Some work, some don’t. Tell us what works and tell us what doesn’t.

Walden Well, look, certainly TiVo really didn’t get off the ground, and I think that was probably because it was using, to some degree, very, very old technology. So that was an investment that certainly wasn’t well-founded. If you’re looking now at Igloo, I think the decision to go into Igloo is the right one because it does give the company an opportunity to participate in a particular market segment that we’re not currently in. We’re partnering with
the leaders in that pay-to-view area, and it’s like a lot of these new
technology businesses—you’ve got to be in there for the long haul, really, I
think, to start to see the results coming through. Look, Sky television
itself—I may have the numbers wrong, but I don’t think Sky produced
really a dollar of profit for at least 12 years.

Tremain How can that—just to make a supp. How can it be the right decision when
I understand current subscriptions to Igloo are about 6,000 and your
forecasts were, at this point in time, about 15,000. Secondly, you’ve already
divested some of your shareholding in that, so I’d be interested in
comments on those two issues.

Kenrick The pay TV business is one that you invest upfront. Typically what happens
is your costs are incurred on day one, and then you have a period of time
where you build up a subscriber base, so in the initial period your costs
exceed your revenues. The goal is then to grow your subscriber base to such
an extent that you then become profitable. What we’ve seen with Igloo is,
you know, we’re still in those very early stages. The reason that we’ve taken
the impairment is because we think that, you know, it’s an accounting
treatment of the carrying value of the asset, but the indication is—

Tremain Based on the forecast of the success of the business or not.

Kenrick Yes, but the indication is that it is going to take longer than what we
originally thought for this to be a profitable business.

Tremain Longer or a lot longer? I mean 6,000 versus a forecast of 15,000 seems to
me to be quite a long way behind.

Kenrick I think, to Wayne’s earlier comment, entering into a pay TV business is not
for the faint-hearted. It is something that there is a long period of
investment before you can expect to get a return, and I think that what
tends to happen is people look at a business like Sky right now and talk
about how profitable it is and how strong its financial performance is, and
tend conveniently forget the decades-worth of investment that preceded
that. Whilst Igloo will be somewhat different, it follows that same pattern.

Tremain So you’re confident about the future of Igloo? There’s no discussions at the
moment of divesting further of that particular investment?

Kenrick We don’t have any current plans to, no.

Young Coming back to the property at Hobson Street and the work you’re doing
around that, your needs have changed in terms of being a broadcaster and
now a media company, so what’s your plan going forward for that property?
What we need is a property that is going to set us up for the next 25 years. The current property has served us well for that same period of time, but what we are seeing is less of a distinction between how content is distributed and a need to create an environment that is far more dynamic, that has got more fluidity between different areas, and has the ability to enhance the way that we distribute things in ways that we probably can’t predict right now, so a big part of it is flexibility. A big part of that is creating an environment where teams of people can work together and you can reassemble how many are in that team and what the make-up of that team might be at any point in time. And we also need to remind ourselves that we’re in the content business. So we’re currently renting space in an office right now which is a generic office. What we’d like to see is that we can bring content to life in that environment.

Right, that sounds good.

Continuing on the distribution part, you have recently entered in partnership for the English Premier League, and you’re distributing their content on air. I would like to know what sort of planning you have in future to get into partnership with such consortiums or partners to enhance your viewership.

Sure. Let me give you—I guess a contextual response, and then Jeff, who is our content expert, can talk to some of the specifics. We’re in the business of providing New Zealanders with the content they most want to see, and that continues to evolve and change. There’s some of that that we create and make for ourselves, there’s some that we buy from others, and there’s some that we work in partnership with others around, and we will continue to explore all three avenues to ensure that we have the content that most New Zealanders want to see. Jeff, you can probably talk more specifically about EPL and that relationship.

I think it’s really interesting. I mean, as Kevin said, we are looking, obviously, to continually broaden and expand our content delivery via many platforms now. The opportunity that came around with the EPL was an unexpected one, but I think if you look globally there are more and more entities beginning to become involved, particularly in sport and the provision of sport across the world. I think Coliseum is probably the first of several that we will actually see active in this space. From our perspective as a media company, we really want to work with the people that have the rights to various properties, and the EPL is one. It’s been 20 years since we’ve last had it on Television One, and it’s great to have it back there.

With the recent results of the census in 2013, you must have seen that there is an increase in the ethnic community and their numbers have really increased. So what is the plan for Television One or TV2 to go into that sector to cater for the ethnic community in the near future?

The critical balance that we need to manage is the size of the audience versus the ability to turn the eyeballs into dollars. What we need to ensure is that there is a significant critical mass of advertisers that are willing to spend money to get their message in front of those audiences, and when that
occurs, then it obviously makes financial sense for us to invest money in that content. There is an audience for pretty much any form of content you might like to find. Unfortunately, there’s not always an advertising demand that would offset that cost. At this stage we are more likely to partner with others rather than to make a big play in that space, because there’s no evidence that would suggest that it’s going to be commercially viable for us in the near to medium term.

Genter

Just coming back to the sale of land to Skycity, Sir John Anderson told this committee 2 years ago that there were quite a few plans for the B block, which is 85 to 91 Hobson Street, which has since been sold to Skycity. He said it was fully occupied, it would be expensive to move, that TVNZ had plans for this. When exactly did TVNZ decide to move from Hobson Street?

Kenrick

Sorry, I wasn’t a party to those earlier conversations with Sir John, but what has happened since that period of time is we have concluded a strategic review of the business and looked at what we do want to focus on and what areas we see as being less core to the business. When it comes to property, we had three buildings on Hobson Street. One of those was essentially being used for storage and overflow, and the other two buildings were being used as part and parcel of what we do in running the business.

What we found was that we could absorb that number of people into our primary building if we refurbished that and we changed the format and the layout of that building. We felt that there was a willing buyer that was prepared to pay a price that was in the best interests of TVNZ, and hence we took advantage of it. We’re not a property business; we’re a content business. So if we can consolidate into a smaller space and get more effective use of that dollar to free up more money to put into content, we think that’s really consistent with our strategic plan.

Genter

I appreciate that point, but can you tell us when exactly it was that TVNZ made this decision?

Kenrick

Let me just refer to my notes. The TVNZ board approved the sale of 93 Hobson Street on 5 July and approved the sale of 85 to 91 Hobson Street on 3 September.

Genter

Right. And can you tell the committee approximately how much more the dividend would have been if there hadn’t been the need for this dividend relief because of the refurbishment, or give us an estimate?

Tremain

That’s an offset, isn’t it?

Kenrick

I’m not sure I fully understand the question. I guess you’re either paying a dividend or you’re reinvesting that in the business. I think that the agreement that we’ve reached is to reinvest that in the business to cover the net cost associated with the refurbishment.

Genter

And you’re not going to give us the amount of the net cost associated with the refurbishment at this time?

Kenrick

From last financial year?

Genter

Yeah, and ongoing or estimate.
Kenrick The ongoing estimate becomes somewhat challenging because we don’t know exactly what the profitability is going to be and we’ve yet to conclude the final negotiations in terms of the costs of the refurbishment, so both of those are open to change. We will disclose those as and when those commitments are put in place.

Faafoi I’m just going to ask a supplementary question on Julie Anne’s question and then I’ve got a completely new line of questioning. The sale of the land we’re talking about at the moment settles on 21 March, but is there any other land on that block that you own that SkyCity is looking at buying?

Kenrick I think you’d probably have to ask SkyCity, but there’s no other land on that block that we’re seeking to sell.

Faafoi OK, let me put that question slightly differently. If you own other land on that block, are you in any discussions with SkyCity that they want to get their hands on it?

Kenrick No.

Tremain I just want to start a bit of a different line of questioning around the culture at Television New Zealand, and start by asking: is Television New Zealand a breeding ground for Labour Party activists?

Kenrick It was going to come! We don’t believe so. We are in the process of conducting a very thorough review and investigation in terms of what took place. We’ve got some very capable external and independent people who are actively participating in that. We will be guided by the conclusions and recommendations that come from that review.

Tremain We’re dealing with the financial review here of last year. What resources at Television New Zealand do you think were utilised to not necessarily encourage but to facilitate meetings from the Labour Party, and other political parties for that matter?

Kenrick I would rather wait until we’ve concluded the investigation, and that is under way, and then we can talk about facts and what’s actually occurred, as opposed to—there’s no shortage of opinion, but we’d rather conclude the review and come back with some facts.

Tremain Some of the facts are on the table though, surely. I mean, rooms were used?

Kenrick That’s my understanding, yes, but as I say the purpose of the investigation is to uncover all the facts. We’ve committed to making the outcomes of that publicly available.

Tremain Do you think there needs to be a culture change at Television New Zealand in this regard?

Kenrick My personal opinion is that we had some poor judgment by some individuals. I think to extrapolate that into something which is a cultural issue for our entire Māori and Pacific department, let alone the organisation as a whole, is something that I don’t think is founded.

Tremain Are there any other employees that you’re aware of that are mounting campaigns within Television New Zealand to become candidates?
Kenrick: No. I know one who is an ex-employee, but other than that I’m not aware of any, no.

Tremain: So existing employees who remain in your employ, are they moved on? What is the situation? Because I understand there is a second political activist who is currently in your employ.

Kenrick: Do you want to be specific about whom?

Tremain: I understand Mr Coffey.

Kenrick: So, Tamati has worked with us for many years. He’s no longer employed by TVNZ.

Tremain: Has that employment contract finished?

Kenrick: Yes.

Faafoi: Just before I ask a question, I just want to state very clearly that from this side of the equation, and also as a former staffer of TVNZ, that any use of public broadcaster resources or time is completely unacceptable. But my question is, I guess, because there is an investigation now into whether or not there was any perceived bias in that unit, you’re the editor-in-chief, you have to keep a close eye on what comes out of those kinds of departments. Did you or anyone that you delegated to keep an eye on that content notice anything before this happened?

Kenrick: No, we didn’t. We have a number of checks and balances in place to ensure the integrity of our editorial output. So no one individual has unilateral ability to influence that editorial output, and on that basis we would like to think that we’ve got the right processes and things in place.

Faafoi: Just to be clear, I am familiar with the referring-up process and also the checks and balances. Nothing came across your desk, as editor-in-chief suggesting there was any bias here?

Kenrick: No.

Tremain: Do you think this has given a hit on TVNZ’s reputation in terms of your independence as reporters?

Kenrick: The outcome is not one that was planned or designed, and we are absolutely gutted that it has occurred. Our understanding is that this is an isolated individual, and potentially a small group of individuals, and we want to be absolutely sure that that is the case. Then what we can do is review what processes we can or should review and do differently to make sure it doesn’t occur again.

Tremain: What’s the time frame for the review? When do you expect to be announcing the findings and changes to any processes or systems within Television New Zealand?

Kenrick: The focus is very much on the quality of the review, as opposed to the time frame of it. We’ve committed to the principles of natural justice, which means that we need to ensure it’s fair and accurate. We need to get input and feedback from multiple parties. We need to give them the opportunity
Mitchell: Have you gone back and reviewed any of those editorial pieces done by anyone that now has been exposed as being a political candidate, and if you have gone back and reviewed, have you identified any that you feel there has been unfair treatment or poor editorial approach or bias to you?

Kenrick: That is the focus of the investigation, and my understanding to date is that there hasn't been anything identified, but it's still in the throes of that process. So we've been very clear about the scope as being the output from our Māori and Pacific team through the period of time that Shane was general manager of that, and we've also committed to review, over that same period of time, any presentation roles that Shane played on the Q+A programme.

Mitchell: And have you done anything right now? I know you're waiting for the result of the review, but has management done anything right now to try to identify or establish whether or not there's any other aspiring political candidates, regardless of what party, inside TVNZ that have got access to the development of editorial material?

Kenrick: We gather from people, on annual basis, a declaration around conflicts of interest. My personal view is that we should expand that to be more specific about participation in political parties and to then, off the back of that, ensure that we've got the right checks and balances in place.

Mitchell: But other than that, have you done anything outside of, say, a declaration to actually identify or see whether or not there are any existing political aspirants inside the organisation?

Kenrick: We are conducting the review. We expect the review to give us some really good insights about what we should be doing. What we don't want to do is to trigger a bunch of tactical initiatives that might be quite unfounded, as opposed to conducting the work, gathering the facts, and then basing our decisions around that.

Mitchell: So nothing has been done up until now then. You're waiting for the result of the review.

Kenrick: We have no reason to suspect or believe that there is any editorial bias in any other parts of the business. The scope of the inquiry here is specifically around one department and around one programme.

Young: Were you surprised this happened?

Kenrick: Yeah, very much so—surprised and disappointed.

Young: And do you feel that there's a permissive attitude in TVNZ's culture?

Kenrick: No. We were very clear that there was a risk in this particular circumstance. We confronted that explicitly with the individual involved. We sought and received assurances from him. We relied on those assurances and acted accordingly.
Bakshi As you have just mentioned, you are reviewing the editorial. If the report comes up that the editorial was biased, will you be giving, as part of natural justice, the other party to come up and take air time to clarify their position?

Faafoi You want a half-hour show or something, do you?

Kenrick It's a hypothetical question. I'd prefer to focus on the facts as and when they're known, and we can respond to that at that point in time.

Huo There is a huge gap between the mainstream media and the ethnic communities. The mainstream media's understanding of, for instance, the Asian community probably is still at the line dancing level. Do you have any plan to bridge the gap?

Latch We work with NZ On Air, I guess, on a range of programmes to celebrate the diversity of peoples living in New Zealand, and I guess to some degree it depends on the programme proposals that are put forward for our review and evaluation, and then the process goes that we then take the ideas through to NZ On Air. So that process will continue. It seems to be working well.

Yang Yes, essentially, I was going to ask a similar question. Basically, you just said—back to Kanwaljit’s question—that you are partnering with some other people or organisations for programmes for, I think, communities. Who are these partners?

Kenrick We are currently negotiating with a party. I mean, my preference is not to disclose the commercial sensitivity at this point in time.

Yang OK. You mentioned that because of commercial problems that you might not be able to show the programmes, then are all the programmes you are not having now driven by commercial interests?

Kenrick I don’t see that there’s necessarily a separation between the programmes that New Zealanders want to view and the programmes that are commercially viable. In fact, there’s quite a strong overlap. In an advertising-funded environment, advertisers want to put their messages in front of a critical mass of audiences. So if we’ve got a programme that no one’s viewing, it’s also going to be unattractive to advertisers. Conversely, if we’ve got a programme which is hugely appealing and it attracts a significant group of viewers, that is going to represent value for advertisers. So I don’t see the need to separate them.

I do think we need to run a commercially viable business, but the way that we do that is providing the content that most New Zealanders want to see most often. We have 18 of the 20 most watched programmes in the last 6 months. We have the most watched news programme. We have the most watched current affairs. We take real pride in the quality of our content and the audiences that we are able to deliver off the back of those.

Yang I certainly understand that you do need to consider commercial liability. But on the other hand, I think you do need to consider the strategic importance of certain communities, because Auckland is now the most ethnically diverse city in the world. So it is important that you have a strategic plan,
trying to basically cater for the interests of these communities. That’s why I’m asking. There are some programmes which may be not necessarily commercially viable but are still important.

Kenrick Yeah, and there is a particular initiative which is commercially sensitive that we’re working on at this point in time. But I do think we need to acknowledge and understand that New Zealand is a nation of less than 5 million people, and when you start slicing that into niche-market opportunities, quite often those niche opportunities are financially unviable. So in a market of the scale and size that we have, we need to focus on a broad reach. TV programming needs to appeal to hundreds of thousands. There’s probably more avenues for us to look at more niche-type content in any online environment, where we can maybe appeal to tens of thousands, but in prime-time TV that really does become quite problematic to get the maths to stack up.

Faafoi I’m just going to join my ethnic friends here in asking a supp there. I guess what essentially you’re saying is that because you’re running a commercial environment and while you’re State owned, I think, or more or less—more becoming less a public broadcaster—the likes of the programming that many people have talked about around this table hasn’t got a hope in hell of getting anywhere where people are going to watch it.

Kenrick If there is a critical mass of viewers that share the opinions that have been expressed in this room, then it would make a huge amount of sense for us to make that available. But if not, then it becomes problematic from a financial point of view.

Faafoi So, essentially, what you’re saying—anything that appeals to minorities is going to be stuck on a Sunday morning still. That’s the reality, isn’t it?

Kenrick Um—

Faafoi It’s a yes or no question.

Young Sunday morning’s great.

Faafoi I’m not saying anything about the quality; I’m just talking about the commitment to the programming.

Kenrick I think we are committed to providing New Zealand’s most watched video content. There’s not a lot of value in us providing content that people don’t choose to view. There is no shortage of people who would tell us that we should provide more of any number of genres or types of programming. The difficulty is getting a similar number of people to actually line up in their behaviour and watch it, to make it commercially viable.

Faafoi So if you’re talking about commercially viable, would you prefer not to show any of New Zealand content here because it’s much cheaper to get hold of and people will watch it?

Kenrick No, I haven’t said that at all. In fact, what we find is of the highest rating shows—

Faafoi No, but I’m saying is that a better business proposition?
Some of the highest rating shows that we have are the New Zealand shows that are produced locally. New Zealand’s Got Talent was the highest watched show in over a decade, and that was all about New Zealanders seeing themselves on screen. We invest significantly in local content. We'll continue to do so. In fact, in this coming year we expect to spend somewhere in the region of a hundred million dollars on local content.

How much of that will come from NZ On Air?

That’s the investment from ourselves from within the organisation. NZ On Air on top will be probably directly to us about another $5 million or $6 million, and then most of NZ On Air’s funding actually goes to independent producers to produce shows for ourselves and for other broadcasters.

I just have a supp on this, and I just wanted to ask one other question about the strategic review you mentioned. On this topic, is it not the case that there are some audiences that will never be commercially viable simply because they’re not the target demographic for advertisers? And they could be a substantial number of people, of New Zealanders who would be interested in a certain content like, for example, people over the age of 60, 70?

Our starting position is to provide the content that most people want to watch. Then the challenge for us is to say how can we turn that viewer attention into dollars, and some of those have got a higher commercial value than others. But I do think we, like the rest of the world, face an ageing demographic. I think many of the commercial audiences tend to cap things at a certain age, but I expect that over time that will expand, because it’s a growing proportion of the population. They tend to have more disposable income, and I suspect that that’s going to be of appeal to advertisers.

So the only audiences that are going to get content are those that have a lot of disposable income and aren’t target demographics for advertisers, basically?

In an advertising—

In a commercial—

In an advertising-funded business, we need to provide things that are going to have appeal to advertisers.

And viewers?

Well, advertisers also want to appeal to viewers. So—

Only certain viewers, though, right?

It’s a pretty simple exercise. No viewers, no advertisers. You know? So you have to get the viewers first. The way you get that is the most compelling content. If you do that really well, then what you’ll have is something which is of appeal and interest to advertisers.

Does that influence your treatment of news and current affairs?
Kenrick  In what way?

Faafoi  Well, you want to get the most viewers. Does that change the way you look at news and current affairs?

Kenrick  Well, we take pride in the fact that we have New Zealand’s most watched news. We have New Zealand’s most watched current affairs. We need to continue to tailor that around what audiences are looking for.

Faafoi  I’m talking about the treatment of news and current affairs. So let’s say Seven Sharp, which is a vastly different show to what you’ve had. Is that a commercially driven decision?

Kenrick  It’s an audience-driven decision.

Faafoi  What drives the audience?

Kenrick  Well, the behaviour by consumers, in terms of what it is that they choose to watch.

Faafoi  So it is a commercial decision—how you treat that specific show, in terms of a news and current affairs treatment.

Kenrick  Quite simply, what we found was when we looked at the audiences at 7 o’clock, aside from Shortland Street, which continues to have a huge audience every night, both networks were providing shows that had less viewership than what was preceding that, and there was a pretty clear indication from audiences that they were looking for something above and beyond legacy formats of current affairs shows.

Tremain  I want to look to the future. We’ve had a bit of a discussion before about Igloo and whether that was going to be successful or not and some decisions that the board had to make around that. Just thinking about the online presence—obviously, a much more difficult forum to drive advertising revenue. What’s your thinking on that online position? Where’s TVNZ heading in that direction?

Kenrick  We believe that online viewership of video content will continue to grow. Our Ondemand offering is the market-leading play in New Zealand, and in the last 6 months the number of streams has grown by 88 percent. We expect that it will continue to have very strong growth, but I think we also need to put it in context of TV viewership.

So if you take online viewership of video content and TV, online globally represents about 3 percent and TV about 97 percent. So, yes, we expect online to continue growing, but we don’t see it superseding TV anytime soon. In fact, increasingly, the big opportunities are the integration between the two. The America’s Cup was a good example of that, where we had a lot of people that were watching the first race on TV but watching the second race on a mobile device or on a PC in the office.

Tremain  Do you treat them as different profit centres?

Kenrick  We do in order to ensure that they’re both going to be contributing, they’re both viable, but, ultimately, they’re part of the broad P&L which is TVNZ.
Tremain: So is online a loss-leading product at this point in time?

Kenrick: No, it is a cash-positive, profitable business.

Tremain: It is? OK. So in percentage terms you talked about 3 percent of the audience. Is that reflective of Television New Zealand, or is it higher or lower, and is the revenue for TVNZ similar or different?

Kenrick: The revenue is reflective of that kind of split. You know, for us the pace of growth—in the last 6 months our TV revenue was up 2.4 percent, our online revenue was up 23 percent. So whilst the pace of growth is significantly higher, the starting position is significantly lower.

Curran: Thanks for your presentation, which I'm sorry I didn't hear. I had to be in two places at once this morning—I'm back now. It's very interesting to hear that statistic around the 23 percent growth online. I know that it's from a small base, but it's growing steadily and the trajectory is certainly going up in terms of people viewing content online, and we know the trend is worldwide towards that. Can you tell me—have you got any statistics on the uptake of smart TVs?

Kenrick: I don't have the specific numbers to hand, Clare, but what—

Curran: So you know, though, how many people are buying smart TVs and connecting to the internet through those. Have you got data on that?

Kenrick: We do have some data on that. What we're seeing is as people replace their TVs—the new generation of TVs, by and large most of them, if not all of them, are smart TVs. However, the number of people that take advantage of that and actually connect them online is quite modest, but we expect that that will grow. One of the challenges you face is that each manufacturer of TV sets has a somewhat proprietary approach to how they do that, and so from a user perspective, depending on what TV you've got as to what process you need to go through to take advantage of that, and I suspect that that's one of the things that limits the uptake.

Curran: So the uptake of your TVNZ Ondemand app, is that the 23 percent figure that you were just quoting? Is that the growth trajectory?

Kenrick: So the 23 percent relates to the revenue growth from digital media, which is both TVNZ Ondemand and onenews.co.nz. In terms of scale of our Ondemand offering, we have had stream growth of about 88 percent in the last 6 months. I mean, a good week for us would be a million streams.

Curran: And a lot of that would be on other devices other than smart TVs?

Kenrick: Yeah, our mobile app has now been downloaded half a million times.

Curran: I guess, with regard to internet TV, because that's growing in importance in New Zealanders' homes and as fibre becomes available, then it's going to become even more important. Is it true that your TV Ondemand service is only available on one brand of television—smart TV?

Kenrick: In terms of the actual use of the native smart app within that TV, that's correct. What we’re finding, though, Clare, is that the area that we’re seeing the biggest uptake is in tablets, which seems to be well suited to watching
video content. But you have a number of people who will then take the content from a tablet and they’ll project it on to their TV.

Curran But I’m talking about smart TVs, which are growing in importance in New Zealanders’ homes because they’re big, because they’ve got the big screens, and because people are buying them and starting to turn them on because they’ve got the capability through fibre to get content and because very slowly we’re starting to get the more content deals becoming available. I guess what I’m asking you: is there an exclusive deal between TVNZ and one brand, which is Samsung, to provide your TVNZ Ondemand service? Now, if so, how could that be, given that TVNZ is a public organisation?

Kenrick No, that’s not the case.

Curran So it’s not the case that TVNZ Ondemand is only provided through the Samsung TVs?

Kenrick Yes, it is, but it’s not because of any exclusive arrangement we have with Samsung. The additional complexity that you add to a technology environment every time you add another proprietary interface has to be weighed up against the incremental audience that you might deliver off the back of that.

Curran So what about the other brands of internet TVs? Why is it that you can’t access TVNZ Ondemand through those brands?

Kenrick Because we’ve chosen to prioritise other devices that will reach a broader range of audience.

Curran That sounds like “exclusive deal”.

Kenrick I see it as more of one of timing, Clare. The distribution via iPhones and iPads far outweighs any smart TV application that is put in place, and that’s why we prioritise them ahead of it.

Curran So does your arrangement with Samsung involve only providing the TVNZ Ondemand service to the Samsung?

Kenrick No, it doesn’t.

Curran So there is no reason why you couldn’t be providing it to TV brands?

Kenrick Well, the critical thing is it needs to represent value for TVNZ. If the cost and the added complexity of putting that in place outweighed the benefits we’d get from that, then it would be foolhardy for us to progress that.

Yang Regarding online viewing, you mentioned that now TVNZ thinks of itself as being more a video content business than just a TV business. Now you have tables here showing the average audience for different programmes. These do not include online viewing, I guess. Actually, my question is what’s the income from online viewing in terms of percentage—or if it can be more specific, it will be better.

Kenrick So which page and which document are you referring to?

Yang On page 20-21. The tables regarding the average audience for different programmes, these figures do not include online viewing, I guess. Actually, my question is what’s the income from online viewing in terms of percentage—or if it can be more specific, it will be better.
Kenrick: The revenue that we derive from online viewing is on a par with the time spent viewing online business TV, which is about 3 percent.

Yang: 3 percent?

Kenrick: Yeah.

Yang: But it’s growing fast?

Kenrick: Yes it is, off a relatively modest base.

Genter: You mentioned earlier that the decision to move from Hobson Street was the outcome of the strategic review. Would you be able to provide the committee with a copy of the strategic review and any other documents associated with the move?

Kenrick: I didn’t say that the decision to sell was on the back of the strategic review. We did a strategic review which looked at what we should be doing in the business over the next 5 years, and the decision to sell the property was consistent with that. The focus of the strategic review was not about property per se; it was more about the future of TVNZ and how we’re going to succeed in the digital space, and the integration between content online and on air.

Genter: Oh, so the decision to sell those properties was for other reasons not related to the strategic review?

Kenrick: I think if my recollection of the question that you asked previously was about a previous chair who had expressed different plans about what we may or may not do with the property. The strategic review helped us to focus on where the future is in terms of content, where the audiences are going to be, how we can participate and the way that we can make money, and also identified non-core aspects of the business that if we divested we would free up resource to invest more in content. Property was one of those non-core areas.

Genter: And are there documents related to the decision around property and moving away from Hobson Street and the refurbishment? Are there any reports or reviews that were undertaken that help to come to that decision that you could provide the committee with?

Kenrick: We have information that was presented to the board when the board made that decision. So, yeah, absolutely there’s detailed documentation around that.

Genter: Are those available publicly?

Kenrick: Well, we tend not to make our board papers publicly available.

Genter: OK, right. So would we be able to request them as part of this—the board papers specifically related to the decisions made around the property?

Young: Anything submitted a year ago is in the public domain, so there’s issues around that—confidentiality and commercial sensitivity.

Tremain: You can probably request them under an OIA.
Mitchell Can I just have a supp on that question, because just coming back to the change, the move, that you're making, it's also an attempt to modernise the workspace and how you're actually going about business, isn't it? Could you talk a little bit about that, because I think you made quite a big fundamental change in the way even people are working together.

Kenrick Sure. I think we’ve learnt quite a lot about property in the last 12 months, and working with various architects and other advisers. The shift from the building that was created 25 years ago to, you know, I guess the contemporary thinking of today—big shifts in terms of a space that is characterised by offices, and offices tend to be really good for having quiet workspace but they are space inefficient and they don’t promote working and sharing of ideas openly between groups or individuals, whereas what I think we are embarking on is something which is more reflective of activity-based working. It’s more an open-plan environment.

The people that we have moved to temporary accommodation have all moved to an open-plan environment, which is better utilisation of space but the real value we’re getting is the integration and the engagement between groups of people that otherwise wouldn’t have occurred as freely or as frequently.

Faafoi Can I just return to Igloo and ask a few basic questions. I’m just trying to get my head around some numbers. So you guys invested about 12 and a quarter million? Is that right? And then you diluted the investment halfway through last year to take it down to roughly 34 percent, and so what is the value of your shareholding now in Igloo?

Kenrick What we have done is we have booked our share of operational losses against the carrying value of the asset through the period of time that we’ve held it. What we’ve done at the half year is we’ve taken a further impairment charge to reduce that carrying value to zero.

Faafoi So I guess I’ve not counted. So I guess I’m trying to figure out what is your loss from the initial investment to where you are now?

Kenrick Well, our share of the losses of the business go against the carrying value of the asset, which is in keeping with accounting principles and rules about how you should treat the value of investments. We expected that this business would lose money for a period of time. The indications are that it would lose money for longer than what we originally proposed, and yet we continue to be a shareholder in the business. We continue to work with our JV partner Sky to grow the value of the business through growth and subscribers.

Faafoi So you’re committed to it long term?

Kenrick We are still an active participant, we are still a shareholder in the business, and we still have aspirations to grow its performance.

Faafoi So you’re committed to it long term?

Kenrick Well, as I say, you know, it’s incumbent on us as a shareholder in the business to maximise the value and the return we can get out of it.
OK. You see, we were told earlier that you’ve got around 6,000 subscribers—Mr Tremain has already brought this up—and, roughly, you need 15,000 to get some kind of break-even or profitability point. Last year you came here and said that you’re confident—Clare Curran asked: “Are you are feeling confident about Igloo in this direction?”. You said yes, and then 4 months later, in a letter to the shareholders, you diluted your shareholding in the company. So what happened in those 4 months that made you change your mind?

The big opportunity that we were focused on when we last had the conversation around this was the transition to DSA—

But you knew—that wasn’t something new though, was it?

Well, if you let me finish the answer. What that presented was an opportunity for people to determine how they would be digitally connected. In some cases that was FreeView, and in some cases it was Igloo, and in other cases it was Sky. So Igloo participated in that process, and that’s what we saw as the opportunity to grow subscribers.

The challenge with the Igloo business has been how do we ensure that we’ve got active usage, because it’s a subscription-driven model. So whilst we’ve got a number of set-top boxes out there, the real value of the business is driven by how many purchase a channel pack on a repeated basis.

OK. This is my final question on that. Given the investment you’ve made, given your actions in June last year, given where your subscription levels are now—and you’re saying that you’re committed to it long term—do you think Igloo was a good investment to make for TVNZ?

I think when the decision was made at the time to invest in Igloo, it made a lot of sense. It was about making a play in an area that was expected to grow and that TVNZ wasn’t currently participating in.

The way that it’s turned out, there’s been a number of areas that we’ve been disappointed in, but at the same time what we need to do is continue to focus on how we can grow that subscriber base and continue to improve it.

So I guess, sitting here right now, what you know since you signed on the dotted line, do you think it was a good investment?

I think there are other investments that we’ve got better returns out of, faster. This one’s obviously going to take a whole lot longer.

And you are committed long-term to it? I guess I don’t want to see another TiVo, where you said you were committed to it and then, all of a sudden, next year we’ll be here and you would’ve dumped the whole thing altogether.

I think that in the world that we live in, there are going to be any number of new evolving distribution opportunities. We are going to participate in as many of those as we possibly can. Some will work and some won’t. I think that, at a minimum, what you get is some great learning and insight out of them. If you’re in early on these things, you get first move or advantage in...
terms of picking up on the benefits, and you’re first to feel the pain if they
don’t work out. But I think we are committed to being the leading provider
of the content in New Zealand, and, therefore, we are going to continue to
invest in additional and new distribution channels.

Curran Just a quick supplementary question on that, Mr Kenrick. I admire your tact
in how you are describing TVNZ’s commitment to Igloo. The truth would
be that it is a dog. My question is, really, are you continuing to share the
costs or bear the costs of advertising for Igloo?

Kenrick We do provide some promotional support for Igloo.

Curran Do you share those costs with Sky or is that marketing cost borne by
TVNZ?

Kenrick Well, Igloo has a raft of marketing initiatives. Some of those include
advertising on TVNZ channels.

Curran I’m sorry, I am quite specific about this: is TVNZ bearing the cost on its
own for the television advertising of Igloo, and promotion?

Kenrick No.

Curran You’re not. So Sky is contributing to that cost?

Kenrick Yes.

Curran Can you give a percentage of how much TVNZ is paying and how much
Sky is paying—not actual figures, but a percentage?

Kenrick If I look at the marketing—

Curran 50:50? 70:30?

Kenrick Well, if I look at the marketing budget for Igloo, TV advertising is one
component of that and TVNZ has some channels that provide advertising,
as does Prime, from Sky’s perspective. So that’s part of it, as is any activity
they might do in terms of outdoor billboards, bus backs, radio, social
media—

Curran Can you give us a ballpark figure on the marketing of Igloo and the
amount—the percentage roundabout amount—being borne by TVNZ, a
ballpark figure?

Kenrick In cash terms, nothing, because we put our capital upfront, so we are not
incurring any cash cost associated with the marketing information of it.

Curran It’s on our television screens every night, Mr Kenrick. It’s being advertised
every night. There’s a cost to that. I know you might be bearing it internally
if it’s a cost, so—

Kenrick Yes, and I think there is an opportunity cost if there was an alternative
buyer for that advertising time. If what we are doing is providing advertising
that was otherwise unsold, the cost of that for TVNZ is effectively zero.

Curran Just to clarify, though, that’s a zero cost to TVNZ for marketing of Igloo. Is
that what you’re telling us today?
Kenrick: No, I’m not. I’m saying that if there wasn’t an alternative buyer for that, then the cost of that is effectively zero. If there was in a buyer for that, then—

Curran: That sounds like accounting-speak to me.

Mitchell: If no one’s there to buy the space, then there’s no cost associated.

Just very quickly on Igloo. There are short-term investments and there are long-term investments riding on it. It appears that Igloo is emerging as a long-term investment. You’ve alluded to the Skycity model as an example. So, you know, I think we will accept that maybe you might have got a better return on the short-term investment. However, you’re in this thing now. I guess the question is: are you committed to it and do you see a genuine return, even though it may be a long-term investment on the Igloo investment?

Kenrick: We will continue to monitor the performance of it. We will continue to support it actively as a shareholder. In terms of the long-term prognosis, I don’t have an answer for you on that. But what I do know is that we have invested, we have stumped up, we are a participant, and we’re going to drive it as well as we possibly can. Would we like to see it succeed? Absolutely. Can I guarantee that that will happen? No, I can’t.

Young: Well, I’d like to thank you, Mr Kenrick, Mr Waldon, Mr Latch, and your other team here. All the very best, and thank you for coming to the Commerce Commission.

**conclusion of evidence**
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The Education and Science Committee has conducted the financial review of the 2012/13 performance and current operations of the Tertiary Education Commission, and recommends that the House take note of its report.

Introduction

The Tertiary Education Commission (TEC) is a Crown entity established under the Education Act 1989. The TEC’s principal role is to give effect to the Government’s Tertiary Education Strategy by issuing guidance and allocating Government funding to tertiary education organisations, and monitoring their performance. It also provides advice to the Government on the tertiary education sector.

The TEC’s total revenue for 2012/13 was $2.759 billion, down from $3.161 billion in the previous year, mostly due to a 13 percent reduction in grants revenue. The TEC recorded a total operating surplus of $6.205 million, a decrease of 83 percent from the previous year, reflecting a lower grants surplus, and an operating deficit caused by a lower allocation from Vote Tertiary Education.

Operating environment

We suggested that the TEC might have lost its way recently, becoming overly bureaucratic and thus unable to deliver the value that it should. The TEC told us it is making changes, and is confident it can provide value by acting as an independent investor in the tertiary sector, rather than simply an allocator of funding. The TEC has begun discussions with the chancellors and vice-chancellors of the universities about adopting this approach, and expects it to result in universities and the TEC discussing longer-term spending strategy.

The TEC believes an investment model would require a revised governance model. We also discussed the possibility of a wider review of the university sector, and specifically the desirability of universities specialising. The TEC intends to present position papers to the Minister on these topics. We will watch with interest any developments in this area.

Non-university sector

We heard that some at the TEC think that the role of the polytechnic sector needs to be reviewed, as there are a number of regions where competition for funding between polytechnics and universities results in a significant amount of wasted money for little return. The TEC said that the roles of universities and polytechnics had not been clearly delineated, and any review of the sector should address this issue.

We are aware that the industry training organisation (ITO) sector has undergone extensive reform in recent years, and fewer trainees now fail to achieve any credits. The TEC recognises that improvement is still needed in areas such as course completion and credit attainment. The commission is engaging more with the management of ITOs, and has also improved its oversight by introducing an industry training register. We hope these changes deliver more improvement in performance.
We are aware of education performance indicators introduced recently for tertiary education organisations. We heard that institutes of technology and polytechnics have responded positively to these indicators. The TEC expects to increase the achievement threshold set by these indicators periodically, but is aware that this process will produce diminishing returns. It expects that indicators will eventually be tailored to individual institutions.

We are aware of instances of private training establishments receiving funding to deliver a course without having prepared any course materials or a curriculum; some have apparently approached a polytechnic shortly before the course was due to start seeking to purchase these resources. The TEC said it actively encourages tertiary organisations to share and sell course curricula to each other, to avoid a proliferation of similar qualifications. We heard little value is added when multiple organisations create similar qualifications, particularly at lower levels, where most of the qualifications are generic. Some of us are concerned that some polytechnics’ pass rates are driven by funding models. The TEC is aware of concern that organisations are passing students to avoid losing funding, and is seeking to prevent this happening.

**Governance**

We are aware that the TEC advises the Minister on appointments to governing councils, and heard that it has recently started to help train new council members. In 2010 the Government changed the governance arrangements of institutes of technology and polytechnics, including a reduction in the number of council members, and a requirement for council members to demonstrate the ability to govern. We heard that performance in the sector has improved since these changes were made.

**Youth Guarantee Scheme**

The Youth Guarantee Scheme is designed to provide fees-free tertiary places for eligible domestic students aged 16 to 19 years to study towards a level one, two, or three qualification. The TEC funds approximately 127 tertiary education organisations in New Zealand to offer Youth Guarantee programmes. We heard that funding decisions are influenced by the regional spread of education provision and the number of young people not in employment, education, or training in each region, among other factors. Tertiary organisations must ensure that the funding is targeted at the learners most in need. The TEC encourages all providers to track their learners’ progress after education, to ensure that their provision remains relevant to local businesses and the economy.

**Performance-Based Research Fund**

The Performance-Based Research Fund (PBRF) is intended to encourage and reward excellent research in the tertiary education sector. The fund is designed to increase the average quality of research, ensure that research continues to support undergraduate and post-graduate teaching, and improve the quality of public information on research outputs, among other things.

The PBRF is the second-largest research fund administered by the TEC, at $1 billion over six years. We heard that a review conducted by the Ministry of Education found that the rate of inter-institutional collaboration has increased since the PBRF has been operating. The TEC has developed guidelines to ensure that the resultant research is relevant to New Zealand, but it recognises the need for an evaluation to determine whether the PBRF
continues to create the right incentives for academic focus. We look forward to seeing the outcome of any review of this fund.

**Canterbury rebuild**

Budget 2011 provided up to $42 million for additional trades training places for the Canterbury region, to meet the expected increase in labour demand for rebuilding. We are aware that funding for an additional 1,173 full-time-equivalent student places was made available through this programme, but only 702 were delivered by providers. Private training establishments were allocated 199 of these places, but delivered only 90. The TEC explained that the apparent shortfall in delivery is the result of inaccurate forecasting of demand, and it reallocates any remaining funding. The TEC is confident that demand will be met at some point.
Appendix

Approach to this financial review
We met on 19 February and 19 March 2014 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)
Catherine Delahunty
Hon Jo Goodhew
Chris Hipkins
Colin King
Tim Macindoe
Tracey Martin
Simon O’Connor
Grant Robertson
Dr Megan Woods

Evidence and advice received
Office of the Auditor-General, Briefing on Tertiary Education Commission, dated 17 February 2014.

Organisation briefing paper, prepared by committee staff, dated 17 February 2014.

Tertiary Education Commission, response to written questions 1 to 140, and 141 to 154, received 28 January and 28 February 2014.
2012/13 financial review of Transpower New Zealand Limited, and Report from the Controller and Auditor-General on Transpower New Zealand Limited: Managing risks to transmission assets

Report of the Commerce Committee

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Transpower New Zealand Limited and Report from the Controller and Auditor-General on Transpower New Zealand Limited: Managing risks to transmission assets

Recommendation

The Commerce Committee has conducted the financial review of the 2012/13 performance and current operations of Transpower New Zealand Limited, and examined the Report from the Controller and Auditor-General on Transpower New Zealand Limited: Managing risks to transmission assets, 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 Alison Andrew, who replaced Dr Patrick Strange in early 2014. Mark Verbiest is the chairperson of the board. We thank Dr Strange for his service and wish him well.

Transpower is 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 2012/13, Transpower generated total revenue of $918.4 million, compared with $783.8 million in 2011/12. Its after-tax profit of $263.7 million exceeded the previous year’s $84.8 million.

Grid infrastructure

We asked Transpower about the current state of the national grid infrastructure, and how ensuring its resilience might affect transmission charges. We heard that recent investment in the grid has resulted in a short-term increase in charges, which Transpower expects to level off after April of this year. Transpower acknowledged that its grid is aged by international standards, and updating it is important for ensuring security of supply. Transpower did acknowledge that the grid is more reliable now than it was 20 years ago and it is in a far more stable condition.

Transpower told us that it has a comprehensive programme to manage its transmission assets, replacing or repairing parts of the grid as necessary. A new asset management system, Maximo, has allowed Transpower to prioritise its work more accurately in recent years. Transpower told us that bringing some functions back in-house has also improved its asset management.

We asked whether any legacy projects were still to be addressed, and were told that scheduled major rebuilding projects have been completed, but significant investment will still be needed to meet future replacement needs. Transpower said that it must balance the need for reliability against efficient use of capital. We heard that risks are assessed carefully.
when deciding between replacing assets and having spare parts to hand. We were told that information on the management of grid assets is publicly available. Transpower said that Ministers are kept informed of its capital expenditure needs and the Government monitors the situation closely.

**Report from the Controller and Auditor-General**

In 2013 we examined the report from the Controller and Auditor-General on *Transpower New Zealand Limited: Managing risks to transmission assets*. The report found that Transpower New Zealand Limited is in a good position to reduce the likelihood of power failure, and that it solves problems as they occur and to a high standard. While the Auditor-General found that Transpower has the governance capability to oversee complex projects, she also found that the organisation needs an integrated long-term planning strategy, drawing on data held in multiple systems and formats. Transpower recognised this issue, and had begun to improve its planning before the report was published. A follow-up report is expected this year.

We are particularly interested in Transpower’s capability to oversee and implement its new risk management schemes, and how the Auditor-General intends to measure it. We were told that their outcomes should suffice to indicate whether systems are managed properly. This is an area which we will monitor with interest.

**Tiwai Point aluminium smelter**

We asked Transpower if additional upgrading of the grid would be needed in the event of the Tiwai Point smelter closing, and were told that expenditure would be necessary to move the resultant excess power north. In particular, infrastructure between the Clutha and Waitaki rivers would be stretched. The work involved has been planned for and the groundwork has been done, but the project would not begin until the closure of Tiwai Point was certain. Transpower said it has no more knowledge about the potential closing of the smelter than has been released publicly.

**Future demand**

We asked Transpower if its projections for demand were realistic, in the light of recent low growth in demand, increased solar generation, and the potential closure of the Tiwai Point aluminium smelter. Transpower acknowledged that demand can be volatile and planning involves some uncertainty. It tends to err on the side of caution, rather than risk overcapitalisation. Transpower has plans for managing any increase in demand for two or three years while it assesses the likelihood of its continuing to rise.

We asked how prepared Transpower is for increasing growth in Auckland. It believes that now a transmission ring and feeder have been constructed, supply to Auckland is more reliable and the system will be robust for the foreseeable future. Transpower noted that the situation is prone to change, so flexibility is important. Assuming Auckland’s growth continues as expected, however, Transpower believes that substantial capital investment will not be needed there for another 20 years.

Transpower also noted that peak demand is not the main driver of its expenditure. A drop in demand growth can actually increase pressure on transmission infrastructure; the first response would be closing coal plants in the North Island, which would mean more power coming from further away to service the growing population in Auckland, putting stress on the grid.
Debt levels
We asked Transpower about its high level of debt and if it had any plan to mitigate the risks with securing future funds. It told us that it has a broad programme of measures to spread risk. It obtains funds from multiple local and international sources, and extends the maturities on senior debts. Transpower told us it expects its debt to peak at $3.6 billion in the next financial period, compared with $3.3 billion currently. In addition, risk is managed through a strict policy on hedging and the use of credit swaps.

Compared with overseas transmission agencies, Transpower believes its debt profile is reasonably conservative. It has pursued this in order to maintain its current credit rating. Transpower told us that international best practice is to keep debt levels at between 60 to 80 percent of assets, and Transpower currently sits at about 70 percent. It admits that an increase in debt might improve the bottom line, but this has to be balanced against efficiency and minimising the overall cost of finance. Transpower believes that it is in a position to access funds in the event of a crisis. We asked if it would favour a uniform gearing ratio for state-owned enterprises, but it did not think it appropriate.

Community projects
Transpower has a number of community projects, mostly designed to engage with communities and landowners affected by grid infrastructure, to preserve community goodwill. Projects include assistance with planting projects and maintaining community buildings.
Appendix A

Approach to this financial review

We met on 13 February and 13 March 2014 to consider the financial review of Transpower New Zealand Limited. We heard evidence from Transpower New Zealand Limited and received advice from the Office of the Auditor-General. We also heard evidence from the Controller and Auditor-General on her report, Transpower New Zealand Limited: Managing risks to transmission assets.

Committee members

Jonathan Young (Chairperson)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Julie Anne Genter
Mark Mitchell
Hon Chris Tremain
Dr Jian Yang

Gareth Hughes replaced Julie Anne Genter for this item of business.

Evidence and advice received

Transpower New Zealand Limited, Presentation to the committee, 13 February 2014.

Transpower New Zealand Limited, Responses to written questions 1—145, received 13 February 2014.

Transpower New Zealand Limited, Responses to additional written questions 146—153, received 10 March 2014.

Office of the Auditor-General, Briefing on Transpower, dated 13 February 2014.

Organisation briefing paper, prepared by committee staff, dated 13 February 2014.
Corrected transcript of hearing of evidence 13 February 2014

Members
Jonathan Young (Chair)
Kanwaljit Singh Bakshi
Hon Clayton Cosgrove
Clare Curran
Kris Faafoi
Gareth Hughes
Mark Mitchell
Hon Chris Tremain
Jian Yang

Witnesses
Patrick Strange, Former Chief Executive, Transpower
Alison Andrew, Chief Executive, Transpower
Howard Cattermole, Chief Financial Officer, Transpower
Mark Verbiest, Chairman

Young Well, welcome Mr Verbiest and Dr Strange. Good to see you, sir, and also welcome Alison Andrew, new chief executive, and also Mr Cattermole. It’s good to have you here. Now, we’re going to give you probably no more than 10 minutes, less would be great, just for your presentation and then we’ll come to questions.

Verbiest Thank you very much. Could I, firstly, acknowledge our new chief executive, Alison Andrew, who is week 2 in the job. It’s not the norm, but such is his commitment to Transpower and the industry that Patrick agreed to attend today as well, given that this is a report about the last financial year. So I’m very appreciative to Patrick for coming along.

Young Yes, likewise.

Cosgrove You might want to have a word to Solid Energy. They could adopt the wonderful principle you’ve established today. That would have been helpful a year ago. Thank you.

Verbiest Look, last year we had a very successful year, from our perspective. Our revenue increased to $918 million. As you’ll be aware, our revenue is largely regulated. We have maximum allowances set by the Commerce Commission. We produced a healthy profit, which was enhanced significantly by the sale of an operating unit we had in Australia, which was
not core to our business, d-CyphaTrade, which added nearly $66 million to the bottom line and with a successful sale, it was achieved.

In terms of our operational measures, they were all very healthy, with one proviso. We are very fixated—probably, our largest operational issue that gets the most attention both at the board and the management level is safety. We operate in a high-risk area. We set ourselves virtually impossible safety targets and have a very strong commitment to safety, but, nevertheless, our number of medical treatment injuries that were reported was higher than the target that we set. So we have a very active programme involved on safety. Our issues tend to be more related to our subcontractors, but the point is that we’re responsible for them, as well. We’re not shedding our accountability for safety in that regard.

We commissioned two of our major projects. You’ll be aware that in the recent 2 or 3 years we’ve had quite a significant CAPEX uplift as we commissioned new projects. The North Island grid upgrade was completed successfully last year and we brought the Cook Strait new link online and enhanced that also within this financial year, in December, to add a total capacity of 12,000 megawatts across that link.

We have also now, pretty much with most local councils, agreed transmission line corridors. Very important, obviously, for New Zealand generally that Transpower has ready access to these corridors and, again from a safety point of view, we don’t have unwanted activities that are literally very proximate to the grid, from both a safety and a reliance point of view. We successfully launched a financial transmission rights market and a new gas market.

Our CAPEX programme, as I’ve indicated, has peaked and going forward we’re certainly forecasting lower CAPEX going forward. A large chunk of our expenditure had been related to three major projects, the last one of which we’re hoping will be commissioned in very short order—the North Auckland and Northland project. And in the last financial year, of the $684 million that we’ve spent, $256 million of that was related to these three projects.

We anticipate that with low to flat demand growth, going forward, our CAPEX should stabilise around the $300 million to $400 million level going forward for the next few years, and probably the majority of that CAPEX is actually around refurbishment, replacement, and repairs. We still—on an international basis, comparing ourselves to our peers—have a somewhat aged grid and we are still working, in effect, on some catch-up to ensure that the grid stays as reliable as possible.

We’ve also adopted in the last few months a service company mantra as the tenet of our strategy, which is all about being as efficient as possible with the grid that we have and trying to minimise and defer as much further investment in the grid as possible. So we are now working very steadily, using technology and other techniques on things like demand side response, which can be deployed, and successfully defer transmission investment going forward.
Look, that’s all I wanted to say by way of opening up, from my perspective. I might just get Alison to make a few brief comments about a few of the forward looking aspects around safety, demand, etc.

Andrew

Thank you, Mark. The slide we’ve got in front of you is around the safety culture of Transpower, and this shows the significant progress the company’s made to become a more safety alert company, towards zero harm. So there has been very significant progress—still a lot of work to do.

A number of our incidents, as Mark said, we have too many, still, medical treatment injuries, lost-time injuries. What we really want to focus, though, on is those near high-potential incidents, the incidents where we could actually have a fatality. Most of our medical treatment, lost-time injuries, while regrettable, are not of those significant high impact. They’re more ankle rolling, knee rolling, those sorts of things. But our focus is absolutely towards trying to have a zero harm industry.

One of our challenges is working with our service providers and working with the subcontractors to our contractors, and ensuring that the whole delivery chain is as safe as possible. We’re doing a lot of work with our service providers to make sure they’re on that journey with us.

Talking about the forward projection for power demand, there’s a chart in there, which shows you quite a wide range of where demand could go in the industry. And the point we want to make is it’s quite volatile and quite unpredictable about what is going to happen in the future, but it’s quite evident that we could have zero growth in demand for power. It could be quite a different change, going forward. So we want to make sure that Transpower can ensure that the grid is available and is reliable for demand as required, but we don’t overbuild. And that’s quite a challenge for us, going forward, to actually work out what the demand will be and we have to be mindful we may have flat growth.

Cosgrove

Sorry, over what period are you forecasting?

Andrew

If you look at this chart here, we’ve gone out to 10 to 15 years, but it’s near future. It is quite volatile.

Verbiest

We look at this every year, basically, and update our forecasts, but we try to be as forward looking as possible, given that transmission investment is a long-term game and these are long-term assets.

Andrew

If we look at transmission prices, we have given you a graph here, which shows you transmission prices, both in nominal and in real terms, and it’s just showing that over time, in real terms, transmission prices have not gone up significantly, but, clearly, in nominal terms there has been an increase. But this is put in context of the actual transmission prices over the long term.

And the following chart is a build-up of actually where the price difference between 1990 and 2013—shows the inflation adjustments and real price increases. And if you look at this chart, the transmission cost increases are in green, and you’ll see there’s very little, in fact, no real increase in transmission prices over that period. So we are very well aware there is a
significant debate—and rightly so—around end-user, consumer electricity pricing, but this chart, I think, does help put it in context the contribution that transmission prices make to overall electricity prices.

Transpower does have a significant investment and is very careful to make sure we keep good relationships with the communities, and the stakeholders, in which we operate. We are very mindful of making sure that we keep landowners and communities onside when we need to do these major rebuild and repair projects. We’ve spent over the year $1.36 million in CommunityCare Fund grants to these projects—three regional Greenline projects initiated and over 10,000 plants provided by Transpower. This has been very successful for us, to make sure that we’re working with the communities as we’re doing these major projects.

So the summary—it’s been a strong financial performance for 2012-13. We have a very strong balance sheet. Clearly, there’s an issue yet on the NIGUP outcome. In post these major projects there’s going to be an increasing emphasis on improving efficiency and productivity, on prioritising and optimising our expenditure, and improving our customer service. Thank you.

Young Great, well, thank you very much for your presentation. Let’s come to questions. In your chairman’s report, Mr Verbiest, on page 4, it says: “As a result of the significant reinvestment to restore the resilience of the grid, transmission charges are increasing in the short term.” Can you define just the short term and that increase?

Verbiest Well, we’ve got an April increase schedule, I think—Howard?

Cattermole The one there will be, yes.

Young That’s in the graph, is it?

Cattermole The chart that Alison referred to shows that increase, and then we’re anticipating a levelling off of prices thereafter.

Young On the graph it shows going up to 1.5 cents per kilowatt/hour, then dropping back.

Cattermole Yeah, in real terms.

Young OK. All right. OK, so then you refer to the fact that—

Verbiest Sorry, chairman, just to clarify, that represents, if you like—as a result of us commissioning these new assets, essentially.

Young Yep, right, so it’s a lot of commissioning costs in there. I understand that. Thanks. You also mentioned in your opening remarks that, in terms of your international comparison with other similar type entities, we have what is described as an aged grid. This committee has gone through the Auditor-General’s report of 2011, looking at the infrastructure of a national grid. Can you make some comments around that in terms of the security of supply issues that you have been addressing these last number of years?

Verbiest Make no mistake, the grid is sound and reliable as it is, and we’ve got a team that works very hard to ensure that that’s the case. We have a programme
that’s, for example, centred around substations—a whole lot of parts that have been in place for a very long time. It’s about a programme that we have, which is formulated and under a framework. That prioritises the assets that need the most work. There’s a programme of replacement over time.

Andrew Perhaps I can add to this. The grid, by its nature, will have a variable life. Some assets will be brand new, like, for instance, the big work we’ve done on the new poles and the HVDC link upgrade. There’ll be some parts that are quite old—they might be 50 years—and still fit for purpose, because we’re not going to be replacing things all at once, and they’ll be keeping the grid reliable over time. So we’ve spent a lot of time and have some way to go, but have made significant progress around asset management and really trying to understand, as Mark said, when the right time is to replace, when the right time is to repair, and what critical spears we should have to really make sure we make the grid as reliable as it needs to be. We still have work to do, but we’ve actually made significant progress on that. But in answering your question, our grid, by its nature, will be of varying ages. Some parts will be brand new, and some parts will be appropriately relatively old. That’s the nature of a long-term grid.

Verbiest What we did deploy in the last financial year was a new asset management system known as Maximo, and so through technology we are increasing our own knowledge of increasing the granularity of the asset base that we have so that we can properly prioritise maintenance and replacement.

Tremain Is the grid more reliable, more secure, than it was 20 years ago?

Verbiest Yes.

Strange Without a doubt. We were definitely getting very stretched in a couple of places. Without a doubt we’re back to the stable situation.

Tremain That’s good to hear. Second point is along the lines of—you indicated that it’s still not as good as some, and, further to Jonathan’s question, I don’t feel you answered that question well enough. What would we need to do to take it to a stage to be at international best practice? What would be the key investments we would now need to make?

Verbiest Well, what we are doing—the first key investment was that asset management system. We’ve brought some other core functions that were handled by contractors back in-house as core functions, so that our people feel ownership of the assets in a greater sense. The key thing is prioritising, as opposed to being a little less piecemeal, perhaps, in years gone by, in terms of the way that maintenance has been carried out.

Tremain And are there any legacy projects that you still think we need to address in the next 5 years?

Andrew I’m reasonably confident that the big rebuild—the things we absolutely needed to do because the grid was significantly losing reliability—we’ve largely got those projects behind us. You can never say we’re not going to have issues, because that’s the life, but we’re very confident now that we’ve hit the big things, but there are still a number of maintenance, reliability,
and replacement issues, and I’m confident the team now has the tools and is starting to get the data to make better decisions. If you look at our capital profile, there is still a significant investment to make sure we replace parts at the appropriate time when they are the age—we can have some parts when we do have some failures.

So we’re never going to have a system that is entirely reliable. That would be inefficient use of capital. It would be overcapitalised. So now it’s about us being optimising and efficiency. We’re getting through that big catch up, but we will be spending significant amounts, but being very prudent and careful about how we do that at the optimal time.

Cosgrove You talk about the fact that you’ve got the Maximo system. This is a risk management assessment tool, I presume. Can you talk us through exactly how that works in practical effect, and also what visibility and information are you providing Ministers in terms of the risk profile of your assets?

Andrew Patrick, can I ask you the question?

Strange Yeah, look, we’ve got millions of assets and they’re all likely to fail. You’ve got to look at the reliability of an asset and the risk of it failing and also the consequences of it failing. So you’re trying to optimise those all the time. Like this transformer we absolutely cannot afford to lose. The risk is too high; therefore we’ll replace. We might have an alternative scenario saying, well, providing we can get a new one in 48 hours or 46 hours, we’ll be all right, so we’ll have a spares policy. All the way through to, look, we’ve got enough redundancy in the grid. Sure, it has a high probability of failure, but the consequence is not so high to justify doing anything about it. So it’s constantly making those trade-offs across the group.

In terms of transparency, the whole philosophy is that information should all be generally—

Cattermole To the industry, so the Commerce Commission as a regulator gets total transparency on all that.

Strange If you read our submission on RCP2—well, don’t unless you want to go to sleep at night. It’s probably 1,500 pages. All that is public data.

Cosgrove And specifically to Ministers, because I would’ve assumed that Ministers would want to take quite an interest in ensuring that it’s as close to optimal as possible, but also Ministers may form a view that some sort of capital injection might be required, depending on the information you give them. I don’t know if there are any discussions around that.

Strange No, look, I’ve worked through two different Governments now and both have been very supportive, I’ve got to say, in terms of what’s necessary in transmission—various Ministers. So they do query: are we doing the right thing? Are we not sort of underspending on our infrastructure?

Cosgrove Have they raised any concerns?

Strange They have not raised any concerns, but I’d say in both Governments, they’ve monitored it pretty closely. I mean, we all know transmission is
pretty essential to the nation’s wellbeing and we don’t want to get into a situation where—

Verbiest You’ll be aware that through the major upgrade phase, we didn’t pay any dividends for a couple of years, and those funds were used partly to fund those major projects.

Cosgrove And dividend projections going forward?

Verbiest Dividend projections going forward are pretty much consistent with the underlying level that we’ve been paying to date. So there’s no likelihood of special dividends. I think our policy is set out now.

Cattermole Yeah, the projections are set out in our SCI.

Verbiest In our SCI forecasts, $151 million - odd this year, $188 million next, and $211 million in 3 years’ time—what we would expect in the normal course as of today.

Cosgrove And have there been any discussions with Ministers about increasing or decreasing that?

Verbiest None.

Cosgrove Well, that dividend policy—Ministers are happy with what you’re paying out.

Verbiest Yes.

Cosgrove Right. So no discussions or pressure—

Verbiest None.

Cosgrove —as there has been in the past. OK.

Faafoi Can I just ask a question that I think Mr Tremain has already asked in a slightly different way. Do you have any idea of what proportion or percentage of the network might be needing replacement soon and what that might cost them, and how critical that part of the network might be?

Strange The average life of components in the network range from about 20 years for electronics, like the control systems on some of our big stuff will only last 20 years, a bit longer than your desktop computer, whereas big assets are 60 years. So if you think—I don’t know what our asset base is now.

Cattermole Nearly $5 billion.

Strange Nearly $5 billion. You could say that every year about 2 or 3 percent of that has to be replaced. So we look at our average age of those components. Transformers are about 35 years, I think, nominal life about 50. It used to be growing; it is now stabilised, and we think 35 is about right. So, basically, most of that $300 million or so we’re spending in CAPEX going forward is just that maintaining the grid.

Verbiest And we shouldn’t get too carried away. When we talk about an aged grid, that doesn’t mean that things are about to fail. You can never say never, but we think the grid is in a stable and reliable position now.
Andrew and I think we also want to recognise that there has had to be a significant catch-up because there was under-investment, and I think the prudent way to operate this is to make sure that we keep it in a sensible state; we don’t have these big lumpy investments. There will be from time to time, but not a big catch-up where reliability is compromised.

Young Are we at a sensible state?
Andrew Yes we believe so.
Verbiest Yes.
Young Yeah, we’ve got your CAPEX now going forward I think you mentioned is about 300 to 400.
Verbiest 300 to 400, yeah.
Young As opposed to, we got up to I think 900 million in 1 year?
Verbiest That’s right. That’s at its peak—yeah.
Young Yeah, that’s good.
Hughes Thanks very much for the presentation. My question is around your projections for future peak demand. It is interesting, you know, you’re expected figure is an increase from 6,500 megawatts to 7,500 megawatts. Do you think that’s realistic, given we’re seeing demand for about 2 percent in the last year? We could see Tīwai close from 2016. And things like solar have grown 370 percent in the last 2 years.
Andrew That was the point that I was raising—that it’s quite volatile, and it is very possible that demand may not go up at all. So there’s a lot of uncertainty, as you say, like Tīwai, like solar. It’s very hard to predict that, so I think it’s plausible to have a wide range which could be from nothing to figures you’ve suggested. So what I think is important is that operators like Transpower are mindful of the fact that demand could be quite volatile, and, as far as possible, has plans in place as robust as possible to be able to deal with that uncertainty.

Strange I can probably answer that. We have to always be able to keep the lights on whatever happened. So we have a prudent growth, say 4 percent increase in peak. We have to know that if that happens, we can keep the lights on. What we don’t want to do is go and spend, you know, half a billion dollars and then find it didn’t happen. So what we’ve developed are things like demand side options which we can run for 2 or 3 years, and what they do is buy us time. So if Alison faces that 4 percent increase, she will keep the lights on, but she won’t be building big infrastructure until she’s certain.

But the other thing to watch is that it’s not actually peak demand which drives a lot of our expenditure. We are basically in part a transport mechanism from all the renewable stuff—Taupō and south, all the way into the South Island to Auckland, which is getting bigger. If you guys have got a cure for that, we’ll leave that up to you. Actually, if demand growth goes
down, we will probably get higher transfers on the grid, because what we’ll see is the thermals in the far north—the Huntly coal units closing earlier, and more are coming from the south. Actually, Tiwai closing will increase Transpower’s loading because you’ll have 600 megawatts free in the deep South Island and that will get soaked up by Auckland, and some more thermals in the north will close. So it’s complex. But what we don’t want to do is create a white elephant and say it’s going to grow at 4 percent and possibly spend a lot of money. Demand side is a big short-term option for us on that.

Hughes So let’s say hypothetically Tiwai did close in 2016. Would you need further grid upgrades to be able to move that power north?

Andrew Yeah, we do need to spend some money to do that. It’s just to enable the connection to the grid. And the HVDC link has given us a lot more flexibility to be able to do those sorts of things, but we would need to spend some money and I’ll get Patrick to talk about details.

Hughes Do you have a figure, an estimate?

Strange Yeah we have. The piece between the Clutha and the Waitaki would get stretched. We had a project approved about 3 or 4 years ago to spend roughly $160 million. Some of that was needed for reliability, and that work is ongoing. So, give or take, you could say there’s about another $90 million for the project which would have to be triggered if Tiwai was definitely closing, which we have no view of. That would take about two summers.

We’ve done all the engineering work for it. We’ve got all the consents, so we’re ready to go. But we will not spend that money until the day that we know Tiwai is definitely going to go. So we’re in good shape I think. What we don’t want to do is go and spend that $100 million, put it in everybody’s charges, and then find Tiwai’s still there in 20 years.

Cosgrove On that last point of Tiwai, have you had any—presumably you’ve had discussions with Tiwai prior to and post the Meridian deal being locked down, given that their notice periods halved and they could if they wished go by 1 January 2017. Have you had any discussions, and, if so, what’s the nature of those discussions?

Strange I don’t think we know anything more than others. We form our own views—

Cosgrove So you have had discussions?

Strange We keep discussing with them what their plans are. With the New Zealand entity they say they have no plans to go.

Cosgrove Does it concern you that—what interpretation do you then put on an agreement which halves the notice period? Why would an entity require halving a notice period if they weren’t looking at exiting sooner rather than later? Have you raised that issue with them to try to get an interpretation?

Strange I think if I put myself in their shoes, honestly, that gives them a better option value if the New Zealand dollar goes through the roof, their economics, given we’re just exporting electrons.
Cosgrove: So it gives them an easier exit route. Is that it?

Strange: Well, it gives it flexibility and it probably means they don’t have to make a decision to go as early, so you could say it extends their time they’ll be here.

Cosgrove: I appreciate your interpretation, but can you go beyond that? Have you had any—

Strange: No.

Cosgrove: —information or indications or detail from Tīwai themselves.

Strange: No, we have no indications of any plans over and above what we can read in this prospectus.

Cosgrove: Have you asked?

Strange: Yes, we have asked.

Cosgrove: And they’ve said what? They’re not telling.

Strange: They say they don’t know. They say they believe they will be here for the long term but, you know.

Young: What sort of investment, in terms of doing that link up between Clutha and—[Interruption] You say it’s 90.

Strange: It’s about $90 million of additional money. It’s probably going to be a bit less because we’ve done some good engineering. It’s more the time it takes. It’ll take a couple years.

Young: Right—thanks.

Tremain: Can I just ask additional to that—the Tīwai Point site, going back to the Auckland City, there’s no doubt that that is still going to grow. Given the current investment that you’ve done through the Waikato, what sort of timeframe does that give us into the future, as in futureproofing Auckland?

Andrew: One of the key things it’s done is improve reliability to Auckland. So we now have a ring and a feeder, so that’s much more reliable. So we believe we’ve got a good situation for Auckland. In any system there’s always going to be your bottlenecks—you remove one and then another one becomes that. But we feel we’ve got a good robust system for the foreseeable. You never say it, but if Auckland grows dramatically, if we have dry years, things happen. The grid is dynamic and things can change and we need to be flexible for that.

Tremain: So you still haven’t quite answered my question. We’ve got a 20-year horizon for growth in Auckland, putting the Tīwai aside. I don’t want to put words into your mouth, but what sort of—

Strange: We’ve got 20 years before we’d absolutely have to do anything significant.

Tremain: Putting Tīwai aside.

Andrew: Assuming Auckland’s growth is as we predicted.

Hughes: Just on the demand growth projections, do you have a view, and did you submit to the Electricity Authority’s transmission pricing methodology on
the avoided cost of transmission? I know many distributor generators around the country are quite concerned around the proposals. They got about $50 million, I think, in the last financial year. Are we making the most of distributed generation potential?

Cattermole We certainly made a submission to the Electricity Authority, so we’re monitoring that whole process very closely. I don’t think we expressed a particular view on that issue, but the whole consultation that’s going on we’re heavily engaged in.

Yang I have questions regarding the technology, which you touched upon. You say that technology will be a key enabler for getting the most out of the grid, thereby deferring the need to build new lines. My questions are, first of all, are you satisfied or happy with the technology you have got so far, in terms of hardware and software, and secondly, is there any technology that you think will be good to have but too expensive?

Andrew That’s a good question. I mean, we have to balance, and clearly we want to be innovative and introduce new technology, and the upgrades on the grid, like the new pole upgrades, have got some very good technology and good investment in that, but we have to be mindful too of reliability. We’re not going to be a company that introduces bleeding-edge technology. That would be imprudent. We’ve done some work on Transmission Tomorrow, and some possibilities for what might be coming in the future. We closely monitor that, and at the appropriate time we’ll introduce it as part of our capital proposals. With our systems and processes, we’re confident we’ve got some very good stuff coming forward. There’s always more to do, but it’s always the dollars. Patrick, did you want to add anything to that?

Strange No. I mean, I think you’re right. In some areas we have to be bleeding edge. We have the most modern DC system in the world now. In theory, the world is looking at us, at what we’re doing with that. We are two islands and shipping a lot, so we do need to be bleeding edge there, but on other things we’d rather be prudent followers, because if we get it wrong, then we all know about it. It would probably be on the front page of the newspaper, and we can’t afford that.

Yang So we could say that what we’ve got is actually a world-class grid. Would you say that?

Andrew No, I think again, coming back to the point about the age, we’ve got some old pieces and some new pieces. We’ve got some parts of the grid, as Patrick said, that’s world class, and we’ve got some other parts that are not. But it’s not necessarily prudent for us to spend to get there. So it depends on the application.

Verbiest Technology-wise though, we have the right technology, the appropriate technology, in place and we have the right sorts of plans in terms of looking forward.

Bakshi You mentioned about the Greenline projects and CommunityCare funding. Can you elaborate a little bit on that—what’s happening and what are your future plans about the Greenline project?
Well, I will get Alison to speak about Greenline, but broadly our community projects are very much centred around our engagement with the communities in which we have direct engagement with landowners, with small communities, where we have our lovely structures sort of passing through, and so having some direct involvement of our people, and actually spending some money in those communities has worked very well to improve our overall engagement with our stakeholders.

In terms of Greenline, Alison do you want to—

I was just going to add to that, but perhaps I'll pass it over to Patrick on that one. But I would just elaborate that, as Mark has said, with our big towers going through we rely on good community will to ensure that we can keep those corridors and work on our lines and do things, so we do invest in making sure that we keep those stakeholder relationships very constructive and very positive. So that investment is very focused and very targeted to where we are doing the work. Patrick, do you want to embellish on Greenline?

Yeah, Greenline is just shades on the community trust, which might do things like paint a hall in a place, in the shade of the towers. Particularly our younger staff, a lot of our staff wanted to get involved in some of these projects, and a lot of the communities wanted a value on, say, re-greening a swamp we've gone through, or something—things like this. So we've got a programme. We put a little bit of money in, but importantly our staff are the volunteers and they then go and work with the community on planting, etc.

It's tiny amounts of money, but we find the engagement with the local communities who would, you know, put these beautiful structures in, Mark calls them, has really lifted. So it's been a very successful programme, courtesy of our coms fund.

I've got a question. In terms of your capital projects that you've completed and the ones coming up, they have put Transpower in the situation where it has quite high, I guess, borrowings in a sense from that. So in terms of going forward what sorts of things are you doing to mitigate any risk with securing funding going forward, at an affordable rate?

We have a very broad programme that seeks debt funding from a number of areas. Of late we have raised quite a bit of capital, including in the last year, from the local markets. Two things really. It's the spread of our debt portfolio, but we've also very actively encouraged the Treasury team within Transpower to look at pricing on a competitive basis. We've looked to extend—as the markets have allowed us—we've looked to extend the maturities on our senior debt quite significantly.

So if you compared our debt profile today to what it was, say, 2 or 3 years ago you would find the longer dating of maturities. So I think peak debt we would forecast will be around $3.6 billion in the next financial—it's currently around $3 billion—$2.9 billion to $3 billion.

$3.3 billion.
Verbiest $3.3 billion now. OK. It’s a very stable situation. Beyond that, as you will have seen from our annual report, we’ve got a very strict Treasury policy around hedging and also looking at our credit risk, and using swaps to basically lessen our risk.

Young Sure; thanks very much. How do we stack up compared to other transmission entities in different jurisdictions in terms of our debt profile?

Verbiest Look, I think we stack up very well. Some might say our gearing could actually move a little bit further than it is. We think it’s at about the right place: reasonably conservative. We want to maintain our current credit rating, where it sits today, and that’s very important in the context of if there was another global financial crisis we want as full access to debt markets as is possible, and to try and avoid shutting down avenues for further debt funding.

Tremain So what you’re saying is that your debt profile—why the infrastructure companies internationally is higher than 80 percent of assets, is that right?

Verbiest No, it’s not.

Cattermole No, it’s currently about 70 percent, I think.

Tremain So what is international best practice then?

Cattermole The range is sort of between about 60 and 80, so the benchmarking we do suggests we’re pretty much in the middle of the range for similar companies to us, which are highly regulated, transmission-only companies.

Tremain But at the level that you’re borrowing at, at the moment, would a lift in the debt actually improve the bottom line?

Cattermole Arguably, yeah, you get into a—we should be able to reduce our funding costs or our overall cost to capital. The efficiency of our balance sheet is improved by having a prudent level of debt, so that’s really what we’re looking at, at minimising our overall cost of funds.

Verbiest Make no mistake. We look at this every year. We examine our capital and our broad funding strategy. But the one place that we do not want to be is in a situation where, if there was a crisis, we weren’t in a position to actually access funds. So we’re quite—I think we’re appropriate. It’s a bit like how we manage the grid in real time. I think we’re in the right space.

Cosgrove So presumably you would not favour, for instance, across all SOEs, including yourself, a uniform gearing ratio? That would be inappropriate, presumably?

Cattermole Absolutely. The range of businesses—it just wouldn’t be appropriate.

Cosgrove So you would share New Zealand Post’s view that you’re a different entity—they had a similar view. An individualised gearing ratio is appropriate. So there hasn’t been any pressure for a uniform gearing ratio by the Government, as there was in the recent past?

Verbiest No.
Cosgrove And if there was, that would be inappropriate, I presume, or it would be a risk factor, as you’ve outlined, for your business?

Cattermole Depends what the ratio was, I think.

Cosgrove Solid Energy said the same thing. Just a general question. Did you have any difficulty in accruing the information for the committee’s questions, particularly around salary bands and things like that? It’s not a criticism, so don’t skip a beat. Did you have any difficulty complying with questions?

Cattermole We didn’t have any difficulty. There’s a lot of work.

Cosgrove A lot of work, but no constraints on you providing that information.

Cattermole No. Some of the level of detail for some of the questions is focused very much on Government departments and—

Cosgrove Yes, sure.

Cattermole —is hard to apply to us, but in general—

Cosgrove But things like salary bands and contractors, you know, you didn’t feel that was—it wasn’t work to rule; you could provide that. OK, thank you for that. Appreciate it.

Mitchell Mr Strange, just wanted to acknowledge you and thank you for coming in today. I know you didn’t have to. I’d just like to acknowledge the new CEO as well and just ask that—because, you know, Mr Strange has done a great job, there’s no doubt about that, but a fresh set of eyes is sometimes a really good idea and healthy for any organisation. I’m just wondering, one of your objectives is improving efficiency and productivity. Do you have any ideas, could you assure the committee, in terms of how you want to approach that?

Cosgrove He wants to know how good the other guy was.

Andrew I have to tell you also I’m 8 days dangerous, so—

Mitchell I acknowledge that.

Andrew And I’m lucky coming into a business that is well run. There are no particular burning platforms or things I have to get in there and make significant changes in a hurry. But, clearly, as we come off this build programme we are well aware of the sensitivity of energy pricing, and we need to be mindful about how we do our bit to be as efficient as possible and keep our costs as reasonable as possible while still ensuring that we have a reliable supply of electricity. So that’s a journey. We talked about the asset management programme being a key part of that, but also having a good look at our organisation to say: “Are we being as efficient as we need to be?” So that will be a focus for me going forward, and I’ve done this in other places but it’s appropriate we do what’s right for Transpower, what’s right for the business we’re in, how we find this right balance, and bringing the organisation along. So I’ll be working with the team on it but you won’t see anything tomorrow. I’m still learning lots of things.

Mitchell Yes. Thank you.
Cosgrove      We share our appreciation of the work you’ve done, as well.
Mitchell     Yes, exactly.
Young        Well, thank you very much indeed everybody and Dr Strange, thank you for your contribution to Transpower over the years and for what you’ve been able to furnish with information to our committee as well over the years. We wish you all the best.

conclusion of evidence