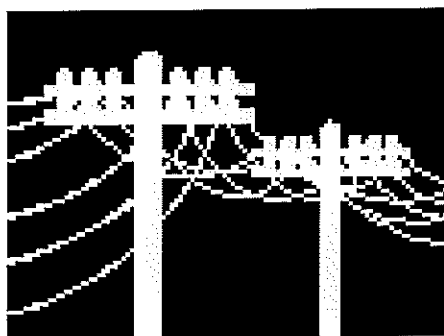


# **LINE TRUST SOUTH CANTERBURY**



## **OWNERSHIP REVIEW**

**2011**



# LINETRUST SOUTH CANTERBURY

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## LINETRUST SOUTH CANTERBURY

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### Ownership Review March 2011 TRUSTEE COMMENTS

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The Trustees of LineTrust South Canterbury acknowledge and thank the Directors of Alpine Energy Ltd for their report in the three-year ownership review of the Trust. The Trustees also congratulate the Company on its recent performance and efficiency.

The conclusions and recommendations of the report from the Directors are in accordance with the collective opinion of the Trustees.

At a forthcoming joint meeting of the Directors and the Trustees, the Trustees anticipate a unanimous decision to continue the Trust ownership of 40% of the shares in Alpine Energy Ltd.

G S R EAMES  
CHAIRMAN

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# LineTrust South Canterbury Ownership Review March 2011

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In a letter dated 29 November 2010 the Trustees initiated a review in terms of clause 4 of the Trust Deed. The Directors of Alpine Energy are required to report to LineTrust South Canterbury on a number of matters, in a manner prescribed by the Trust Deed. A summary of the requirements is appended to this report.

## **1.0 Introduction**

### **1.1 Industry Overview**

The electricity industry is essentially made up of four sectors being:

- |                 |   |   |
|-----------------|---|---|
| 1. Generation   | : | Production of Electricity in Power Stations |
| 2. Transmission | : | Long Distance Transport on National Grid    |
| 3. Distribution | : | Local Transport by Regional Line Businesses |
| 4. Retailing    | : | Regional Billing and Customer Services      |

### **1.2 Alpine Energy Ltd and it's Shareholders**

Alpine Energy Ltd is the regional distribution business for South Canterbury covering the traditional area except for the Hakataramea which is supplied by Network Waitaki through Kurow, and the upper Rangitata which is supplied by Electricity Ashburton through Mayfield.

Alpine Energy Ltd has four shareholders being:

LineTrust South Canterbury	40.0%
Timaru District Holdings Ltd	47.5%
Waimate District Council	7.54%
Mackenzie District Council	4.96%

The initial Trust, established in 1993 to hold shares on behalf of all consumers on the network, was resettled in 2002 to provide perpetuity period of eighty years from 19 July 1993.

## 2.0 Performance Analysis

There are three key measures of performance for an electricity lines business being reliability, price of services and profit.

### 2.1 Reliability

The Commerce Commission has devised several reliability measures, some related to length, type or voltage of lines, and others related to customer service. The need for any business to focus on customer service is paramount and so the best performance parameter to consider is SAIDI, being the System Average Interruption Duration Index. This gives outages in terms of minutes per year.

Alpine Energy's ranking against industry peers has dropped since 2006. This decline is principally as a result of outages across our network due to severe weather events.

Adjusting for these severe weather events, and the one-off Timaru substation fire during 2009, Alpine's reliability would sit just under the New Zealand average.

Year Ending 31 March	SAIDI		
	Minutes p.a.	NZ Ranking	NZ Average
2006	58	3 <sup>rd</sup>	153
2007	1,057 <sup>1</sup>	27 <sup>th</sup>	272
2008	150	13 <sup>th</sup>	214
2009	201	15 <sup>th</sup>	223
2010	332 <sup>2</sup>	27 <sup>th</sup>	171
5 year average	360	-	207

<sup>1</sup> This includes long outages resulting from a heavy snowstorm in June 2006.

<sup>2</sup> This includes 169 minutes resulting from a cable fault / fire in the Timaru Substation in December 2009.

### 2.2 Price of Services

Alpine's price of services, especially line charges, continues to be amongst the lowest in New Zealand, although with different companies having a different mix of fixed and variable charges and different structures for off peak controlled supply, comparisons are difficult. A simple measure is the line revenue per unit sold on the network:

Year Ending 31 March	Line Revenue ¢/kWh	NZ Ranking	NZ Average
2006	4.3	5 <sup>th</sup>	5.6
2007	4.2	4 <sup>th</sup>	5.8
2008	4.4	5 <sup>th</sup> =	5.5
2009	4.2	2 <sup>nd</sup>	5.9
2010	4.6	2 <sup>nd</sup> =	6.2

## **2.3 Profitability**

The profitability of the company is a little more difficult to consider because we have the effects of the lines business which is the regulated part of the company, and the wider Alpine Energy Group which includes investments in subsidiary company NetCon, and associate company Rockgas Timaru. Rankings of the lines business part of the company are possible from Commerce Commission statistics, however no comparative statistics are available for the Group which is the true extent of the Trust's investment.

Year Ending 31 March	Lines Business Profit		Group Profit on Shareholder Funds
	Return on Investment (ROI)	Ranking	
2006	9.5%	4 <sup>th</sup>	10.4%
2007	7.1%	9 <sup>th</sup>	11.8%
2008	10.1%	13 <sup>th</sup> =	11.7%
2009	11.1%	7 <sup>th</sup> =	12.5%
2010	8.0%	15 <sup>th</sup>	10.0%

## **2.4 Conclusion**

The above performance statistics show that Alpine Energy Ltd, despite the disadvantages of a network spread across a sparsely populated provincial region, consistently meets high standards of operational and financial performance.

## **3.0 Continued Trust Ownership**

### **3.1 Strategic Ownership Issues**

Alpine Energy Ltd is a strong business entity and puts the sustainable interests of the company and its shareholders ahead of specific agenda and sectional interests. South Canterbury has few companies with the financial strength and commitment to invest and therefore make a real economic difference to the region as a whole.

Alpine Energy has chosen to retain ownership and management of the infrastructure assets, and its subsidiary contracting company NetCon Limited. NetCon operates as a separate, stand-alone company, at arms length from its parent.

### **3.2 Advantages of Continued Trust Ownership**

The Trust is a single purpose organisation, directly elected by all consumers and representing no specific consumer segment. It is in a unique position to be focussed on the company, its sustainability and performance. While it is possible for a small vocal group to catch the Trustees attention, the Trustee responsibilities imposed by the Trust Deed, and the 3 yearly election process for Trustees ensures they remain accountable to all consumers, and the needs of the community at large.

The Trustees therefore have a unique opportunity to develop a vision for the future of Alpine Energy that will benefit the whole South Canterbury region and ultimately the consumers. Should the Trust shareholding be distributed it would be more difficult for many individual

shareholders to exert such influence over the District Council shareholders who are perhaps more focussed on a vision for their specific district and ratepayers.

The Trust as a single entity is therefore a strong and influential shareholder able to negotiate equally with the District Council shareholders.

The consequential advantage to the company of continued ownership is that 25,000 beneficial interests in the Trust are co-ordinated by the Trustees into a single strategic vision, rather than many thousands of shareholders having a diverse range of views.

An early share distribution would likely see widespread cashing up by consumers and dissipation of the community wealth accumulated by the Company and Trust. This would be likely to result in Timaru District Holdings having over 50% of the shares, and thus having control of the company,

Also, should the 25,000 consumers hold the shares, individual shareholders would have minimal influence on the operation of the company.

The potential costs to the company should the 25,000 consumers hold the shares, is significant. This would include the servicing of the shareholders with interim reports, dividends, the annual report, the election or appointment of the two directors the Trust presently appoints and the costs of the annual meeting and extraordinary meetings.

### **3.3 The Disadvantages of Continued Trust Ownership**

There is a risk that the 3 yearly Trust elections might focus on populist issues and circumvent the genuine legal and commercial responsibilities of the company, as these are much too complex to be represented and comprehended in a public debate. This could create the opportunity for political capture of the legitimate commercial responsibilities of Trustees and the potential for conflict between Directors and Trustees.

Some would consider that rather than a common vision, there is a strong case for widespread shareholding and diversified views as this will bring a broader partnership between individual investors and collective bodies such as District Councils. Continuation of the Trust as a single holder of 40% of Alpine Energy's shares prevents this opportunity from arising.

Continued Trust ownership deprives the individual beneficiaries of the Trust of control and access to their assets.

### **3.4 Arguments Discounted**

It needs to be noted, however, that the traditional political arguments for community ownership and control are not easily justified as it is considered there is appropriate protection against abuse of the natural monopoly. The traditional arguments that should not be accepted as relevant to the debate on Trust ownership include:

- (1) That a share distribution will lead to foreign control and therefore irresponsible management of prices and reliability.
- (2) Collective ownership with zero profit targets solely in order to avoid taxation is a proper use of community assets.

- (3) Low prices through low profit will encourage economic development in the region. There is however, a widely held view that low prices generated by business efficiency and reasonable company profits are helpful in assisting economic growth.

### **3.5 Options Arising From This Review**

After considering the issues in this review, the Trustees will have a number of options. These include:

- Continue to hold the shares and distribute the dividend proceeds each year.
- Commence a process of share sale or distribution involving consultation with the public.

The current Trust dividend distribution policy reflects the level of line charges paid, and therefore the contribution of the various consumer groups to the profit and accumulated value of the company.

The Trust in reaching its decision on the preferred option will need to consider the issues outlined above and in addition, a number of further issues including:

1. Alpine Energy Ltd, which under the requirements of the Energy Companies Act 1992 operates as a successful business, is well equipped and positioned to make informed commercial decisions on expansion and development investments, and brings to those decisions a financial ability to ensure they proceed.
2. The ongoing change in the regulatory environment for line businesses makes sustainable decision making uncertain if the best interests of the consumers are to be preserved.
3. The high level of misunderstanding in the wider community about the intent and form of the industry reforms makes it difficult for consumers to make informed decisions on their personal options.
4. Opportunities to add value to the business by reducing operating and management costs are better investigated and implemented by commercial directors who are able to consult fully with owner representatives who have a detailed knowledge of a very technical industry.
5. While Timaru District Council no longer includes a target to increase its shareholding in Alpine Energy Limited in its Annual Plan, a distribution of shares by the Trust would easily enable the Council to achieve control of the Company by purchasing freely traded shares.
6. Successive Local Government Reforms, and the spectrum of views on commercial development amongst elected members of the Council would tend to prevent Alpine Energy operating as a normal business with a normal commercial risk profile. Local Government demands tend to ensure elected Councillors operate in a risk averse environment.
7. Local Government Reform is requiring Local Bodies such as District Councils to operate their commercial investments in an increasingly transparent manner. This places the wish of individual Councillors to meet social goals through the pricing of electricity line services in conflict with the corporate responsibility of Councils to avoid cross subsidies.
8. The sale of shares as a block may realise a "control" premium which would be reflected in the subsequent cash distribution to shareholders.
9. If a distribution of Trust shares occurs it is better to be done as a single event rather than a progressive trickle. This will ensure that any selling shareholders are able to maximise sale price and value through the creation of an active market for resale of shares.

10. The share distribution should, if it occurs, follow the following process:-

- Valuation of shares.
- Identification of and notification to Trust beneficiaries of their entitlement value.
- Trust beneficiaries elect to receive shares or cash.
- Trust beneficiaries and existing shareholders can elect to preferentially purchase more shares from the pool created by those electing the cash option.
- Based on the size of the pool the then shareholders should consider whether the company buys the remaining shares or offers them for sale to the market at large.

This proposal gives preference to ongoing local share ownership in the medium term and ensures the company retains shareholder loyalty through strong performance.

## **4.0 Other Matters**

- 4.1 No external professional advice has been obtained in respect of the preparation of this report.
- 4.2 The directors have given regard to the public consultation undertaken in 2001 that resulted in the resettlement of the South Canterbury Power Trust on LineTrust South Canterbury with a perpetuity period of eighty years from 1993.

## **5.0 Recommendation**

After considering the main outcomes of the above discussions, being:

- Alpine Energy's strong performance and efficiency
- The desire of consumers to continue with Trust ownership
- The vision of current trustees that ensures Alpine Energy contributes to the growth of South Canterbury

the Directors have discussed the matter of LineTrust South Canterbury and its ongoing role.

The following recommendation represents the Board's view:-

That the Directors of Alpine Energy recommend that LineTrust South Canterbury continues with its current shareholding in Alpine Energy Limited.

Directors  
Alpine Energy Limited

## **Attachment**

- LineTrust South Canterbury Review Terms of Reference (extract from the Trust Deed)



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# LineTrust South Canterbury Review

## Terms of Reference

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The Trust Deed requires the Directors to prepare a report considering proposals and available options for the future ownership of the shares owned by the Trust.

The Trust Deed gives the Trustees three (broad) options:

- retain the shares in the Trust; or
- dispose of a portion of the shares and retain the remainder of the Trust; or
- dispose of all of the shares

The report is to contain:

- (a) an analysis of the performance of the Company to the date of the report, together with a discussion of the advantages and disadvantages of continued Trust ownership;
- (b) if a distribution of shares is recommended, a draft Share Allocation Plan detailing:
  - the manner in which and the Consumers to whom the shares (if any) and assets constituting the Trust Fund are to be distributed and such shares and assets may be distributed to a greater or lesser extent to some or all of the Consumers;
  - the manner in which and the Consumers to whom the proceeds of the sale of shares (if any) received as a result of a disposal of shares are to be distributed and such proceeds may be distributed to a greater or lesser extent to some or all of the Consumers;
- (c) a summary of the professional advice (if any) obtained in respect of the preparation of the report.
- (d) a statement as to whether or not the directors have had regard to any views expressed by the public with respect to ownership.

The Trustees shall comment on the report to the Directors and upon completion of their review of the report, the Trustees shall make the report available to the public together with a summary of their comments. ['available to the public' means making the information available for inspection at any office of the Trust or any office of the Company or at any other place in the District on normal business hours on any business day, after giving 3 days notice of the place(s) and times in a newspaper].

The Trustees and the Directors shall in respect of the report and no later than 1 month after the date of the report, implement the Special Consultative Procedure set-out in Schedule 2 of the Trust Deed.

Following completion of the Special Consultative Procedure and not later than 6 months after the report date, The Trustees and the Directors shall meet and, after taking due account of the view expressed by the public and the Directors, the Trustees shall decide whether to:

- retain the shares in the Trust; or
- dispose of a portion of the shares and retain the remainder of the Trust; or
- dispose of all of the shares

If the shares are to be retained by the Trust, the Trustees shall notify the public by making the information available for inspection at any office of the Trust or any office of the Company or at any other place in the District on normal business hours on any business day, after giving 3 days notice of the place(s) and times in a newspaper.

If the shares or any portion of them are to be distributed, the Trustees shall prepare a Share Allocation Plan in terms of Schedule 3 of the Trust Deed.

