

Electricity Reform Transition Unit

IDG Certification Report

1 December 1998

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1 Introduction

This report is part of a suite of documents completed by ERTU and provided to the Minister of Finance and the Minister for State-owned Enterprises on 1 December 1998. This suite of documents, summarised below, outlines the work ERTU has carried out, its proposals for implementing the split of ECNZ into three new SOEs and its view on whether Government's objectives for the split can be met.

As part of its **Interim Certification** provided to Ministers on 1 September 1998 ERTU identified a series of key tasks for each of the Interim Development Groups

("IDGs") to undertake as they prepared for establishment as new SOEs. This report considers the work undertaken by these IDGs in light of their **Terms of Reference** and the identified key tasks.

2 Approach to Review of Key Tasks

ERTU's terms of reference required it to develop an **Implementation Plan** with key steps and strategies for achieving the split of ECNZ. This plan devolved a significant number of tasks to the IDGs. ERTU was responsible for driving the implementation process.

Accordingly, in carrying out its review of the work undertaken by the IDGs, ERTU has not attempted to question or look behind commercial decisions or judgments made by the IDGs, or the supporting analysis undertaken by the IDGs and their respective advisers.

Where an IDG's analysis or conclusions seemed materially different to ERTU's, ERTU has investigated the IDG's supporting reports to determine if there were issues which might threaten achievability of the split.

However, the primary focus of the review of the IDG certification reports has been to ensure that the IDGs have completed their assigned tasks to a reasonable standard.

3 Key Tasks

3.1 Commercially Viable and Effective Competitor

Each IDG has undertaken its own investigation and analysis of its commercial viability and competitiveness. Each has concluded that the relevant SOE will be commercially viable and an effective competitor, subject to the assumptions and qualifications set out in their respective certification reports.

3.2 Business Plan

All three IDGs have prepared a business plan. These documents demonstrate that the IDGs have an understanding and clear view of the nature of their respective SOE's business and that they have identified key business issues which could impact on the future of the SOEs.

3.3 Financial Performance Projections and Optimal Capital Structure

Each of the IDGs has prepared financial projections. However, Waikato IDG and Huntly IDG have not identified an optimal capital structure. This omission is not material as the capital structure is an issue in which the Crown as shareholder will have significant input and, in any event, the SOEs' capital structure will alter following their revaluations in 2000.

3.4 Develop an Organisation Design and Corporate Build Plan

All three IDGs have designed an organisation structure. However, each has acknowledged that the precise nature of the structure may change following the appointment of the Chief Executive and senior management team. Each IDG has developed a plan to establish the SOE and ERTU has confidence that all three SOEs will be in a position to assume responsibility for the business on 1 April 1999 with a minimum of risk.

3.5 Identify Location and Function for Corporate Office

As announced by the Minister for State-owned Enterprises in October the IDGs have chosen the locations and functions of their corporate office:

- Waikato SOE: "The principal operating activities of the Waikato SOE will continue to be managed from the existing Hamilton offices. In addition, the Waikato SOE will establish a small corporate support office in Auckland";
- Huntly SOE: "The operations office will continue to be run out of Huntly and a small corporate office will be established in Manukau City";
- South Island SOE: "The majority of staff will remain in the operational base in Twizel. South Island headquarters will be established in Christchurch to manage the SOE's South Island retail and customer interests. The Chief Executive may be based in Wellington along with 25-30 staff to maintain and build relationships with the SOE's single largest customer, Comalco, and with Transpower, its largest supplier".

3.6 Protocols to Transfer Staff

The Agreements for Sale and Purchase provide for power station and generation group staff to transfer to the relevant SOE on substantially similar terms and conditions to their current arrangements. Each IDG has plans in place to accomplish this transfer.

3.7 Transfer of Material Contracts

Where appropriate the IDGs have assisted ECNZ in obtaining any necessary counterparty consents to the transfer of material contracts and assets. In some instances the counterparties have sought further information, such as detailed financial projections or information detailing the technical competence of the SOE to undertake the obligations of the specific contract. The SOEs will need to work with ECNZ early in 1999 to provide sufficient information and confidence for the counterparties to provide their consents.

3.8 Agree Basis for the Continuation of the Ngati Tuwharetoa Heads of Agreement

The Waikato SOE and Huntly SOE have agreed to jointly fund the Ngati Tuwharetoa Heads of Agreement.

3.9 Develop Protocols to Effect Renewals of the Resource Consents for the Tongariro Power Development

The Waikato and Huntly IDGs believe that a protocol between them is unnecessary for renewal of the Tongariro resource consents. They consider that the commercial incentives on the two SOEs should provide an environment in which a co-operative approach to the consent process will prevail. ERTU has considered this approach and is satisfied that it is not unreasonable and is workable.

3.10 Access to Shared Services

The Waikato and Huntly IDGs have agreed to contract services for dam safety from a South Island SOE subsidiary. ERTU supports this outcome.

In relation to non-destructive testing and monitoring the Huntly IDG is prepared to make its services available to the other SOEs. South Island IDG and Waikato IDG do not propose to enter into any agreement at this point since they believe these services are sufficiently contestable. ERTU supports this outcome.

Waikato and Huntly SOEs will share some telecommunications sites owned by third parties and will need to negotiate new arrangements. These arrangements can be developed following the decision to proceed with the split.

3.11 Identify Required IT Systems

Each IDG has identified to ECNZ the systems it wishes to transfer and has developed an IT Establishment Plan. ERTU is not aware of any reason why these plans should not implement a successful transition.

3.12 Agree Arrangements to Transfer and Regulate Responsibility under the Tongariro Offset Works Agreement and Waikato River Flood Rules

The Tongariro Offset Works Agreement is to be novated to the Waikato SOE. A back to back agreement with the Huntly SOE will ensure that the costs are shared and that the Waikato Flood Rules are complied with. ERTU supports this outcome.

3.13 Interim Transmission Agreement

ERTU and Transpower have agreed a set of interim arrangements which provide continuity of service while preserving the ability of the new SOEs to negotiate with Transpower once established. The IDGs have accepted these arrangements.

3.14 Operations Plan

All three IDGs have identified the tasks which they believe need to be completed by 1 April 1999. No issues have been raised by the IDGs that would hinder achievability.

3.15 Prepare Draft Statement of Corporate Intent

Only the South Island IDG has prepared a draft Statement of Corporate Intent. A Statement of Corporate Intent is not necessary for establishment of the SOEs. Treasury and CCMAU will ensure that the SOEs comply with their obligations under the State-owned Enterprises Act.

3.16 Assess the Environmental Impact of Business Plan

Each of the IDGs has prepared an environmental report which details the existing status of the resource consents and views of the local community and Iwi. The reports conclude that local environmental effects of the split will be minimal. ERTU has prepared an **Environmental Overview Report** which assesses the overall impact of the split as likely to be positive for the environment.

3.17 Legal Documentation

Each of the IDGs has reviewed the following documents:

- Agreements for Sale and Purchase;
- Offsetting Hedge Contract and Hedge Allocation Agreement;

- Loan Facility Agreement; and
- Intellectual Property Agreement.

The IDGs have confirmed their agreement to these documents in principle.

3.18 Select Name and Prepare Documents to Incorporate

Each of the IDGs has initiated a name selection process and are expected to be in a position to register names by the time of incorporation. The IDGs, Treasury and CCMAU are working together to prepare the necessary documents to incorporate the SOEs.

4 Conclusions

Virtually all of the tasks identified in the **Terms of Reference** for the IDGs have been completed. The two tasks (see 3.3 and 3.15) which have not been completed by two of the IDGs are not critical to the timetable envisaged by the Government and do not threaten achievability of the split.