



[Reading Room: Power Industry](#)

The Changing Context for Mergers/Acquisitions

1997 New Zealand Power Industry Conference

This paper was presented to the 1997 New Zealand Power Industry Conference by Peter McKinlay, Executive Director of MDL, Wellington, March 1997

Introduction

This paper is deliberately speculative in nature. It is based on some years of reflection on the future of the distribution industry drawn from experience in:

- Advising two of the larger energy trusts which emerged from the reform process on matters relating to governance and the future ownership/control of the energy companies in which they have an interest.
- Advising a range of public and semi public bodies on matters to do with ownership, corporate governance and accountability.

The perspective is a somewhat different one from the traditional investment banking/advisory scenarios to which the industry has become accustomed. It reflects a concern with how to optimise performance whilst still maintaining/supporting a public ownership component.

As a final opening comment, I stress that the views set forth in this paper are my own and should in no way be construed as reflecting those of any entity with which I or my firm have been associated in an advisory capacity.

In this paper I will begin by recalling the expectations at the time energy companies were created, look briefly at the merger and acquisition activity which resulted, comment on changing public attitudes and, in parallel with that, what appears to be emerging coalition government policy and finally develop a scenario as to how future activity will unfold. For reasons that I will make clear in the body of the paper, I will be concentrating principally on what may happen with trust owned companies rather than those that are now well entrenched in the private sector or still in local authority ownership.

Background

Reflecting the political sensitivity of the industry, reform of electricity distribution has been an extremely long drawn out process. Though both the 1984-90 Labour Government and the National Government which succeeded it were committed to substantial reform, they had differing views on the very critical issue of ownership. In broad terms, both governments were committed to:

- Introduce contestability into electricity retailing so that one distributor may be able to compete with another for the supply of electricity.
- Improve the overall efficiency of the sector.

The Labour government opted for corporatisation with ownership to be vested in a series of community trusts. In 1990, the then elected members of electric power and energy boards were sidelined as "interim trustees" pending the establishment of the intended community trusts. The Electricity Distribution Reform Unit co-ordinated a process of selecting five persons per board who were intended to become the directors of the new companies (technically, on appointment, they became members of the boards which remained in legal existence for another 2-3 years).

Shortly after their appointment Labour lost the 1990 election. The incoming National government remained committed to the decision to corporatise but was less sympathetic to trust ownership.

After very lengthy debate, and much lobbying by a number of different interest groups, the Energy Companies Act 1992 was passed incorporating a process for corporatisation and determining future ownership. Briefly, the directors appointed in 1990 were charged with preparing establishment plans which were to include a share allocation plan setting out their proposal for future ownership. No guidance was given in the Act as to what that future ownership might be. Instead, a was put in place which required:

- The directors to prepare their proposals.
- Those proposals go to public consultation following the special consultative procedure contained in the Local Government Act.
- Directors then to obtain the agreement of their interim trustees to their proposals. Failure to reach agreement would trigger the default ownership provision in the legislation under which ownership would vest in constituent local authorities within the district of the board in proportion to the number of registered electors.

The outcome, for the 37 boards involved, was a mix of ownership options. 19 boards opted for ownership by long term consumer trusts. Most of the remainder opted for a mix of share give-aways to consumers or electors coupled with minority trust and/or local authority ownership. One board opted for a co-operative structure. In one case, Egmont Electricity, trustees and directors could not reach agreement so the default option was triggered. All local authorities opted to retain full ownership of their interests in their MEDs although some took advantage of the provisions of the act to formalise merger arrangements with adjoining power boards (New Plymouth and Taranaki to create Taranaki Energy Limited; Christchurch and two adjoining smaller boards to create Southpower, Timaru and South Canterbury to create Alpine Energy and Wairoa District and Wairoa Electric Power Board to create Wairoa Power).

The companies which opted for an element of share give-away to consumers or electors all recognised the probability that, as soon as shares were available, there would be strong interest in acquiring them. Accordingly, all put in place various forms of protective mechanisms including in some cases bringing in cornerstone

shareholders prior to the share give-away (WelEnergy and Power New Zealand, each of whom brought in Utilicorp, in Wel's case some time before the Energy Companies Act was passed) and/or incorporating various protective mechanisms in their articles of association. The commonest devices were variants of the so-called "share cap" limiting the proportion of shares which a single holder or group of holders could own, register or have a relevant interest in.

Notwithstanding these various devices, concentration of ownership in a relatively few hands took place quite quickly. Most consumers who received shares treated them as a windfall gain which could quickly be turned into cash and, notwithstanding widespread public concern over privatisation and the potential for monopoly abuse, sold. A number of corporates, both domestic and international, played key roles in this process. Some came in as short term players who exited when they found that prices were too high for achieving their objectives or involvement was creating other complications (Fletchers who withdrew believing that the premiums being paid for assets in the sector were excessive and Enerco who withdrew because of Commerce Commission complications). Two overseas utilities, TransAlta of Canada and Utilicorp of Kansas, have taken major positions and one, IES Industries of Iowa, a somewhat lesser position. The specialist utilities investor Infratil has proved to be perhaps the most strategically adept in building a series of strong strategic/ownership linkages which seem clearly to be the core of two or possibly one major north island groupings.

Finally, in Auckland, we have seen the longest running stalemate in recent New Zealand corporate history with the battle between Mercury and Utilicorp for control of Power New Zealand.

These developments suggest that, so far as the traded energy companies are concerned, most of the action is now over. TrustPower has consolidated itself throughout the Western Bay of Plenty/Rotorua/Taupo area. Completion of a PowerCo/Central Power/Electro Power grouping in the western and lower central north island seems only a matter of time. The former Energy Direct Corporation and Capital Power are now in the majority ownership of TransAlta.

The one significant area of uncertainty is the Mercury/Power New Zealand situation in which it seems that time, the unusual corporate structure of Mercury, possibly the coalition government's foreign investment policy and developments in Utilicorp's own backyard may all ultimately favour Mercury as victor. If this were to happen, and Mercury's directors act as they have said they would, the result would be a merged Mercury/former Waitemata with the control of the balance of the Power New Zealand grouping, the former Valley Power, Bay of Plenty Electricity and WelEnergy then at large.

For the rest of this paper I wish to concentrate on those companies which are still in some form of public ownership, especially those which are owned by trusts.

I begin by reflecting on expectations at the time the energy trusts were established. Although the Energy Companies Act enabled the establishment of trusts, they were not a preferred form of ownership. A March 1991 report for the Electricity Distribution Reform Unit looking at ownership issues concluded that private ownership clearly showed the greatest potential for capturing productive efficiency gains and that:

- All ESA shares should be held by electric power trusts with a requirement that each EPT transfers ownership of a minimum of 70% of the shares within three years.
- Ultimately, the private sector should have effective control of electric power companies with a minimum shareholding of 70% and community trust or

local authority ownership limited to a maximum of 30%.

In order to assist officials assess individual establishment plans and prepare recommendations to the minister an investment banking advisor was contracted to prepare guidelines on the evaluation of establishment plans. Those guidelines included weightings in order to assess different ownership structures and the individual company's financial structures. In respect of 100% trust ownership, the guidelines noted:

"Characteristics

- commercial incentives likely to be weak
- monitoring costs for "shareholders" (beneficiaries) high
- costs of take-over very high
- costs of capital likely to be high (debt and equity)
- ability to alter articles

"A weighting to recognise the poor incentives and potential for perverse behaviour would see scores on all criteria in aggregate:

Reduced by: 70%

Note: in our view this should lead to outright rejection. Because the resulting structure would be reminiscent of the old style power boards which the Government is trying to change".

Notwithstanding the strong criticism from its advisors of trust structures, the government approved a number but sought measures which were intended to offset what were seen as the worst impacts of trust ownership. Specifically:

- In anticipation of continuing public ownership, it had already included in Section 36 of the Energy Companies Act the requirement that "the principal objective of an energy company shall be to operate as a successful business".
- In respect of the trust deeds themselves, it required inclusion of a provision for a periodic review of the role and future of the trust with a requirement for public consultation. There was clearly an expectation that this would give consumers/beneficiaries the opportunity of requiring termination if they were at all concerned regarding efficiency issues or wanted the opportunity of sharing in a distribution of trust assets (the only exception to this review requirement was the Auckland Energy Consumer Trust, the owner of Mercury Energy, as its deed provides for ownership to vest in local authorities at the end of the term of the trust).

Considerable, if informal, reliance was also placed on the responsibilities which it was believed trustees would feel bound to recognise in their administration of energy trusts. There was a clear recognition that these trusts were somewhat unusual. They were public trusts established to hold assets on behalf of a substantial (and indeterminate) class of beneficiaries. Typically, such trusts take a very conservative approach to management of assets with a heavy emphasis on diversification and on managing assets prudently in the interests of income and capital beneficiaries. A primary focus is on the duty to maintain the value of the trust fund.

Energy trusts were being established to own one specific asset, the equity in their related energy company, and to hold that long term. Without exception all trust deeds included a provision to the effect that no trustee would be liable for any

breach of trust merely because the investments of the trust fund are not diversified.

Diversification, however, is not the only duty of trustees. There was a widespread expectation that trustees, acting prudently, would find it difficult if not impossible to refuse a substantial offer for trust assets. This expectation was based on the view that prudent trustees could not reasonably forego an opportunity to realise a premium on their investments.

That expectation was associated with the separate one that the statutory (and occasionally trust deed) framework for the operation of energy companies would be such that the interests of consumers would quite clearly be promoted by mergers. The investment banking report referred to above said of the obligation in Section 36 that "fundamental to the operation of a successful business is ensuring that the economic efficiency objective is achieved". This clearly meant pursuing both productive and dynamic efficiency and achieving an acceptable return on investment. With the promise of information disclosure regulations as a means of constraining the abuse of monopoly, this combination must have been seen as creating a situation in which trust owned companies would, in any event, be seeking to earn a full WACC and pursuing efficiency objectives.

For some trust owned companies, this was reinforced by provisions in their trust deeds. Six incorporated, as one of their objects, a provision along the lines of "to encourage and facilitate the company in meeting its objective of being a successful business by optimising the company's return on its assets, and to distribute to consumers in their capacity as owners, the benefits of ownership of the shares in the company". One adopted an object of maximising return. Typically those deeds then went on to provide that one of the duties of trustees was, in respect of any statement of corporate intent, to ensure that the statement of corporate intent was consistent with the obligation of the directors to operate the company as a successful business and in particular to optimise (maximise) the return on the assets of the company.

What then has happened, and can we draw any conclusions for future merger/acquisition activity.

Most trusts have now completed the first of their regular ownership reviews. All have had support for continuing trust ownership.

One of the most intensely contested, the Horowhenua Energy Trust to the immediate north of Wellington, saw the resolution "that all the shares in Horowhenua Energy Limited continue to be held in trust on behalf of the customers and that the matter of future ownership be kept under review" carried by a majority of 14,830 out of a total of 20,252 valid votes from a total of 34,827 eligible voters. This was an extraordinary endorsement of trust ownership not only because of the size of the majority but because of the percentage of eligible who took part. As students of voting behaviour will know, it is extraordinarily difficult to get significant support on any voting activity for special purpose bodies.

There is no sign that the trustees of any energy trust have felt moved either to respond to an offer to acquire their assets at a premium or to seek such an offer (in fairness, this may be affected by the restrictions that most trust deeds impose on sale of shares which includes public consultation and, occasionally, a poll requirement).

Perhaps a better test of the way in which trustees have interpreted their statutory and trust deed obligations is to look at the "successful business" area.

The following table (sourced from ANZ Securities 1996-97 Review of the Electricity Sector the 1995 and 1996 accounting rates of profit for the various companies whose trusts have maximise or optimise object.

Company	1995 ARP (%)	1996 ARP (%)
Buller (maximise)	1.66	2.32
King Country	-0.14	2.34
Marlborough	0.7	1.7
Northpower	5.5	6.2
Tasman	2.64	4.78
Top Energy	2.08	6.12
Waitaki	3.42	3.74

The circumstances of these companies, including density and size of business, differ quite significantly. Nonetheless, it is hard to avoid the impression that the companies, and their owners, have taken a view on the meaning of maximising or optimising return on assets v would find little support in the financial sector and have done so without challenge.

If this is the case, it is hardly surprising. Trustees may quite reasonably from their perspective it hard to see why they should insist that their companies maximise or optimise profits (and therefore tax on those profits) at the apparent expense of those very consumers to whom they then return those profits as dividends. No doubt most of their consumers would share that

However, even if a consumer beneficiary did object it would be rational to do nothing about the conventional mechanism for challenging a trustee is an action in the High Court. Whether concerned that trustees had let pass by an opportunity to secure a premium on the value of investment in the company, or simply thought that they were not earning enough on their investment, it would be quite uneconomic to challenge the trustees. The cost of court action if successful, would far outweigh the benefit to the prospective litigant (this may simply be an argument in favour of class actions).

Public Attitudes

At the moment, all the available evidence suggests that the public served by trust owned companies agree with what their trustees have been doing. Thus:

- Ownership reviews have been broadly supportive of continuing trust ownership. In some cases, such as Electra, public support has been very substantial indeed.
- There seems to be mounting public concern at the failure of the reform process to do benefit to consumers, with much of that concentrated on companies that do have an element of private ownership.
- There does not appear to be a constituency for further privatisation, especially if that would result in the electricity assets passing into part or full overseas ownership.

Coalition Government Policy

To a degree, the status quo seems to be supported by the terms of the coalition agreement. It is fair to say that interpreting the agreement can have about it something of the same rigor and certainty that is commonly associated with reading the entrails of a chicken but nonetheless

are some strong pointers. Thus, in respect of energy policy the coalition has the overriding objective "to ensure the continuing availability of energy services, at the lowest cost to the economy as a whole, consistent with sustainable development" but then has a strong anti privatisation flavour in respect of the three SOEs and a statement, in respect of legislative implications of the policy agreement that "appropriate changes to regulations under the electricity act to implement changes to fixed line charges and to ensure non discriminatory access over spur lines".

No-one is clear about the meaning of this provision. However, the Minister of Energy has commented that, if more progress is not made in delivering the benefits of reform to domestic consumers, then the Government may be forced to regulate. Separately, the recent report from the Ministry of Consumer Affairs on the domestic contracts of energy companies also hints at the possibility of regulation.

For foreign investment, the agreement provides that in respect of assets presently owned by local bodies or consumer trusts (power and gas utilities, airports, ports) any sale of over 24.9% would require prior approval of ratepayers or consumers".

Again, we do not yet have a clear statement of what this means. Is the government's concern with one off sales of 25% or more or is it concerned with any sale by a trust or local authority which results in an overseas person(s) holding more than 25%. The latter seems likely. Simply imposing a threshold on any one transaction is likely to encourage a series of transactions each beneath the threshold.

Similarly, what is meant by approval of ratepayers or consumers? The answer must surely be a poll. Simply requiring public consultation (as with Wellington City's sale of its remaining 51% in Capital Power to TransAlta) would hardly be seen as giving the public a key role in influencing the decision.

Optimists may argue that the coalition is simply the National party with add-ons and that, whenever it comes to the crunch, any New Zealand First policies much at odds with those of National will simply be ignored. This seems unlikely to be the case in respect of the overseas ownership issue. Ministers, including the Hon Jenny Shipley as Minister of State Owned Enterprises, have already put a peg in the ground over the proposed sale of ECNZ's small hydro plants by making it very clear that the 25% limit will apply to any bid involving TransAlta New Zealand Limited.

The Current Situation for Trust Owned Companies

What we have now is not the scenario which was envisaged five years ago. Where it exists, 100% trust ownership seems fully entrenched. None of the pressures which it was anticipated at the time of restructuring would force trust owned companies into amalgamation have had any noticeable impact.

In my view, two critical factors have contributed to this:

- The governance arrangements of the combined trust/company structures.
- The focus on treating electricity distribution companies as a single business.

Opening up the opportunity for further mergers/acquisitions or strategic alliances in order to bring greater benefits to customers, seems dependent on

understanding this.

First, the chosen governance structures set up what has to be seen as a sub optimal relationship between the owners of the business and those responsible for managing it. Directors were chosen as persons substantially with commercial experience. Trustees, by and large, came from the elected power board context. The former had some sympathy for and understanding of commercial disciplines and a commitment to their application. The latter were from a public ownership/public benefit background.

The relationship was consciously structured as an arms length one. Trustees were to express their requirements through the medium of comment on a statement of corporate intent prepared by commercial directors. In the normal course of events, by the time trustees received the SCI, the major business plan decisions for the year (or longer) had been taken. The process spelt out for energy companies is in contrast with that which the government follows for its own companies (SOEs, CRIs, CHEs etc) of becoming involved at the business plan stage so that there is a common understanding of the assumptions on which the business will operate.

In some instances, at least, the way in which trustees became trustees and directors became directors (in the 1990 legislation which displaced one in favour of the other) set up something of a natural opposition between the two groups. This has been reinforced, I believe, by the way in which directors can resort to the statutory framework of the Companies Act to assert that they, and they alone, are the appropriate people to make decisions regarding the management and operation of the business. As directors, they have a statutory obligation to act in "the best interests of the company" and most directors are aware that this requires them to have regard to the interests of more than just the present shareholders. It is not uncommon for this to be used, by directors of companies with public owners, as a device for holding owners or their representatives at arms length and excluding them from matters which would be seen as "owner issues" in the private sector. There is also at least a suggestion that some boards have discouraged trustees from taking a close interest in the business by telling them that, if they do, they risk becoming "deemed directors" and exposed to liability accordingly.

Effective planning for the future of a business, where major decisions such as merger, acquisition or strategic alliance of some kind are involved and when that business has a single owner and its equity is not, in practice, tradable requires the active co-operation of both parties. Directors need to understand that their role, whilst requiring them to act in "the best interests of the company" also requires them to understand and support the objectives of the trustees.

Trustees, on the other hand, need the skills and insight required to develop and have ownership of the major strategic options available to them. It is not that they receive and monitor regular reports from directors (to the extent that they do). It is they and only they who have the power and responsibility to make the final decisions on major changes in the ownership or structure of the business.

We may have a situation reminiscent of what was seen as being one of the faults of the old power board structures. In an overview of restructuring "The Process of Corporatisation of Electricity Distribution Authorities in New Zealand" written by Peter Farley who was Executive Director of the Electricity Distribution Reform Unit, he had this say:

"The history of ESA mergers provides an insight into the effect of structural incentives. Power boards were special purpose authorities

with no other functions. For boards, mergers resulted inevitably in a reduction in management and board numbers. For local authorities with MEDs on the other hand, the MED operation was just one of a multitude of functions and disposal of the MED would have no effect on the function or status of council members or its senior management.

"The single function, statutory monopoly position of power boards would suggest that they would be more inclined to resist mergers than council-owned MEDs, irrespective of the financial imperatives. The trends in ESA ownership since 1945 strongly support this hypothesis. In 1945 there were effectively 47 EPBs and 46 MEDs. By 1993 the number of MEDs had reduced ... to 21 while the number of EPBs had reduced by only 30% to 33. This casts serious doubt on the common claim that locally elected power boards were acting in the interests of their consumers."

At the nub of the issue of structural incentives is the question of how the interests of the customers are best served. Typically, trustees do this by acting in a relatively passive way. In the complex environment in which the electricity industry now operates, this is insufficient as a means of protecting the interests of beneficiaries (whether as customers or as ultimate owners). As I suggest below, it may be time for a close review of the different roles and incentives of trustees and directors.

Trustees who do not play an active role in helping set the strategic direction for their companies are resiling from the governance responsibility which they must exercise if the interests of customers and the ultimate owners (their beneficiaries) are to be served. This statement should not be seen as critical of existing energy trust trustees. One of the difficulties which they face is that this kind of strategic governance role is not something which normally forms part of the role of a trustee. This points up another problem with trust structures, that their use in the energy sector restructuring was really pushing them into an area, the governance of a major and complex business undertaking, which has not been at all common for trusts. To put it another way, the culture (and the legal framework) of the organisational form is in conflict with the requirements of the governance responsibility.

I turn now to the second question, the fact that electricity distribution companies were treated as a single business for the purpose of restructuring as a reading of the various policy reports prepared at the time makes clear.

In fact, electricity distribution businesses are made up of a series of separate businesses with quite different risk profiles. Thus the typical business includes:

- The lines business. This is very low risk (especially if information disclosure regulations genuinely mean that any write downs in ODV can be recovered from customers through line charges).
- The high risk energy trading business.
- A specialist metering/billing business.
- Network management.

From an investment perspective, the natural owners/financiers of line business assets are not entrepreneurial companies but long term low risk, investors such as life insurance companies and pension funds. A major reason for the existing tension over electricity pricing is that in many instances these low risk long life assets are owned by entrepreneurial companies seeking to obtain above normal

returns to management or entrepreneurial skills through line charges. Much of that tension would disappear if line ownership was stand alone and network management and other services provided under contract in a parallel with the franchise system common throughout the water and wastewater industry in France.

Conversely, energy trading is a business which requires high level skills in the management of risk. It is hard to see why consumers/beneficiaries should carry this risk, which they do at present, especially as many trust owned companies lack the scale to afford the level of risk management needed to operate effectively in the wholesale market. From discussion with people actively involved in this area, it seems clear that most expect one or more of the smaller trust owned companies to incur substantial losses in energy trading, which they will be unable to recover from their consumers who will therefore incur those losses instead as beneficiaries.

Five years ago, industry observers spoke in terms of the industry rationalising to perhaps five or six substantial regionally based energy distribution companies. The assumption was that these companies would be network owners and managers, energy traders and providers of a range of other services.

We have not achieved that and the entrenched position of trust owned companies suggests that we are unlikely to. From a consumer perspective, the present trust company structure is very sub-optimal. Natural objections to sale mean that consumers face at least the following costs which they should not have to bear:

- The overhead and management costs associated with supporting full board and head office structures for what are, by industry standards, very small businesses.
- The cost, as beneficial owners, of bearing the risks associated with energy trading in a market that is inherently and unavoidably risky.
- An absence of the opportunity to achieve economies of scale at an operational level in areas such as network management and metering/billing.

It is here that there is real potential for the interests of trustees and directors to diverge. The strategy which I am about to suggest would give trustees an enhanced role but, at least in smaller companies, would see a substantial diminution in the role of directors and management. This is, however, an issue on which we should reserve judgement as the nature and quality of management in the distribution sector is very much different from what it was in the period covered by Peter Farley's comments quoted on page 10 above. Indeed, there may be an argument that the principal barrier to change is the relative lack of high level commercial experience on the part of trustees and therefore a need for them and their directors to work closely together so that trustees have the confidence and level of comfort required to take what are quite major decisions and directors are given a focus on reducing costs/risks which goes wider than simply improved performance within the existing company structure.

This is because the obvious answer in the interests of consumers seems to be:

- Lay off the energy trading risk by divesting the energy trading function and/or ensuring that there is genuine open access across the network (this may need to be staged by selling the energy trading operation but on conditions which require the purchaser to facilitate open entry as metering technology and new business initiatives, possibly from outside the present industry structure, make this possible).

- Retaining the pure line ownership function but contracting out remaining services.

This approach would, amongst other things, provide an answer to an increasingly difficult problem under the current regulatory regime. There is substantial evidence that major industry players have profited considerably through the purchase of line assets and by applying their management skills to them. One consequence, as this audience will know well, is that the regulator is actively reviewing the regulations with the intent of tightening them to minimise the opportunity for owners to earn excess returns, either directly through achieving an accounting rate of profit in excess of a reasonable WACC or indirectly through skilful cost allocation.

The concern is that major network owners will lose the incentive to push for further efficiency gains as there will be no incentive to do so. The point is well made in an interview with Mike Underhill, Chief Executive of TransAlta New Zealand Limited, reported in the Independent for 7 March:

"Continuing drives for cost efficiencies will depend on whether the shareholders are allowed to benefit from them.

"What is the point, he says, of spending money on ongoing efficiencies when, even if customers get a better deal, the government caps profits?

"From a share market point of view, the real trick for the company is adding value. You can add value by reducing cost. If you can do that you should be able to share with shareholders even if it's greater than WACC, as long as prices for consumers are down.

"You will still get mergers, but people will stop bothering about greater efficiencies... we will see a considerable loss of value to the industry if [the government is strict on the WACC policy]"

The tension is an extraordinarily difficult one to resolve. Arguably, it proceeds directly from the fact that the network manager and the network owner are one and the same. Arms length contracting, through a franchise, lease or similar arrangement, provides a means of dealing with this problem. A network owner, acting on behalf of customers/beneficiaries, has a strong interest in seeing costs driven down as far as possible consistent with desired service standards. This includes an incentive to contract with a network operator on a basis which shares efficiency gains. In such a structure, there would be no need for regulation to restrain abuse of monopoly. The right accountabilities would be in place and the market would operate to deal with these concerns.

In my view, this is the next significant development in the ongoing restructuring of the electricity distribution. Whether it happens will depend on a number of factors including:

- The extent to which trustees and directors of trust owned companies are able to develop a common strategy and purpose. Unless both drive this kind of initiative, neither will be able to achieve it.
- Whether one or two trust owned companies "take a bath" in the wholesale electricity market. Given the fact that trustees are not subject to external market disciplines in any coherent fashion (the electoral process by which they take office is not market related) they can be oblivious to market related issues in the absence of major external shock. A change from this

may be one of the unexpected side benefits of the wholesale market.

For the moment, this vision of the future does not sit well with those companies who have been major players in merger activities since the restructuring took place. They have been able to benefit substantially through the purchase of significant assets before market re-rating of the sector had been completed (or as some would argue for the moment, overdone).

It is, I believe, in their interests also given current value levels in the sector, to seek other strategies for optimising rewards to their management skills. It will be interesting to see which of the current players is the first to recognise and successfully implement this strategy.

Finally, I conclude by noting that, if we do not see this kind of shift within the trust owned sector, then we will have to agree with James Miller, in ANZ Securities' 1996-97 Review of the New Zealand Electricity Sector, in assessing the level of future corporate activity as "the opportunities available are dwindling with a majority of EPCs (particularly in the South Island) unwilling to sell at any price. Politics, not price, will be the key success factor for these transactions. Intuitively, it would be reasonable to assume the shortage of merger targets should drive up prices. However the political angle provides an interesting twist, with a trend that there is also an equal shortage of "politically" acceptable buyers. Moreover, as many companies get larger, and therefore closer to optimal scale, the marginal value of incremental additions will decline".

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