

Institute
of
policy
studies

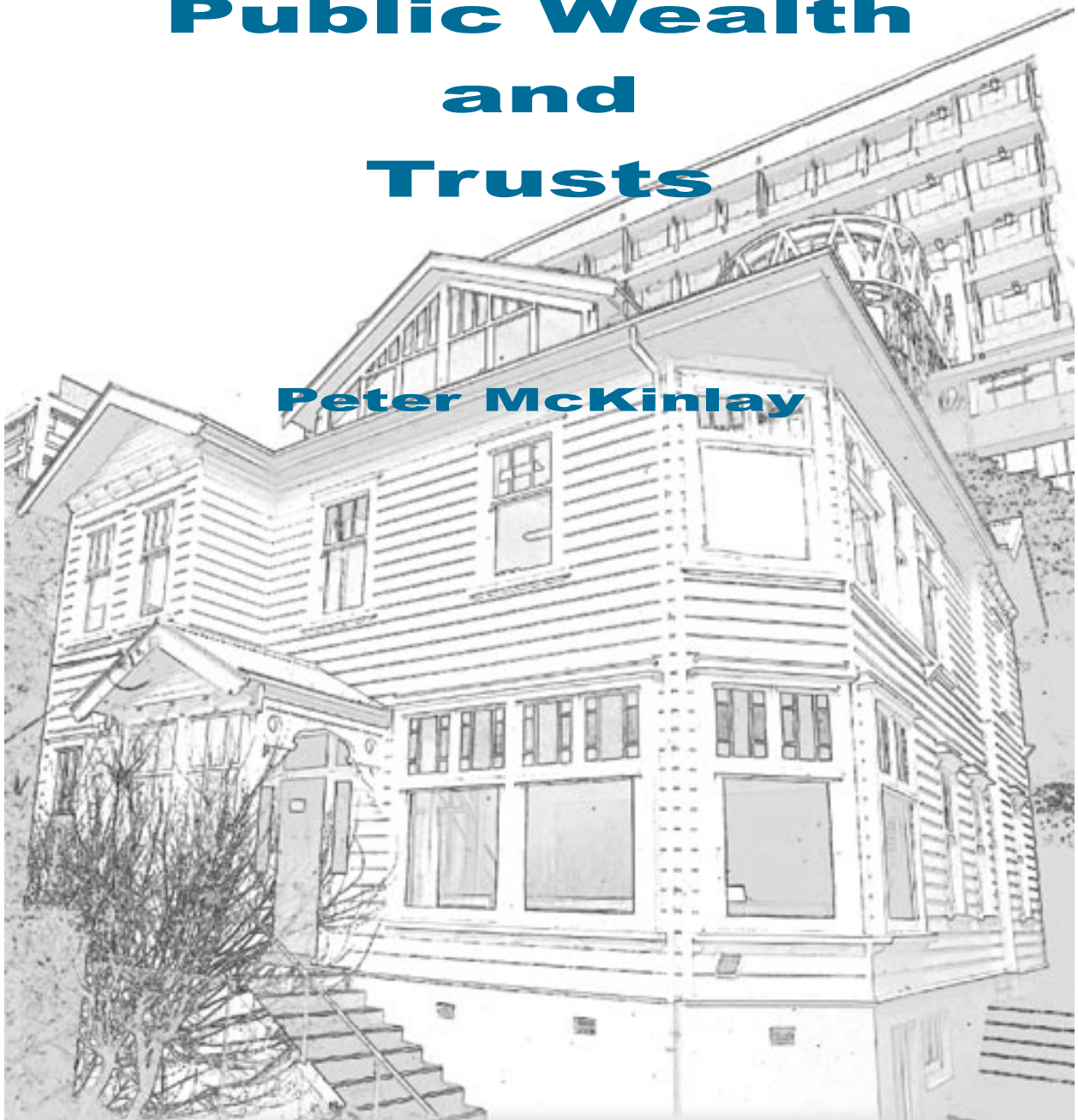
ips policy paper

number eleven / 2001



Public Wealth and Trusts

Peter McKinlay



INSTITUTE OF POLICY STUDIES • VICTORIA UNIVERSITY OF WELLINGTON

Te Whare Wananga o te Upoko o te Ika a Maui

Institute of Policy Studies

Victoria University of Wellington

PO Box 600, Wellington

New Zealand

Telephone (04) 463-5307

Fax (04) 473-1261

e-mail addresses:

Director: arthur.grimes@vuw.ac.nz

Editor: ginny.sullivan@vuw.ac.nz

Design & Layout: david_pearson@paradise.net.nz

General enquiries / Book orders: ipos@vuw.ac.nz

Web Site: www.vuw.ac.nz/inst-policy-studies

contents

Part One: Overview	1
<i>Introduction</i>	1
<i>Method of Approach</i>	1
<i>Trust Structures</i>	1
<i>Community Trusts</i>	2
<i>Energy Trusts</i>	3
<i>Powers (and Patterns) of Investment and Distribution</i>	6
<i>Community Trusts – Investment</i>	6
<i>Community Trusts – Distribution</i>	7
<i>Energy Trusts – Investment</i>	8
<i>Energy Trusts – Distribution</i>	9
<i>Examples of Initiatives</i>	10
<i>Community Trusts</i>	10
<i>Energy Trusts</i>	11
<i>Conclusion</i>	12
Part Two: The Potential and the Barriers	13
<i>Introduction</i>	13
<i>Case Studies</i>	13
<i>Bay of Plenty Community Trust</i>	13
<i>Community Trust of Southland</i>	13
<i>Bay of Islands Electric Power Trust</i>	15
<i>Eastland Energy Community Trust</i>	15
<i>South Canterbury Power Trust</i>	15
<i>Barriers and Impediments</i>	16
<i>Grants From Income or Capital</i>	16
<i>Investment</i>	17
<i>Using Trust-owned Companies</i>	19
<i>Conclusion</i>	20
Appendix	21
Endnotes	31

public wealth and trusts

peter mckinlay

Part One: Overview

Introduction

This paper has been prepared as part of a project being undertaken by the Institute of Policy Studies (IPS) and McKinlay Douglas Limited (MDL). The Ministry of Economic Development assisted this study with funding. The views expressed in this report are independent of the Ministry of Economic Development. The project has the objective of exploring with government policy advisors, the trustees of energy and community trusts, and other key stakeholders, issues relevant to individual trusts playing a role in the economic and social development of communities within their area of benefit.¹

The focus of this paper is on:

- trust structures including key features of their governance arrangements and powers of investment and distribution;
- their historical pattern of investment; and
- examples of initiatives they have taken with a focus on regional economic development or other activity directed towards specific community objectives.

The two sets of trusts have much in common in that they both involve trustees holding substantial public wealth for the benefit of the communities they serve. Both inherited the wealth they now hold² as a consequence of the restructuring of significant public entities as part of a central government-driven process of reform.³ For both, their origin in the industry from which they came is still an important part of the way they

understand their role – many community trusts⁴ emphasise the fact that they originated from regionally-owned trust banks and, accordingly, hold their wealth as the successors to those entities and the focus which they had on combining business and public purposes within the regions for which they held a banking franchise. Similarly, the trustees of energy trusts generally see the wealth which they hold as not just originating from within the electricity industry but, in many cases, as still belonging to energy consumers rather than to individuals or firms in some broader sense.

Method of Approach

The main part of this paper is divided into three sections, each of which deals both with community trusts and energy trusts, so as to highlight similarities and differences. The sections are:

- trust structures;
- powers (and patterns) of investment and distribution; and
- examples of initiatives with a focus on regional economic development or other activity directed towards specific community objectives.

The first two sections provide an overview rather than a detailed trust by trust examination. This is supplemented by more detailed information, trust by trust, in the appendix.

Trust Structures

Both sets of trusts result from restructuring legislation originating from the major reform initiatives undertaken by the 1984/90 Labour Government (although the legislation resulting in energy trusts was not finally passed until 1992 and in a somewhat different form from that envisaged by Labour).

Within this common origin, the structural differences between the two types of trusts are significant. Community trusts were created under legislation that dictated their form. Energy trusts resulted from legislation setting out a process for determining ownership but granting substantial discretion to individual electricity undertakings to determine their future form and ownership.

Community Trusts

New Zealand's regional trust banks had no shareholders and no independent capital. Instead, they operated with the benefit of a government guarantee on deposits and were subject to regulation on the nature of their investments. The Government's objective was to put an end to the guarantee (which it saw as presenting a significant risk) and to encourage the restructuring of what was seen as a group of relatively weak and potentially non-viable banks.⁵ The immediate means of dealing with this problem was thought to be restructuring the banks, as limited liability companies that could then take their chances in the marketplace.

The restructuring process itself was drawn out, partly because of an initiative from the banks themselves to merge as a single entity, and partly because the removal of the guarantee was phased out over a period of time. Ultimately, the commercial restructuring resulted in three banking entities: the ASB Bank (which incorporated the Westland Savings Bank), the TSB Bank and TrustBank New Zealand (which began not as a merger of its member banks but as a trading arm with the merger taking place some years later).

The Trustee Banks Restructuring Act 1988 set out the framework both for the creation of the successor companies as they were called, and for the formation of the individual community trusts.

Key features of the creation of the community trusts included the following:

- The trust deed for each community trust, and any amendments to that trust deed, required the approval of the Minister of Finance. The initial trust deed for each trust followed a standard form provided by government.
- Each trust was to hold its income and capital on trust to be applied for charitable, cultural, philanthropic, recreational and other purposes that are beneficial to the community, principally in the area or region of the trust.
- Each trust is a perpetual trust.
- Trustees are appointed by the Minister of Finance (the original rationale for this was that, as the trusts would be the sole owners of a significant group of banks, it was logical that there remain close oversight via the Reserve Bank, and that trustees

be persons perceived as having the appropriate skills to exercise ownership oversight of banking operations).

- Public accountability was to be by way of:
 - ▶ the publication of annual audited accounts, showing a true and fair view of the trust's affairs, in a newspaper or newspapers circulating within the district;
 - ▶ publication of a list of donations (to be published in association with the accounts);
 - ▶ the holding of a meeting each year open to members of the public at which they would have the opportunity to put questions to trustees but no right to pass any resolutions binding on them.

The Community Trust Act 1999 and predecessor legislation required that the accounts of community trusts should be audited, but left it to individual trusts to select their own auditor. The Public Audit Bill, when introduced, provided that community trusts would be audited by the Auditor-General on the basis that the Crown could control the appointment of their trustees. The Finance and Expenditure Committee then proposed that the trusts also be made "public entities" subject to audit by the Auditor General in their own right – quite independently of the test of "control". Following submissions by the trusts, this proposal was abandoned. And as a result of further change to the definition of "public entity", the Public Audit Act now makes it clear that community trusts are not subject to audit by the Auditor-General despite the fact that the Crown appoints their trustees.

There have been some changes to trust deeds since 1988. Most notably, in 1996 a number of amendments were made to the trust deeds of community trusts updating a number of technical provisions within the trust deeds. The amendments did not affect the core provisions including the purpose for which income and capital is held, the appointment of trustees or the way in which they are accountable.

There is no formal requirement either on community trusts, or on the Minister of Finance when appointing trustees, to consult with the public within their area of benefit, either in respect of possible trustees or as regards the future activities of trusts.

Most community trusts recognise that the communities they serve have a legitimate interest in the way in which they develop their policy on distributions, and have been developing, informally, various mechanisms for addressing this issue. As one example, some trusts have entered into protocols with local authorities within their area of benefit, expressing a mutual commitment to consulting with each other. Other trusts, without that type of formality, nonetheless make a point of maintaining regular contact with local authorities, recognising that they are often engaged in dealing with broadly the same issues (especially when it comes to supporting major community projects). More common, and of real value in bringing different community interests together, is the practice of promoting funders' forums to bring together major community funders (government, philanthropic, statutory and other trusts, and local government) with a cross-section of community organisations.

Some trusts have sought to get a greater degree of community input into the selection process. One has adopted a practice quite common in the public sector when seeking directors or trustees, of developing a job description and a person requirement, advertising for nominations and shortlisting nominees through an objective process. The shortlist is then submitted to the Minister of Finance to consider when making appointments.

The purpose of this report is to be descriptive of trust practice rather than argue a case for or against existing arrangements. Accordingly, it is simply noted that the arrangements for community trusts are somewhat different from those of other public bodies, but the types of developments just cited suggest that trust practices may be evolving to resemble them more closely.

Energy Trusts

Energy trusts resulted from the restructuring of the distribution sector of the New Zealand electricity industry which, prior to restructuring, comprised some 21 Municipal Electricity Departments owned and operated by local authorities, 38 electric power boards which were stand-alone special purpose local authorities, and one government-operated supply authority, Southland Electricity Supply, which had been an electric power board but passed into government ownership in

1938 when it defaulted on overseas loans.

The 1984/90 Labour Government passed legislation under which all electric power boards would have been corporatised and the successor companies owned by community trusts modelled largely on the trust bank precedent. That government lost office before the corporatisation could be implemented. The incoming National Government was less happy with the idea of trusts and revisited the ownership question. It was unable to get a consensus on any particular ownership form. Instead, it opted to put in place a process under which each individual supply authority would determine its future ownership.

One part of the Labour Government legislation had been implemented. This was the replacement of the elected members of electric power boards by persons selected with the intention that they would be the first directors of the energy companies to be formed from the former power boards. The elected members were sidelined as "interim trustees", with the intention that they be the first trustees of the community trusts contemplated by the Labour Government's legislation.

The process which the National Government's Energy Companies Act 1992 put in place required the future directors (known as the "establishing authority") to prepare an establishment plan for the new company which was to include a share allocation plan. No guidance was given in the Act as to who the future shareholders might be. Instead, this was a matter for the establishing authority to propose. Once developed, its proposal was then to go to public consultation as though the establishing authority were a local authority subject to Section 716(A) of the Local Government Act (which spells out what is known as the special consultative procedure). Under that process, members of the public had one month within which to make submissions on the proposal, with the opportunity to appear in person before the establishing authority in support of their submission. Section 716(A) does not impose any obligation on an authority receiving submissions to act on them, even if there is a substantial body of public support behind them.

Two constraints were put in place encouraging the establishing authorities to take notice of submissions made to them. Before an establishment plan could come into effect, it required:

- agreement of a majority of interim trustees – who could be presumed to be more responsive to public opinion than directors might be, given their background as elected representatives;
- agreement of the Minister of Energy who, amongst other things, required the establishing authorities to explain what submissions they had received, how they had responded to them, and why.

Generally, outcomes reflected the perceptions of the people who made up the establishing authority. Some establishing authorities were strongly committed to the idea of private ownership with tradeable shares – which they could achieve through a share giveaway to consumers. Interestingly, there were no cases where 100% of shares were given away solely to consumers. Every giveaway involved distributing at least some shares to an energy trust and/or local authorities. As examples:

- The Hutt Valley Energy Board became the Energy Direct Corporation Limited with 60% of shares given away to consumers, 30% to the Energy Direct Community Trust (now the Hutt Mana Energy Trust) subject to an obligation that it immediately released one-third of its giveaway for placement with institutions as a prelude to a public offering, and 10% to local authorities within the board's franchise area.
- The Waitemata Electric Power Board drove what was perhaps the most aggressive establishment plan. This included a merger with the Thames Valley Electric Power Board to form Power New Zealand Limited as the successor company for the two boards. That plan incorporated:
 - ▶ a mix of a share giveaway to consumers, 10% of its capital to a shareholders' society under a 10-year trust, the capital beneficiaries of which were local authorities within the former Waitemata area, and a give-away of approximately 10% to local authorities within the former Thames/Valley area; and
 - ▶ a complex set of arrangements to bring in new capital incorporating, as a cornerstone shareholder, the American company Utilicorp in association with Todd Corporation Limited (after

a series of corporate plays, Power New Zealand Limited has now become United Networks Limited, nearly 80% of whose issued capital is now held by Utilicorp).

- The Bay of Plenty Electric Power Board began by proposing a 100% share giveaway (in contrast with a number of giveaways, where consumers received equal parcels, this one was weighted towards previous consumption). Following quite robust public opposition to this idea, that board's establishing authority adopted a plan providing for a 75% giveaway to consumers with 25% vested in what is now the Eastern Bay Energy Trust. For a time, the majority shareholder in the successor company, now known as Horizon Energy Limited, was the Fletcher Challenge Group, but this shareholding, after passing to United Networks Limited, has now been acquired by the trust which holds approximately three-quarters of the company's issued capital.
- The Bay of Islands Electric Power Trust is the 100% owner of Top Energy Limited. Currently, the trust has adopted a policy of requiring the company to distribute 100% of its profit by way of dividend that is then available for distribution to consumers. The company itself has shareholders' funds in excess of \$70m and minimal debt. One objective the trust has for the company is that it should develop its business in a way that promotes economic growth within the far north. This is explicitly provided for in its statement of corporate intent and forms part of the company's business planning.
- The Hutt Mana Energy Trust distributes the bulk of its income to consumers as an annual distribution. It holds its income and capital for the benefit of consumers and communities within the district (the franchise area of the former power board). In order to provide a source of funding for community purposes, that trust established a separate Charitable Trust that it funded with an interest-free, on-demand loan of \$8m. The Charitable Trust uses the income from that money to fund energy efficiency activity including energy audit of schools, and retrofitting and research by researchers from the Wellington Clinical School to test the effectiveness of these programmes

especially in reducing the incidents of respiratory illnesses.

The largest group of establishment plans resulted in 100% trust ownership. Most of these companies were small or medium rural or provincial distributors, whose establishment boards appear to have shared with their interim trustees an aversion to any arrangement that would allow ownership of the business to pass outside the district. Approximately 15 power boards developed a common trust deed under which 100% ownership of the company was vested in the trust on the basis that income would be distributed to consumers and capital held also ultimately for them. The biggest power board, Auckland, also passed into 100% trust ownership but under a complex arrangement, which gave boardroom control to the directors (with a strong thrust towards partial privatisation), made the local authorities within the board's district the capital beneficiaries, and provided that all trust income after expenses must be distributed to beneficiaries

Energy trusts when first established did not have a separate statutory framework. Instead, they operated under the same legal framework as private trusts generally (the Trustee Act and associated trustee law). This meant, for example, that they lacked the equivalent of the provisions under (now) the Community Trusts Act 1999 of stated requirements governing accountability and the reporting of information. In contrast, they faced only the obligations set out in their trust deeds. Typically, these involved the publication of audited annual accounts and the holding of an annual meeting the public may attend. Some trusts adopted more comprehensive provisions for accountability (two trusts follow an annual planning process similar to that used by local government).

The Electricity Amendment Act 2001 has addressed the issue of accountability by including new provisions in the Electricity Act 1992 providing for the following:

- Regulations need to be made that would require energy trusts (referred to in the Act as community trusts and consumer trusts) to adopt a code of practice dealing with accountability and access to information and to call at least one meeting a year that beneficiaries may attend (Section 172C). The chairperson of those meetings would be required to

allow a reasonable opportunity for beneficiaries at the meeting to question, discuss or comment on the management of the trust. There is an expectation that the regulation-making power will be invoked only if trusts do not, voluntarily, adopt practices akin to those contemplated by the regulation-making power.

- Beneficiaries rather than trustees need to have the power to appoint the auditor at the annual meeting of the trust (Section 158C). Beneficiaries may seek advice from the Auditor-General on the appointment of a suitable auditor. If the position becomes vacant after the annual meeting, the trustees may appoint an auditor. If the position is vacant for more than one month, the Auditor-General will fill the role until the next appropriate meeting of beneficiaries.

All energy trusts, except those whose trust deeds provide for a specific named capital beneficiary or beneficiaries (examples are the Auckland Energy Consumer Trust under which the local authorities within the former Auckland Electric Power Board district are the capital beneficiaries, and the Eastland Energy Trust under which the Gisborne District Council is the capital beneficiary) or which are constituted as charitable trusts, have provision for a regular review of the trust's ownership of its energy company shares.

In some cases (the majority), that review is to be undertaken by the directors (but this defaults to the trustees if the directors do not meet the required timeframe). In others, it is the trustees who commence the review. The typical review is intended to be wide-ranging, looking at the merits and demerits of trust ownership, and other options. A review will normally also cover whether or not a recommendation should be made on distribution and, if so, put forward a possible distribution plan.

Completed reviews are then available to consumer beneficiaries. In some trusts this is simply through a public consultation process modelled on the special consultative procedure used by local authorities. In other cases, the trust is required to undertake a poll of consumer beneficiaries.

At the time energy trusts were first established (as part of the establishment process of energy companies), both the government and the officials advising it expected

that the review process would result in consumers seeking distribution – preferring to have ‘their’ capital rather than supporting continuance. Instead, the general public response has been strong support for continuing trust ownership.

Powers (and Patterns) of Investment and Distribution

The appendix to this report provides, for community trusts, a trust by trust overview of current investments and distribution policy. It also provides what is intended to be a representative description of the investment powers and activities of energy trusts.

This part of the report deals with some of the generic issues, looking first at community trusts and then at energy trusts.

Community Trusts – Investment

Community trusts have common powers of investment that were drafted to recognise that, initially, they were the holders of shares in the corporatised trustee savings banks. The effect of those provisions has now passed (except for the TSB Trust which continues to be the 100% owner of TSB Bank). Instead, the trusts now operate under the general powers of investment set out in the Trustee Act.

As will be apparent from the appendix, trusts have generally acted under these powers by contracting in professional management to operate a diversified investment strategy with something of a bias towards preserving the value of trust capital. There is a strong view within community trusts that they have an obligation to respect inter-generational equity by ensuring that, year on year, they are able to provide broadly the same level of support by way of distribution within their region in real per capita terms. This theme emerged from discussions with a number of trusts.

From a regional development perspective, one issue which the investment practices of community trusts raises is whether and under what conditions it would be appropriate for them to reserve part of their capital to support local initiatives which might otherwise have difficulty in attracting equity or debt funding. This issue raises some quite difficult considerations. First, the ease with which capital for new ventures can be accessed differs across the country and by industry (some, such as

IT, are currently fashionable, others less so).

The question trustees can quite reasonably put in response to a suggestion that they should be investing funds locally is why they should be expected to take that kind of risk when commercial investors, who may be better placed to manage potentially high-risk investment, have not seen fit to do so. One possible response to this question would note factors such as:

- some areas of the country have less ready access to (or are less well-served by) commercial investors than others;
- commercial investors will commonly have minimum threshold requirements and other stipulations (e.g., regarding liquidity) that may be difficult to satisfy in at least some New Zealand regions; and
- commercial investors may be less well-placed to provide the monitoring and mentoring needed to complement such an investment strategy.

Next, trustees may also be concerned by the fact that the prudent person approach they are required to take could exclude them from engaging in what may be perceived as high-risk investment (or at least in investments where the expected return was not sufficient to compensate for the higher risk involved).

The question of whether or not to use the resources under their control to support investment in local enterprises is properly one which should be left to the trustees of individual trusts (who, in making any such decision, would no doubt be influenced by factors such as their understanding of their legal obligations and liabilities, and the views held within the communities they serve regarding the proper use of community funds). As an example, some trusts have been concerned that becoming involved with economic development could affect their charitable status. This seems unlikely, as virtually all of the special purpose entities (usually known as economic development agencies) set up in New Zealand to promote economic development have been established as charitable trusts and have been recognised by the Inland Revenue Department as charitable for the purposes of the inland revenue acts.

The fact that one trust, the Community Trust of Southland, has created its own investment vehicle for

supporting local enterprise (Invest South Ltd) shows that the problem is not an insuperable one. Whether there are in fact real barriers which need to be addressed is the subject of Part Two of this paper.

Community Trusts – Distribution

The overview of trust distribution practices contained in the appendix shows that, although most trusts make donations to a very wide range of local community groups and activities, they will also often be involved in supporting one or more major regional initiatives. For example, community trusts have played a key role in enabling a number of communities to realise the objectives they have for putting in place facilities such as stadiums, art galleries, indoor sports arenas, and other facilities requiring substantial discretionary capital from the community if they are to proceed.

Community trusts are required, by statute, to report all of the donations they make. It is increasingly common to accompany the report listing donations with supporting material highlighting donations that trustees consider to be particularly significant, and providing some background on the areas which trustees see as being of importance or where new initiatives are underway. For example, in its report for 1999/2000, the Community Trust of Canterbury highlighted the introduction of a new category of grants for major special projects.

However, it is not yet common for trusts to spell out their overall donations policy, including how they establish different categories and set priorities among them, or what their overriding objectives are.⁶ It can be inferred from reading the reports of community trusts that different approaches have been emerging. Some trusts appear to place a very strong emphasis on ensuring an even spread of donation support across different communities and different types of activity, while others concentrate on specific outcomes (one trust sees the major objective of its activity as building community capability and focuses its grants accordingly).

Regardless of the specific emphasis within their donations policy, most community trusts appear to share some common criteria for donations including:

- generally, donations should not act as a substitute for central or local government funding; and

- a preference (not universal) to avoid funding salaries.

Generally, community trusts also seek to ensure a measure of co-ordination amongst different funders, especially in respect of larger donations. Most have taken the lead in organising regular funders' seminars, bringing together central government, local government and philanthropic funding agencies to share views on priorities and on means of ensuring that they do not, at least unknowingly, each end up funding the same project or projects.

Of particular note is the initiative taken by two community trusts (at least) to establish a protocol with local authorities within their area of benefit for the purpose of understanding how the trust will provide support to territorial local authorities to enable significant community facilities in the region of the trust to be established. The focus of this protocol is funding which trusts have available for significant projects. Local authorities working through their mayoral forum are expected to establish and advise the trust of priorities for regional and sub-regional projects.

One trust reports that this initiative has been effective in providing a mechanism which has allowed individual local authorities a means of backing away from establishing competing facilities. In its area, this has seen agreement reached that one major local authority should establish a regional stadium and another a major indoor sporting facility, rather than each trying to do so. Within the same region three local authorities have supported a decision to establish a major water sports facility within the district of one of them, but on the understanding that it is specifically to serve all three.

What appears to be evolving is a growing recognition of the need for different types of public bodies serving the same communities to ensure that their activities are co-ordinated in order to make the best use of their resources. As well as allowing for some prioritisation, discussion suggests that there is another potential advantage – a better means of focusing on the long-term costs of major facilities. Bringing together the various funders allows a focus not just on capital costs (often the primary interest of the community trust) but also on responsibility for, and the likely magnitude of, ongoing operating costs. In discussions held to assist in the

preparation of this paper, more than one trust noted that there was a need to reconsider the emphasis being put on creating major facilities.

Energy Trusts – Investment

In contrast with community trusts, energy trusts do not have a common set of powers of investment and distribution. This reflects the fact that establishing authorities were given a wide degree of discretion to determine the future ownership structure for energy companies. Arrangements vary in respect both of powers of investment and of distribution.

All energy trusts included as one of their purposes receiving and holding shares in the associated energy company. Powers of investment range from specific powers, excluding the investment powers of the Trustee Act, to quite general powers.

Examples of the former include:

- the Auckland Energy Consumer Trust, whose investments are limited to shares or other equity or debt securities of the company; stock, funds or other securities of the New Zealand government; interest-bearing deposits or foreign currency deposits with any bank; or any debt or equity instrument with any domestic or international entity having an approved rating agency credit rating of not less than A- or its equivalent (this power is narrower than it seems as this trust is effectively precluded from retaining income); and
- the Hawke’s Bay Power Consumers’ Trust where authorised investments are restricted to shares or other equity or debt securities of the company or any subsidiary company; the stock, funds or other securities of the New Zealand government; and interest-bearing deposit accounts with any bank.

Examples of the latter approach include:

- Tauranga Energy Consumer Trust, which has power to “invest the trust fund or any portion thereof, notwithstanding that it may be subject to any liability, in any property whether in New Zealand or overseas”; and
- Taranaki Electricity Trust whose trustees “have the powers of investment conferred on trustees by

Section 13(A) of the Trustee Act”. The trust deed also provides that, notwithstanding the provisions of Section 13(B) of the Trustee Act (which imposes a duty to act prudently), they may invest all or any of the trust fund in shares or other equities or debt securities of the company; the stock, funds or other securities of the New Zealand government; and interest-bearing deposit accounts with any bank.

All of the trust deeds for energy trusts include special provisions regarding shares in the related energy company. These may be explicit provisions to the effect that the trust may only hold a narrow range of investments including equity or debt securities of the company; more commonly, deeds will include a provision along the lines of “no trustee shall be liable for any breach of trust ... because the investments of the trust fund are not diversified”. The clear intention of this provision is to enable trustees to concentrate their investments in order to retain ownership of the company (or as much as their resources may permit), even though this would otherwise be contrary to the provisions of the prudent person rule and expose trustees to personal liability.

An issue that may arise for energy trusts is that diversification is not the only requirement which prudent investors are expected to observe. Section 13(E) of the Trustee Act includes other matters such as:

- the need to maintain the real value of the capital or income of the trust; and
- the risk of capital loss or depreciation.

There are scenarios under which concentrating investment in lines companies could present a risk to the capital of the trust for reasons other than lack of diversification (diversification is primarily concerned with minimising the risk of volatility in the value of investments). Prudent trustees should also consider whether there are other risks that could have a significant negative impact on the value of their investments. This would include regulatory risk and the possibility of technological redundancy. It is likely, for the moment at least, that significant negative impact from risks of this kind would be regarded by most trustees as outside the bounds of reasonable probability.

Generally, energy trusts have shown a preference for

retaining investment in their related energy company, and have done this even when major changes in ownership as a consequence of merger/amalgamation activity, or regulatory requirements for divestiture have led to quite significant changes. In some instances, this has seen trusts effectively forced to diversify their investments away from the energy company in which they were originally committed. In one case at least, a trust has voluntarily divested.

Examples of changing investment patterns include:

- The Hutt Mana Energy Trust. As the Energy Direct Community Trust, this trust was allocated 30% of the capital of the Energy Direct Corporation Limited. It was required immediately on receipt of that 30% to divest itself of one-third that was placed with institutions to facilitate a public listing of the company. The size of that trust's shareholding has been gradually diminished as the result of a merger between Energy Direct and what was originally the Wellington City-owned Capital Power to form TransAlta New Zealand Limited, and the subsequent acquisition of that company by the Natural Gas Corporation in which the Hutt Mana Energy Trust now holds just over 10%.
- The Rotorua Energy Charitable Trust was originally a substantial shareholder in Trust Power Limited (as the result of a merger within Trust Power of the energy undertakings of the former Tauranga and Rotorua Electric Power Boards), but has followed a conscious policy of gradually divesting itself of any interest in the electricity sector. Trustees appear to have taken the view that there was a premium value attached to their Trust Power shareholding that they should realise in the interests of beneficiaries.
- The Tauranga Energy Consumer Trust originally held 50% and remains a holder of approximately 22.7% of the capital of Trust Power. It has retained a strong commitment to investing in that company even as merger/acquisition activity has diluted its shareholding and seen other major investors establish holdings in the company. All but a small portion of Trust Power shares are held by four shareholders, the trust itself, AGL (the parent company of NGC), Infratil Investments Limited and

Alliant International New Zealand Limited.

- The Otago Central Electric Power Trust, following the 1998 enforced separation of lines businesses from retail and generation businesses, faced a major shift in its investments as its associated energy company disposed of its retail interests and then sold its lines business in order to retain its interest in local generation. That trust is now in fact reconstituted as a charitable trust, still owning an energy company but with the bulk of its assets in a diversified investment portfolio.

Otago Central Trust was the only energy trust with 100% ownership whose related energy company disposed of a lines business. All other trust-owned energy companies retained their lines businesses and sold off their retail interests.⁷ Those trusts that distributed income to consumers typically dealt with this windfall through a special payment to consumers.

Energy Trusts – Distribution

Distribution policies vary quite markedly, in part because energy trusts, unlike community trusts, are not standardised in terms of potential beneficiaries. As examples, two, Rotorua and Central Otago, are charitable trusts (although the latter has only just changed from being a consumer trust). One, the Eastland Energy Community Trust, is effectively a trust for local economic development. The Central Power Electricity Trust is a non-charitable trust that applies its income primarily to energy-related grants, including undergrounding and uneconomic line upgrades, educational grants and scholarships, research projects and other projects enhancing electricity usage. The Taranaki Electricity Trust holds its income to be applied in one or more of a number of ways, including support for works relating to electricity supply, promotion of energy efficiency and conservation, provision of business and other educational assistance in support of careers allied to the energy industry, projects benefiting the consumers/electors within the district as may be nominated by local authorities, the assistance of new businesses being started in the district where significant employment opportunities are to be created, and other purposes which the trustees consider will benefit electors.

The majority of trusts apply part or all of their income in payment of consumer rebates. Some trusts have more discretion than others in this respect. The Auckland Energy Consumer Trust has no discretion to withhold income from consumers (its only discretion is to determine the amounts payable to different categories). Most of those trusts that are 100% owners of their energy company (Main Power, Scan Power and Horowhenua are examples) receive only enough income from their related energy companies to pay trust expenses. The bulk of what otherwise would be the taxable surplus of their energy companies is rebated back to consumers as a tax-deductible expense in the books of the company.

Most of the consumer trusts adopted (or were created with) deeds whose trusts in respect of income first appear to give trustees quite significant discretion to pay, apply or appropriate income or part of it for the benefit of consumers or some of them, but then go on to contain provisions to the effect that the directors of the related energy company shall, or may, if requested, provide trustees with a report on the distribution of company dividends to consumers. The purpose of this seems to be twofold: first, to allow the directors to express a view on the relationship of distributions to power usage, and secondly, to strengthen the implication that income should be distributed to consumers as a form of rebate.

The key issue influencing distribution policy is the view trustees hold on the extent to which they have a discretion, under that type of trust deed, to apply monies for purposes other than consumer rebates. Some trusts apparently take the view that, notwithstanding the requirement or power to seek a director's opinion on how to allocate the dividend amongst consumers, they are discretionary trusts, and it is the trustees' overriding obligation to determine how best to distribute income. Other trusts whose deeds are quite similarly worded apparently had legal advice pointing them towards a narrower interpretation of their powers which required them to distribute to consumers.

The result is an apparent lack of consistency as between trusts whose distribution powers look to be very similar. It is a separate issue whether this lack of consistency should give rise to any concern – given that the monies being dealt with are local funds, then primarily how they are distributed is a matter for trustees to

determine, recognising their accountability to the districts they represent (an accountability exercised primarily through the electoral process).

Examples of Initiatives

This section provides brief comment on initiatives by community and energy trusts that offer examples of activity that could have precedent value for other trusts. More detailed material is provided in the second part of the report, with its focus on case studies. In this section, four examples are chosen from community trusts and six from energy trusts. (The fact that a number of trusts have obviously been omitted is not to suggest that their activities lack interest in terms of examples which other trusts might like to follow; rather, it reflects the need to limit the range of examples for space reasons.)

Community Trusts

The three community trusts that have been chosen to provide examples of the way in which activity can contribute to regional economic or social development are the Community Trust of Southland, the Bay of Plenty Community Trust and the Whanganui Community Foundation (previously Trust Bank Wanganui Community Trust).

The Community Trust of Southland has, in per capita terms, the largest endowment of any community trust. In a region with a population of approximately 100,000, it has the ability to distribute in the order of \$10,000,000 per annum. As a result, it has tended naturally to focus on large-scale projects, whilst still maintaining the broad base of community donations that is a feature of all community trusts. This trust has taken a lead in partnering with other public bodies in promoting initiatives with a strong economic development focus. As three (but not the only) examples:

- It was an initiator and principal funder of the Topoclimate South project which has been undertaking micro-climate assessment and soil typing of the Southland region.
- In partnership with the Southland Building Society, it formed Invest South Limited with an initial capital of \$5,000,000, to provide partial equity funding to small- and medium-sized companies whose objective is growth, economic development and

job creation.

- This year it played a lead role in establishing the zero fees project for the Southern Institute of Technology with the intention of enhancing access to tertiary education for the local community and assisting SIT to develop nationally-recognised quality programmes that would attract students from outside the region.

The Whanganui Community Foundation has a much smaller capital base than the Community Trust of Southland (in per capita terms, around one third of the Southland endowment). Like other trusts, it undertakes a wide range of donation activity but has one particular emphasis that, to a degree, sets it aside. This trust puts a strong emphasis on building capability whether through grants to organisations for training or related purposes or through holding community seminars and workshops with a strong training emphasis (influenced by recent work on the role of social capital in building strong communities). It considers that there is strong anecdotal evidence that this is having a very positive impact on the community sector.

The Bay of Plenty Community Trust has explicitly endorsed economic development as an objective with significant grants to enable the establishment of 'Business Grow' programmes in Rotorua and Taupo. Of perhaps greater significance in the long term for the development of the Bay of Plenty region, this trust has also taken the lead in developing a protocol with local authorities to serve as the basis for joint priority setting (without undermining the independence of any of the parties).

A number of trusts are very aware of their potential to catalyse activity within their area of benefit and designing their donations policies to reflect this. The Community Trust (of Canterbury) provides a good example with its Major Special Projects category. Under this category, the trust will consider donations over \$250,000 for large projects that will have significant community benefits and outcomes. The Trust is explicit that these should be demonstrated by a high level of public support, including wide-ranging committed financial support from other organisations.

The emphasis on community benefits and outcomes and the partnership approach implicit in the co-funding requirement both point to this as being an example of

how trusts can use their resources in ways which could have very significant flow-on benefits in terms of regional social and economic benefits without the trust activity itself needing to be branded in this way.

Energy Trusts

Energy trusts are a much more diverse group of entities. As already noted, some are consumer trusts allocating all or the majority of their income to consumers as rebates (or accepting that their energy companies distribute their surplus to consumers as rebates pretax). Others include charitable trusts and trusts for general community benefit or for energy-related purposes of benefit to the community.

This group provides a broader range of examples of the potential for trusts, where the trustees are of a mind to do so, to undertake development-oriented initiatives within their area of the benefit. Examples of what energy trusts have undertaken include:

- Bay of Islands Electric Power Trust. This trust, as the 100% owner of Top Energy Limited, has amongst the objectives set for the company contributing to economic development and employment growth in the far north. One initiative reflecting this objective is the establishment of a major call centre in Kaikohe expected to employ an additional 70 people during the current year.
- The Central Power Trust, based in Palmerston North, holds its income for energy-related purposes. It has recently adopted a new grant category 'economic growth' within which grants are aimed at assisting with new businesses in the Central Power District, assisting existing businesses to expand their activities and supporting organisations to promote activities that will attract businesses to the district.
- The Eastern Bay Energy Trust has supported a major retrofit programme working in conjunction with local authorities in the Eastern Bay, with EECA and with the local lines company (Horizon). The focus has been on the energy conservation and health benefits of retrofitting and on the potential such a programme offers to provide employment and job training for unemployed people within its area of benefit.

- The South Canterbury Power Trust as a part owner of Alpine Energy Limited is supportive of that company using its expertise to develop water resources in the region. The construction of the Opuha dam, which has enabled a significant extension of irrigation in the region, is an example. The trust has emphasised the importance of the company being able to continue this type of activity in submissions on the Electricity Industry Bill.
- The Tauranga Energy Consumer Trust makes grants for a wide range of energy-related purposes. Although the trust makes the point that it believes it has not got the power to adopt economic development as a specific criterion for grant-making activity, it is clear from the nature of the grants it has made that there is very real potential for this type of approach to contribute significantly to economic objectives.
- Eastland Energy Community Trust is, in effect, a trust for local economic development. It has supported a number of local initiatives but of particular interest it is currently considering the establishment of a venture capital fund to support new initiatives within its area.

Conclusion

The purpose of this part of this paper has been to provide an overview of structure, governance and activity of community trusts and energy trusts. It is produced as part of a project whose principal purpose is to improve knowledge and understanding of these two important groups of trusts and to provide some indication of the potential which they have, where trustees are of a mind to take this approach, to support social and economic development either on their own or in partnership with others.

The picture is one of a diverse and still-evolving sector, with trustees as well as local communities still working through the exact role which trusts should play and how best to ensure that their resources are available, long term, for the good of the community.

Part Two: The Potential and the Barriers

Introduction

The focus of this part of this paper is on:

- case studies to illustrate the potential contribution trusts do and can make to economic development; and
- barriers and impediments to effective involvement in economic development and means of overcoming them.

Case Studies

Two community trusts and three energy trusts have been selected as case study examples. The community trusts are Southland and Bay of Plenty, and the energy trusts are Eastland, South Canterbury and Bay of Islands.

Bay of Plenty Community Trust

The trust donated \$180,000 over 1995, 1996 and 1997 to groups operating Business Grow in the Bay of Plenty. The major recipients were the Bay of Plenty Business Development Board, Rotorua Business Development Foundation and the Lake Taupo Business Development Agency. The trust's donations were to assist the overall aims of Business Grow and were always in addition to contributions from other sources such as local authorities and government (e.g. Department of Labour).

Business Grow had commenced in Canterbury around 1992-1993 and was aimed essentially at job creation. Inherent in the programme was recognition that:

- 80% of new jobs are created out of existing businesses;
- existing businesses need to feel significant; and
- existing helping agencies were under-resourced.

Although the prime aim was job creation, preservation of existing jobs was also very important (a job saved is a job gained).

Recipient organisations had to report quarterly and annually to the trust. Although the key measures were 'jobs', and new jobs could always be counted, it was of

course very difficult to attribute any job (gained or retained) solely or even primarily to the Business Grow programme. It was even more difficult to verify the numbers reported.

What was easier to report was what the organisations had done with the trust's contributions – numbers of seminars held, enquiries, visits to firms, referrals to other specialists (marketers, planners, accountants, etc.). There was a lot of narrative reporting and this was frequently supported by letters from those who had been helped.

This highlights an issue that may well influence other trusts considering grants for economic development purposes; if there is no reliable means of measuring outcomes (and attributing causality), should they use trust funds to support the proposed activity?

Community Trust of Southland

This trust has been very active in contributing to economic development initiatives within its district. Three are examined:

- Topoclimate South;
- Invest South Limited; and
- The Southern Institute of Technology Zero Fees Proposal.

Topoclimate South

The Topoclimate South Trust is a trust that was formed at the initiative of the Community Trust of Southland and five local authorities to undertake a micro-climate and soil survey of the Southland region. The objective is to obtain accurate information on the region's climate and soils to enable better land use decisions.

Initially, the project sought funding through the Foundation for Research Science and Technology. Its application was declined as, although it was scientifically robust, it was applying existing scientific knowledge and not developing new knowledge or techniques.

The trust in association with local authorities in the region stepped in and provided grants totalling \$1.36 million over the three-year period of the project. It also made available a loan of up to \$1.6 million that has recently been repaid by central government as a grant.

The project is releasing the information it has collected as maps showing soil type and long-term annual heat

pattern. The first set, covering Northern Southland and parts of Te Anau and West Otago, was distributed to local authorities and farmers in mid-2000. Distribution of the second and third (final) sets should be completed by the end of the year. There is strong interest both from the farming community and other groups with an interest in better land utilisation. In response to this, the Topoclimate Trust has recently set up Topoclimate Services and appointed a field officer with a specific brief to assist people wanting to make use of the information the project has generated. It has also recently won consultancy contracts to provide advice to other similar initiatives both within New Zealand and offshore.

Invest South Limited

This company was formed as a joint venture between the trust and the Southland Building Society. The company states its key objectives as:

- to identify investment opportunities within an appropriate sector and risk profile;
- to stimulate economic activity in the company's target market area with the objective of creating new job opportunities; and
- to provide a commercial return to ISL equivalent to the inherent risks by the placement of the \$5 million equity funding in the medium term.

Invest South Limited operates as a stand-alone company with its own Board of Directors (all prominent local business people) and an experienced Chief Executive. Care has been taken to ensure that the company operates an investment decision-making and monitoring process appropriate to managing the risk involved in acting as a specialist minority investor in locally-owned companies.

Prudential limits set for investment purposes include:

- a maximum of \$750,000 would be available for any one project;
- a maximum of \$1.5m would be invested in any one market sector;
- the minimum amount of an applicant's shareholders' funds after the receipt of the ISL investment should be not less than \$300,000;
- the maximum percentage of share capital that ISL

will generally subscribe to in any one investee company is 49% of the total shares on issue after the investment (which could mean that ISL may be the largest single shareholder).

The Community Trust has recently agreed to increase its investment in Invest South Limited from \$2.5m to \$7.5m and will thus be the majority shareholder. The trust is conscious that, in investing in ISL, it must be satisfied that it has complied with the prudent person rules of the Trustee Act. It has taken legal and investment community advice which has supported its decision – in other words, what it has demonstrated is that there is no inherent barrier under the prudent person rules to investing quite significant funds in equity investments in local firms provided that appropriate criteria are set and processes are in place.

Theoretically, the trust could have decided to be a direct investor in the companies that form ISL's portfolio. What seems clear instead is that the trust has recognised the importance, in an activity such as this, of ensuring that it has separate expert direction and management from people selected because they have relevant skills and experience (a stance supported by a recent independent report which endorsed the importance of having in place an intermediary structure able to provide monitoring and governance arrangements appropriate to the nature of ISL's investments).

Southern Institute of Technology – Zero Fees Proposal

The Community Trust has been a strong supporter of educational initiatives of various kinds and has worked closely with SIT. The trust is familiar with the difficulties facing regional polytechnics and sees strengthening SIT as an important part of supporting the local community. It also recognises the need for a highly qualified and skilled workforce, the role that SIT can play in developing this and the impact of financial barriers on access to tertiary education.

Together with the Invercargill Licensing Trust (another major local trust), three local authorities (Invercargill, Southland and Gore) and local corporates, a total of \$7.25 million has been committed to SIT over a three-year period on the basis that students on approved courses will not be charged tuition fees.⁸ The impact on SIT's student numbers is expected to be an increase from

approximately 1,800 EFTS in the year 2000 to 3,000 EFTS in the year 2003. (Early this year, SIT's chief executive expected that this year's student numbers would be 40% up on last year – see *The Southland Times*, 14 February 2001. The actual outturn was an increase of 55%.)

Quite apart from the benefits of improved workforce training, the flow-on economic benefits to the community are expected to be a significant multiple of the total funding cost (and news media reports of the impact of the scheme suggest that there has also been a significant impact on inward migration).

Bay of Islands Electric Power Trust

The Bay of Islands Electric Power Trust is the 100% owner of Top Energy Limited. There is a specific focus in the statement of corporate intent between the trust and the company on the company's business contributing to economic development. The stated objective of the company, as set out in the SCI, is "to operate a successful business, maximising the value of the company in the long-term for the benefit of the shareholders". This is to be achieved by utilising the strength of Top Energy investing in business activities which:

- reflect the company's capabilities and competencies;
- focus on activities that contribute to economic development in the Far North District;
- provide new employment opportunities; and
- reflect a responsible approach to environmental and social issues.

(Further criteria set out normal commercial requirements.)

Reflecting this approach, the company will this year increase its Kaikohe staff by a total of 70 and expects to spend \$200,000 on training (much of the increase will be in the development of a call centre as a business activity serving a variety of national and international clients).

The company's own commitment to regional development is expressed on its website as:

... the far north community is enthusiastic about the company's commitment to service based employment and local residents welcome the prospect of a stable work environment in

the customer service industry – enabling them to combine their careers with the region's bush and beach lifestyle.

As a substantial community owned organisation, Top Energy is in the forefront of this new direction for the Far North, drawing on its own successful commercial history and strong customer service ethic to create growth and employment.

The company's commitment is underpinned by renewed interest in regional development within New Zealand.

Eastland Energy Community Trust

As described in Part One, this trust is in practice constituted as a trust for regional economic development and the trustees see this as a primary objective of their grant activity. The trust is currently considering the best use of the capital distribution it received from the company following the sale of its retail interests (a sum totalling \$6 million).

Trustees are considering the possibility of establishing a venture capital company to be a source of debt and/or equity funding for local businesses in need of start up or expansion funds. For this trust a critical issue is whether such an investment is consistent with the prudent person provisions of the Trustee Act. In this respect they are in a somewhat different situation than the Community Trust of Southland whose commitment of \$7.5m to Invest South Limited represents just under 4% of its capital. On a book value basis (recognising that its energy company may now have a somewhat higher value), \$6 million is 23% of the trust's assets and virtually all of its assets apart from its energy company investment.

South Canterbury Power Trust

This trust holds 40% of the capital of Alpine Energy Limited (remaining shareholders are Timaru District Council with 42.7% and two smaller local authorities with the balance).

The trust distributes its income to consumers but has been supportive (along with other shareholders) of the company's business philosophy which includes acting as a strategic investor in the South Canterbury economy. The rationale put forward by the Board of Directors is

that, as the largest locally-owned company in an area which is not normally a priority for outside investors, it has a responsibility to look for investment opportunities which, as well as meeting its rate of return criteria, will bring collateral benefits to the local economy.

The trust support for this philosophy, and its rationale is set out in the submission the trustees made to last year's Ministerial Enquiry into the Electricity Industry. The points it made included:

- Small regional electricity network companies such as Alpine Energy Limited have traditionally played important roles developing the use of their region's water resources. This is now severely compromised by the previous government's electricity reform legislation.
- The development of a region's water resource for in-stream and primary production enhancement is frequently uneconomic without the ability to earn revenue from the generation of electricity.
- The present structure of large and often multinational generating companies do not have the same regional commitment as locally-owned network companies to develop small but important regional water resources.
- Network companies, with their engineering expertise and their traditionally high equity, are the natural business to be involved in the development of such schemes.

This is a very interesting example of the potential, with the support of their owners, for network companies to play a significant role in economic development without compromising their commitment to their core business – in other words, without straying outside their area of expertise and thus increasing the risk to their business and to their shareholders.

Barriers and Impediments

This section examines possible barriers and impediments to trustees using income or capital under their control (whether as grants or as investments) to support economic development objectives. They are considered on the assumption that trustees would undertake such activity if they felt that they could, but believe that, because of one or more barriers or impediments, they

are not able to do so.

Whether there may be barriers and impediments, and how best to deal with them, is now considered by looking at the different means available to trusts for supporting economic development. Briefly, these are seen to be:

- grants from income or capital;
- investment of capital; and
- encouraging or directing a trust-owned business to undertake activity with an economic development objective.

Grants From Income or Capital

Whether trusts can support economic development by way of grants from income or capital turns on how their trust deeds express their powers to apply income or capital.

Community trusts have a common set of powers. Their legislation sets out the purposes for which they hold their funds and these have been carried through into a common form of wording in trust deeds (which themselves require the approval of the Minister of Finance, something which extends to any alterations). The standard formulation is that "trustees shall stand possessed of the trust fund upon trust to be applied for charitable, cultural, philanthropic, recreational and other purposes being purposes being beneficial to the community principally in the specified area" (the specified area being the area in which the former regional trustee savings bank conducted business).

It seems widely accepted that grants for economic development purposes are included within this formulation – see the examples cited of the Bay of Plenty and Southland Trusts.

The position is much less clear in respect of energy trusts as a class. Unlike community trusts, they do not have a standard form of trust deed. Two are charitable trusts. For them to be able to make grants for economic development purposes would require a clear acceptance that, as a matter of law, such grants were charitable. The fact that the charitable trust structure is commonly adopted as the corporate form for economic development agencies provides some support for the view that grants for economic development purposes may themselves be charitable but that is a matter on which individual trusts would need to take their own legal advice.

A number of other energy trusts hold their capital and income for purposes beneficial to their consumers, often expressed in terms of energy-related purposes. Others hold their income and capital to be paid or applied to or for the benefit of consumers.

There is room for considerable uncertainty regarding the extent of these powers. As noted in Part One, the Tauranga Energy Consumer Trust, whose deed is very similar to that of a number of the so-called rebate trusts, believes that it can make grants for the benefit of consumers generally even though similar trusts argue that the wording of their deeds implies otherwise.

Even in situations where trustees believe that, if they distribute income, they are bound to do so by way of distributions to consumers, there may still be significant scope for funding economic development activity if trustees are of a mind to do so. A number of the deeds for energy trusts give trustees a broader discretion to pay or apply monies from capital than they have to pay or apply monies from income. Some of these deeds, although apparently requiring income distributions to go to consumers, give trustees discretion instead to accumulate money as part of the capital of the trust fund. Other deeds may not include a power to accumulate but still give trustees discretion as to the application of capital.

These matters are complex. Because the deeds are not standard, the powers and discretions of the trustees of each trust need to be considered separately. Apparently minor differences in wording may as a matter of law confer quite different powers or discretions on trustees. Differing legal opinions may, on similar sets of wording, result in one group of trustees believing that they have adequate power and another concluding that they do not.

A preliminary assessment of the extent to which the trustees of energy trusts actually have power to make grants for economic development purposes indicates:

- some trusts by the narrow wording of their deeds are absolutely precluded – the obvious example being the Auckland Energy Consumer Trust;
- most trusts quite probably have the power to do so but in some cases at least this may turn on using capital rather than income, thus turning trustees' attention to how they release capital – whether by accumulating money from income and then applying that once it has taken on the nature of

capital or by finding means of turning part of their share investment in their energy company into capital which can be available for that purpose.

In the final analysis, the question is one for the trustees of individual trusts and the probability is that, except in instances where deeds are so tightly drawn that there is no possible power, trustees who are genuinely committed to finding a means of distributing monies for economic development purposes will find that it is possible to do so.

Investment

Whether trustees can make capital available for investment with the objective of promoting economic development is again a function of the powers they have, both in terms of their trust deeds and under trustee law generally.

Community trusts have wide powers of investment – expressed as the power to invest in any form of investment for the time being authorised by the law of New Zealand for the investment of trust funds. Currently, a power of this kind means investment in any form of asset subject to satisfying the prudent person requirements of the Trustee Act.

The investment powers of energy trusts differ markedly. Some have investment powers quite narrowly constrained to shares or other securities of their related energy company or high quality fixed interest securities (government stock and bank deposits). Others have broad powers of investment expressed in terms such as “invest the trust fund or any portion thereof, notwithstanding that it may be subject to any liability, in any property whether in New Zealand or overseas”.

Most deeds contain a power of variation that allows trustees, if they see fit, to redraft provisions such as their investment powers. Typically, the power to vary the trust deed is subject to a super majority of trustees and to public consultation.

The main concern trustees have expressed about powers of investment for economic development purposes is that such investment may be outside the requirements of the prudent person rules and thus expose trustees to personal liability.

Trustees expressing this concern point to factors such as New Zealand's relatively unregulated capital

market. There is an implication that investment propositions that are capable of earning a return commensurate with the associated risk should have no difficulty in accessing capital. Accordingly, the demand that local funds should be available to support local business can be seen as a demand that trustees should be prepared to accept a less than market return.

This concern may be underscored by pointing out that there is no realistic market in equity investment in small- or medium-sized local firms – in essence, the trust would be relying on other shareholders to provide the exit and the very fact that they are looking for external funding raises some doubt over whether they would have the capacity, down the track, to buy out a trust investment.

One difficulty for trusts is that, at the moment, there is no hard and fast legal rule that can be turned to for clear guidance. A 1996 paper by one of New Zealand’s leading fund managers on the prudent person requirements of the Trustee Amendment Act 1998 states “it is important to note ... that the act does not tightly define a test for the prudent person duty of care, it simply refers to the duty of care being in the nature of a rule. Probably the standard of care required of trustees in practice will have to emerge through the courts. The standard of care would seem to be assessed with reference not only to investment performance but also to trustees’ conduct”.

The Invest South example already referred to shows that one trust has received independent professional advice that it can set aside part of its capital to be invested as minority equity participation in local businesses. However, it should be noted that:

- the total amount set aside is rather less than 4% of the trust’s capital; and
- it has set up a separate structure that has its own expert management and has put in place quite rigorous application and monitoring procedures.

Trustees of other trusts could properly conclude that it was dangerous to argue that simply because one trust has felt satisfied it can make such an investment, another trust can equally easily do so. Factors such as the proportion of trust capital being committed and the robustness of the management arrangements available

would obviously need to be taken into account.

There does seem to be a very real issue here. It is not appropriate that trustees should be asked to take the risk that their decisions might be subject to legal review and their actions found to be in breach of the prudent person rules. Even if they have available liability insurance that would protect them from personal loss, the fact that legal proceedings could result is a major disincentive.

A related issue arose in the United States in the late 1970s in the early stages of development of its venture capital market. The obvious source of significant funds were the monies under management by pension fund trustees, but the prudent man rule contained in the Employee Retirement Income Security Act appeared to preclude this type of investment (or at least raise doubts as to whether it was lawful). In 1979 the rule was clarified so that this type of investment was clearly within the power of trustees (subject to limits on the percent of funds committed). One consequence was a major increase in the flow of funds into new venture capital funds (see ‘Does Capital Spur Innovation’, working paper 6846 of the National Bureau of Economic Research).

To remove doubts regarding trustee powers in New Zealand, government could amend the Trustee Act by making it clear that investment in certain higher risk asset classes, such as venture capital or local economic development funds, was an authorised investment. Provisos on this could include:

- a limit on the percentage of total capital any trust could invest in that way;
- (possibly) some reference to trustees being satisfied that the means adopted for managing that investment were adequate to the risk involved – care would need to be taken with such a proviso because of its inherently subjective nature. It might be best expressed as a requirement that trustees had independent professional advice that the arrangements for managing those funds were appropriate to the nature of the risk;
- a restriction on the types of trust to which the provision applied – for example, to any community trust or any trust (including any successor trust) formed as part of the share allocation arrangements for the establishment of an energy company.

There are means other than legislative amendment for overcoming the difficulties facing trustees, assuming that they do want to become involved in this type of activity. Possibilities (which would need to be confirmed by legal advice) would appear to include:

- amending their trust deeds to provide for an explicit power to undertake that type of investment – section 13D of the Trustee Act explicitly allows a trust deed to set aside the prudent person duty;
- settling part of a trust’s capital on a separate trust established for the explicit purpose of investing in local activity for the purpose of promoting economic development.

There is a further issue that, although not in the nature of a barrier or impediment as such, would also need careful consideration. This is the question of capability.

Trustees of community trusts are appointed by the Minister of Finance. In making appointments, the Minister is to have regard to any recommendations which existing trustees might make (but is not bound by them), and no person shall be appointed unless that person is suited for appointment by reason of either knowledge of or experience in business, banking, law or accountancy (a provision that appears to relate to the fact that, when it was first inserted, the trusts owned regional savings banks) or that person’s interest or involvement in the community.

The major focus in appointment now appears to be on the suitability of appointees in managing a major donation programme (although the experience of individual trusts as reported in the course of preparing this paper does appear to vary). There is no necessary linkage between this and the capability needed to oversee the management of what amounts to a venture capital or start-up fund.

Trustees of energy trusts are elected (with a couple of exceptions where they are appointed). Again, there is no necessary link between this means of selecting trustees and the capability needed.

Trustees, even if satisfied that they have the power and are convinced that the activity is one for which they should provide funds, should be cautious in doing so unless they are satisfied, by independent advice, that

they could put the necessary governance and monitoring in place. It is likely that prudent trustees would conclude that in order to ensure that appropriate governance and monitoring arrangements were in place, it would be desirable to use a separate vehicle along the lines of Invest South (see section on Invest South Limited above).

Using Trust-owned Companies

Two trust-owned energy companies (at least), Alpine Energy and Top Energy, have an explicit policy of undertaking activity that will contribute to economic development in the area. One of these, Top Energy, is 100% owned by a trust that has a commitment to distributing the whole of its income to consumers. Its trust deed, in respect of income, requires trustees to obtain a report from directors on how the dividend should be allocated amongst classes of consumers and obliges trustees to have regard to that report. Although the primary power to deal with income is written in discretionary terms, it is made subject to the clauses dealing with the report from directors and could be interpreted to mean that trustees are obliged to distribute income in accordance with that report (an alternative interpretation is that, if trustees exercise their discretion to distribute to consumers, then they must do so in a manner consistent with the director’s report).

The significance of this is that the Bay of Islands Electric Power Trust is an example of a trust that may believe that it has no power to utilise income other than as consumer distributions. It has probably not considered the alternative of utilising capital, although its deed appears to give it somewhat more discretion in the use of capital than income (an interpretation which would also be reinforced by the fact that one of the stated objects in the trust deed is “to distribute to consumers the benefits of ownership of shares in the company”).

The trust also has the objective “to encourage and facilitate the company in meeting its objective of being a successful business by optimising the company’s return on its assets”.

Apart from the objective of encouraging and facilitating the company, and an associated objective of retaining shares until they are sold, transferred or otherwise disposed of following an ownership review, there appears to be nothing in the trust deed specifically regulating how trustees should approach the relationship

between the *trust as owner* and the company. However, the Energy Companies Act 1992 does contain what amounts to a code for regulating the relationship.

Under section 37, “all decisions relating to the operation of an energy company shall be made by or pursuant to the authority of the directorate of the company *in accordance with the statement of corporate intent (if any)*”. Under section 39, the directorate of any energy company is required to prepare a draft statement of corporate intent, submit it to shareholders, and complete the statement of corporate intent after taking into account any comments from the shareholders.

Under section 40, shareholders may by resolution passed at any general meeting of the company require the directorate to modify the statement of corporate intent. The shareholders before doing so are required to consult the directors and also to have regard to the principal objective of being a successful business.

What this appears to provide is a framework within which the trustees of an energy trust, even although they may have limited powers to distribute income or capital other than to consumers individually, do have the power to influence their energy company to undertake business activities which trustees believe would contribute to economic development within the area. The only constraint is that they must have regard to the successful business objective.

This is not an issue that trustees, generally, appear to have considered in any depth. It is likely that even the initiatives taken by the Bay of Islands trustees (agreeing on development-related objectives in the statement of corporate intent) or in South Canterbury have been seen as totally consistent with the core business of the company.

In concept there appears to be nothing to prevent trustees influencing their related energy company to undertake quite major activity which they believe will contribute to development in their area, so long as that activity is intended to generate a commercial return. In the far north, in theory this could see trustees encouraging the company to take an interest in a range of infrastructure development options unlikely to be undertaken by the private sector as such and for which other public bodies (as an example, local authorities) may lack the capital, the expertise or both.

The potential for trust-owned energy companies to

become engaged in commercial activities with an economic development objective appears to be quite considerable. Most have relatively little debt, quite significant assets and a commercially-oriented board and management.

Trustees, of a mind to encourage economic development, might see working through their related energy company as the best available vehicle. Typically it has significant capital resources and a strong commercial infrastructure.

The idea of energy companies acting in this way, although relatively novel in New Zealand, is not a new one internationally. Acting to promote economic development has long been a key part of the business of most American utilities, driven partly by the commercial motivation of increasing utilisation and partly by favourable tax arrangements.

Conclusion

This part of this paper has looked both at case studies of actual instances of activity with an economic development purpose and at possible barriers and impediments confronting trustees who may wish to engage in such activity but believe that for legal or other reasons it may not be appropriate to do so.

The picture that has emerged is one of a diverse range of activity, and of a growing interest in seeking out opportunities trustees can legitimately pursue. What is also clear is that decisions of this type are very much a function of local circumstance, including the history of individual trusts, community attitudes, and, for energy trusts the exact nature of their legal powers.

Generally there do not appear to be insuperable obstacles facing trusts that wish to become involved in economic development activity although there may be merit in clarifying the extent of trustees powers to invest in such activities.

Appendix

Details of Community Trusts and Energy Trusts⁹

This appendix provides brief details of the investment policy/assets of each community trust together with information (gleaned from annual reports and statements of account) on their donations policy. It also provides similar information on energy trusts. Given that there are 28 of these and that they differ in type, it has been decided to use a sample illustrating different types rather than provide equivalent information on all 28.

Community Trusts

The following information summarises the value and management policy of each trust's investments and their focus for donations. Where available, the information has been taken from the Annual Report as at 31 March 2000, otherwise it is from the 31 March 1999 report.

The Community Trust of Otago

As at the end of the 1999-2000 financial year, the trust has \$182,715,000 worth of assets in total. \$180,731,000 is in investments, of which \$79,747,000 is held in New Zealand and \$100,984,000 is held offshore. The annual report simply states that managed funds are managed "externally".

The trust sees small donations of less than \$10,000 to a range of community organisations as the most important, as these sustain a wide range of community activities. They primarily support sport and recreation to add to the fulfilment of life for their community.

Recently they have moved to further support arts and culture, and technology for primary and secondary schools. They have also been involved in establishing a video library of promotional and publicity material for the use of Otago businesses and other organisations. The trust sees this as an economic development exercise to establish a base for cohesive regional promotional material.

The recent 2000 report states the trust is considering an Otago-wide economic development initiative, while continuing to support community organisations.

The Community Trust of Mid & South Canterbury

In 1999, the trust adopted a new investment policy and appointed Guardian Trust to manage the trust's capital base. The trust has \$35,790,684 in total assets, of which \$10,996,815 is debt investments and \$7,416,136 is equity investments, with the balance of \$17,672,843 held in term deposits at National Bank of New Zealand, ANZ Banking Group (NZ) and WestpacTrust, and other short-term debt investments.

There is no specific stated donations policy. In the 1999 year, large donations were made to arts, sport and senior citizens organisations, while youth groups, schools and toy libraries received numerous smaller donations. The trust has also launched a Community House project to lease office space for community-based organisations and occupies offices in the building so as to be accessible to the community it serves.

West Coast Community Trust

As at the 1999-2000 Annual Report, the West Coast Community Trust had \$4,691,210 worth of assets in total. \$4,670,100 was in investments. While their report only states what type of investments some are, they are held as follows:

ASB Bank	\$120,000 (6-month deposit)
AMP Asset Management	\$4,500,000
TCNZ Finance	\$50,000 (15-year deposit)
West Coast Community Trust Charitable Company	\$100

The trust has a ceiling on the total amount of donations it can give in any one year. It is no more than the trust's income from the previous year. The trust gives a grant to each of the districts it covers and also gives a regional grant. The maximum amount for each is \$10,000.

Donations are made to a wide range of groups, but have included the Hokitika Districts Business Promotion Association and a wide range of volunteer organisations such as St Johns Association and the Volunteer Fire Brigade. Educational groups have also benefited.

The Community Trust of Southland

As at the end of 31 March 2000, the Community Trust of Southland had assets totalling \$195,539,840, of which \$194,393,049 were investments. The trust earned \$3.9 million more in the 1999-2000 year than it did in the previous year. The overall return from its investments was 8%.

The trust's investment objectives are:

- to preserve the value of the initial capital entrusted to the trust;
- to maximise the total amount of income that can be earned from the trust's investments over the long term (subject to a prudent level of portfolio risk);
- maintain stability in income for annual donations.

The annual report does not break down what type of investments are managed by which company, but they are managed by the following, chosen as specialists in their class:

AMP Asset Management
Armstrong Jones (NZ) Ltd
Morgan Stanley Dean Witter
State Street Global Advisors
Invest South Ltd

The investments comprise:

New Zealand Shares	\$10 m
Cash	\$67 m
Offshore Shares	\$58 m
Loans	\$1 m
New Zealand Bonds	\$56 m
Invest South	\$2.5 m

The investment in Invest South Ltd (a venture capital company set up in conjunction with Southland Building Society) will increase as the trust has resolved to become majority owner by investing a further \$5 million in the company. The decision to do so was swayed by the success of Invest South since its inception in 1997, and the need for a local investment company. Since then Invest South has invested \$3.3 million in eight southern projects that have resulted in 40 new jobs.

The trust recently reduced the risk in their investments by allowing no more than 35% of their investment to be in shares.

The trust has supported a wide range of community organisations and projects. These have included the Invercargill Inner City Development, the Southland Stadium, community centres and oncology equipment for the Otago/Southland Regional Cancer Centre. One of the most successful programmes for the year was funding of \$200,000 on the basis of \$2 per person for 34 millennium celebrations and events.

In addition, the trust awarded 40 bursaries for tertiary education (\$1500 pa for 3 years) and three tertiary scholarships (\$3000 pa for 3 years). The bursaries are awarded both on need and ability and the scholarships for excellence.

A major project for the trust in 2000-2001 and for the next three years is the fee-free scheme at Southern Institute of Technology. Along with the Invercargill Licensing Trust, local authorities and some corporates, the trust has funded \$3.5 million of the \$7.2 million needed to the scheme, although an unspecified portion is to go into constructing a proposed arts centre. As the scheme carries a level of risk, this is to ensure that there is some enduring benefit to the community.

The money will be contributed over three years. Part of the trust's contribution (\$500,000) is to make up a shortfall from other funders, which will be repaid in year four of the scheme.

The (Canterbury) Community Trust

The trust has a total asset value of \$461,946,701, of which \$461,210,224 is in investments. This includes \$4 million in property. The rest is held in a range of financial institutions as follows:

NZ Equities	Tower Asset Management
New Zealand Fixed Interest	AMP Asset Management BT Funds Management
New Zealand Cash	AMP Asset Management BT Funds Management Tower Asset Management
Global Equities	Alliance Capital

Lazard Asset Management
Marvin and Palmer

Global Fixed Interest

Mercury Asset

The Annual Report for 1999-2000 states global equities as the best performer in that year. The focus of the investment policy is risk minimisation.

The trust has recently established two new categories for donations, one being the Environmental Project category and the other Major Special Projects. The latter is for one-off projects over \$250,000 designed to bring significant benefit to the community, while the former is for funding local conservation and environment projects, or educational work in this area.

These new categories join the trust's existing categories of:

Welfare and Social
Education
Infants and Children
Miscellaneous
Hospital and Medical
Recreation and Leisure
Sport
Economic and Employment
Vans
Disabled
Youth
Music and Culture
Festivals

Sport and welfare remain the biggest recipients of donations and the trust also awarded tertiary bursaries as part of the education category.

The Community Trust of Wellington

The 1999-2000 Annual Report totals the assets of the Community Trust of Wellington at \$51,814,611. Investments make up \$50,291,937 of this. \$26,560,468 of these investments are managed by Tower Funds Management and \$20,401,469 are managed by BT Funds Management.

When compared with the other community trusts in New Zealand, the Community Trust of Wellington has limited funds. This is due to the formula used by the bank

prior to the TrustBank New Zealand share float. This considered the region's funds in the bank and not the population base. Wellington received approximately 1% of the asset and has around 10% of New Zealand's population. All the other trusts have a ratio more favourable than this.

In the 1999-2000 year, the trust found that general donations were curtailed due to the commitment they had made in previous years to larger projects. Those larger projects include the Wellington Regional Stadium Trust, Sport Wellington Region, the City and Sea Museum, the Embassy Theatre refurbishment and the Karori Wildlife Sanctuary.

So that the donations made make a difference to as many people as possible, the trust makes donations under five categories:

Educational and childcare
Welfare, health and community support
Recreation, leisure and sport
Cultural (includes music and the arts)
Heritage

It has contributed to community health with substantial support to the Newtown Union Health Service and WellTrust, an organisation for drug abuse. The trust supports a wide variety of smaller groups to complete both routine and innovative projects.

Waikato Community Trust

The Waikato Community Trust ensures that its funds reserves are managed so that the "vital work of the community can be carried on in the event of a market downturn". Total assets are \$220,568,000, of which \$218,774,000 are in investments. These investments are managed as follows:

New Zealand equities and cash – Tower Funds Management

New Zealand fixed interest investments and cash – National Mutual Funds Management

Global Fixed Interest Assets – Rothschild Asset Management

Global Equities (passive) – State Street Global Advisors

Global Equities (active) – Lazard Frères Asset Management

Like many other trusts, it supports sports around its region. It has made a commitment of \$1.25 million over a three-year period to SportsForce, an organisation for volunteer coaches. It aims to support charitable, cultural, philanthropic, recreational and other purposes of benefit to the community.

Further aims the trust is setting out to support include:

- organisations setting up training for staff or undertaking long-term planning;
- groups that are working collaboratively and sharing resources;
- groups and programmes that deal with issues impacting on the community; and
- projects that deal with the underlying causes of social problems.

Eastern and Central Community Trust

The Eastern and Central Community Trust has \$148,950,226 in total assets, of which \$142,404,177 is in investments.

They are allocated and managed as follows:

New Zealand Shares	\$20,174,0282 BNZ Investments
International Shares	\$74,093,427 State Street Global Advisors
New Zealand Bonds	\$29,697,189 ANZ Funds Management and some self managed
International Bonds	\$17,438,279 ANZ Funds Management

Donations for the year include a raft of community projects, including a summer reading project for libraries around the area. Educational facilities, sports and the arts feature highly in the list of donees, although a large amount of small donations have been made to Guides, Scouts, Girls and Boys Brigades, as well as health, Age Concern and heritage groups.

One feature is the tertiary studies bursaries made

available to students in the area who may not otherwise have access.

The trust has recently established a 'Shooting Star' initiative that is designed to inject a further \$7.23 million into community projects. The funds for this project have been allocated from reserves deemed to be surplus to requirements. Allocations are made on a population basis and the trust is working in conjunction with local government to identify projects in order to bring maximum benefits to the various communities.

The ASB Trusts

The 1999-2000 Annual Report states the ASB Bank Community Trust as having a total asset value of \$169,915,000, with \$169,892,000 of this in investments. This was made up of the Trust's 25% share in ASB Bank and some call and term deposits managed in-house. The trust has more recently (August 2000) sold its shares in the bank for \$560 million. The shares were sold to the Commonwealth Bank of Australia, which bought 75% of the bank for \$252 million in 1989. The remaining 25% was valued at \$84 million at the time.

The trust sold its investment when it became clear that the trust would be required to help fund the bank's expansion, depleting funds normally used to make donations. The sale proceeds have been placed in diversified funds, producing a much higher income than retaining bank shares. Overall the funds are predicted to give the trust another \$30 million a year to donate to the community. A loan to the bank of \$60 million to the trust was also to be repaid, giving the ASB Trusts a total of \$1.09 billion.

The ASB Charitable Trust has a total asset value of \$456,997,000. Of this, \$454,732,000 is in investments, which are managed externally in the following categories:

International Bonds	Fleming Investment Management
International Equities	JP Morgan Investment/ Vanguard Investments
New Zealand Fixed Interest	AMP Asset Management
Other New Zealand Investments	Tower Funds Management

The Community Trust makes 58% of its donations to youth, sport and recreation. A further 23% goes to social services. The Charitable Trust makes 15% of its donations to medical projects and a further 15% to cultural projects. Sixty percent goes to social services, youth, sport and recreation, and education. These groups represent the trust's target areas. The significance of donations from the ASB Charitable Trust is the number and variety rather than size.

Bay of Plenty Community Trust

At the end of the 1999 financial year, the trust had an asset value of \$111,481,000. There was \$111,280,000 in investments. \$600,000 was on term deposit at WestpacTrust and BNZ. The report states that other funds are held under common funds management.

Donations and contributions were, like other trusts, varied, but included some specific major projects such as \$11,000 each to employment initiatives TaskForce Green and Business Grow, sports groups and Presbyterian Support Services for their Children and Families project. Millennium celebration committees in Opotoki and Whakatane received over \$33,000 each to promote events in their areas. Other donations included welfare, health and youth.

The trust is scoping partnership possibilities with local authorities for projects with a common interest and cites housing as a possible example. The trust made contributions to Habitat for Humanity in the 1999 year.

Wanganui Community Foundation (formerly Trust Bank Wanganui Community Trust)

The trust has a total asset value of \$48,543,477. Investments total \$48,521,407. These are managed by Tower Corporation Holdings Ltd (\$22,929,961) and ANZ Funds Management Limited (\$22,581,395). Both have a range of domestic and international investments.

Donations in the 1999-2000 year included matching dollar for dollar government grants for technology in schools. Other projects for schools also were a major feature. The trust has placed emphasis on supporting organisations that focus on the disadvantaged, and has supported foodbanks, gambling societies and resource centres. Community employment initiatives also received support. Like other trusts, the trust awarded tertiary

scholarships, \$12,000 in total to students at Wanganui Regional Community Polytechnic.

TSB Community Trust

This trust wholly owns the TSB Bank and is responsible for distributing its dividends to the community of Taranaki.

This trust has a total stated asset value of \$10,665,187. \$10,600,000 is in investments, held as \$10 m worth of TSB Shares and the remaining \$600,000 in TSB Bank Ltd Investments. As at 31 March 1999, the net asset backing for those shares was \$3.71 per share. The value as stated on the annual report was the par value when gifted (20,000,000 fully paid shares at 50c). Essentially this puts the value of the trust's shareholding at \$74.2 million.

The bank's substantial growth (16.14% in the 1999-2000 year) has meant increased dividends being paid to the trust. The dividend payment to the trust at the end of the 1999 year was up 27% on the previous year.

The increased dividends meant that the trust was able to support major sport and recreational projects across the Taranaki, in particular upkeep and extension of cricket grounds and pools. Heritage and support of the Festival of the Arts is also a major feature. The trust also gives numerous small grants to benefit the community.

Energy Trusts

This section of the appendix is divided into two parts. The first looks at a selection of individual energy trusts chosen either because of differences from energy trusts as a generic category or because they provide examples of investment or distribution activity relevant to this report's focus on the potential of trusts to engage in activities supportive of regional economic or social development. The second part deals, briefly, with trusts not covered in the first part; all these trusts are 100% owners of their energy companies, and the majority follow a practice of leaving the management of the business to the board of directors and concentrating on the two activities of negotiating the statement of corporate intent (including monitoring performance) and overseeing the return of benefits to consumers.

PART ONE

Auckland Energy Consumer Trust

This trust is the beneficial owner of 100% of Vector Limited (previously Mercury Energy Limited). Under its trust deed, it is required to distribute the whole of its income from Vector to consumers and has no discretion to retain funds.

The book value of its investment in Vector Limited is shown as \$300m, the value of its shareholding at the time this was distributed to the trust on establishment of Mercury Energy. The current value of that holding will be substantially greater – Vector Limited’s Statement of Financial Position as at 31 March 2000 shows shareholders’ equity as \$734.6m.

Eastern Bay Energy Trust

This trust owns 77.2% of the capital of Horizon Energy Distribution Limited. Originally, as the Bay of Plenty Electricity Consumer Trust, it owned 25% of what was a significantly larger company. As a consequence of the separation enforced by the Electricity Industry Reform Act 1998, the company sold its retail and generation assets. The trust’s share of the net proceeds was sufficient for it to buy out the principal shareholder in the company, United Networks Limited, with the assistance of a small amount of term debt.

The trust holds its income and capital to be applied for energy-related purposes of benefit within the community. In the twelve months to 31 March 2000, it approved grants totalling \$1.725m, of which the largest single amount was to Opotiki Trade Training for the Retrofit Project.

Eastland Energy Community Trust

This trust is the 100% owner of Eastland Network Limited. The trust reports a net value of \$26.6m, of which \$20m represents its investment in the company (\$10m of equity and \$10m of interest-free subordinated debt as part of an arrangement under which the company continues to maintain uneconomic lines in rural areas). The balance of the trust’s assets are bank account and term deposits of a little over \$6.7m, representing a distribution made possible by the sale of company’s retail interests.

The trustees’ statement of their understanding of the

purpose of the trust is that:

... the purposes of the Trust were best met by developing an economic development focus when considering the application of the surplus income generated by the Trust. To this end the Trustees have targeted applying the income of the Trust to or for the benefit of the beneficiaries through a grants process which has as its main criteria an economic development focus.

In the year under review, it made grants to a range of community organisations, some associated with the millennium, others for what in broad terms could be seen as community social or economic development purposes.

Hawke’s Bay Power Consumers’ Trust

This trust is the 100% owner of Hawke’s Bay Network Limited. Its 31 March 2000 balance sheet discloses net assets of \$66.5m of which \$65m is the trust’s investment in the company. Total value is somewhat higher as, at the same date, the company’s balance sheet disclosed total equity of \$114.87m.

The priority for this trust is to maintain distribution tariffs at current levels which are among the lowest of any lines company in New Zealand. In essence, benefit to consumers as beneficiaries is achieved not through distribution but through maintaining low tariffs with the company earning a relatively minimal return on capital.

Horowhenua Energy Trust

This trust is also a 100% owner of its associated energy company, Horowhenua Energy Limited (which trades as *Electralines*). In contrast to a number of trusts, this one presents its accounts on a group basis, thus showing both the financial position of the trust (based on the face value of the shares received when it was established, less the impact of a special distribution following the sale of the company’s retail business the result of which is a net equity of \$18 million), and a group statement of position showing total equity of \$53.6m.

Horowhenua is one of a small group of trusts which, rather than making distributions to consumers, has its energy company return the benefit of ownership to them through a pretax rebate on their electricity charges. In the year to 31 March 2000, this rebate (discount

to customers) was \$7.24m.

The trustees' report for the 1999/2000 year deals with an issue that arose in relation to the special distribution made to consumers following the sale of the retail business. Under this trust's deed, consumers are able to vote on how capital should be distributed. They voted in favour of an equal distribution to all consumers. It seems that some members of the trust's community would have preferred seeing funds set aside for community purposes. The trustees' report notes:

... there have been several approaches to the Trust suggesting that any monies the Trust might receive in the future should be allocated to community projects of various types. The Trustees have no mandate to make any such decisions. In the event of any monies becoming available the Trust deed clearly states that it is the electricity users who will decide on the end use of such funds.

Hutt Mana Energy Trust

At 30 September 2000 (the trust's balance date), this trust had a net worth of \$153.8m, the bulk of which was the trust's shareholding in Natural Gas Corporation Holdings Limited with a book value of \$105m. The current value of that holding is approximately \$71.5 million.

The trust had followed a policy of seeking to maintain a shareholding in the company serving the district of the former Hutt Valley Energy Board. When TransAlta acquired Energy Direct Corporation (the immediate successor company to the Energy Board), the trust accepted shares in TransAlta. When the Natural Gas Corporation took over TransAlta, the trust negotiated an arrangement under which it could hold not less than 10% of NGC's capital (acquiring its NGC shareholding at \$1.50 per share), on the basis that NGC was still the main electricity supplier to the former Board's area. NGC has now sold its electricity customer base as a response to the severe trading losses it suffered in the recent electricity supply crisis. As a consequence, the trust no longer has a direct ownership interest in the provision of either lines or electricity supply.

This trust distributes the bulk of its income to customers currently defined as:

... any person who at any appropriate date designated by the Trustees is liable (whether alone or jointly with any other person) to any electricity company which carries on an electricity supply business for payment for electricity conveyed through a metered electricity connection within the district.

As noted in the main report, it has also established a charitable trust, funded with an \$8 million interest free on demand loan, which has been active in promoting energy efficiency activity and research into the health benefits of efficient energy use.

This trust provides an example of one difficulty confronting the energy trust sector – a lack of public understanding of what trust ownership actually means. It was created as part of the process of forming Energy Direct Corporation Limited from the former Hutt Valley Energy Board.

The share allocation plan for the company was vigorously contested, with the 'interim trustees' arguing strongly for trust ownership and the establishing authority (who were to become the directors of the soon-to-be formed company) arguing for full privatisation. A minority view also current at the time was that local authorities should receive ownership (perhaps reflecting a wish to replicate Wellington City's ownership at the time of Capital Power).

The establishing authority undertook quite significant market research to try and determine, as best it could, what the views of consumers actually were. An extensive independent survey showed that approximately 60% supported privatisation through a give-away, 30% supported trust ownership and 10% supported local authority ownership. This result was adopted as the formula for share allocation. Sixty percent of the capital was given away to consumers, representing the private benefit component, 10% went to local authorities and 30% was distributed to the trust representing the ongoing public interest.

Under the trust deed, that capital and the income it produces is held for the benefit of consumers and the communities within the district. Trustees have discretion as to whether and to whom to make distributions.

The fact that trustees have chosen to make the bulk

of their distributions to customers has allowed an impression to arise that it is current customers who actually own trust assets and that trustees are no more than an inefficient filter between those customers and 'their' wealth. It is a view quite inconsistent both with the history of the establishment of the trust and with the provisions of the trust deed. It has, however, been vigorously promoted by trust critics and by the region's leading daily newspaper.

It raises important questions, not just for this trust but also for energy trusts generally. Who has the obligation to ensure that communities (consumers, customers) when considering the future ownership of wealth of this type do have good information on the nature of ownership and on the trade-offs involved when trustees take decisions on distribution?

Otago Central Electric Power Trust

This trust was the 100% owner of Central Electric Limited which had interests in generation and retail as well as owning the lines business. Faced with a need to separate lines from retail and generation, trustees and directors decided the company should dispose of both the lines and the retail businesses and retain generation (the company and its predecessor board had been in the generation business for 77 years). The trust's 1999 annual report disclosed total equity of \$35m. Following the sales –

- it remains the 100% owner of Pioneer Generation Limited as a local generator;
- it has made a capital distribution of \$15m to consumers within the district;
- it has converted itself into a charitable trust which, apart from owning the generation company, has cash assets of approximately \$120m.

This trust is currently considering how best to manage what is a very substantial endowment in a district whose total population is approximately 25,000. Trustees appear to be taking a long-term and strategic approach to developing distribution policy and drawing on the experience of other local trusts (for example, its area of benefit comes within the district of the Community Trust of Southland and there is close consultation between the two).

Rotorua Energy Charitable Trust

This trust was formed as a charitable trust as part of the establishment plan for the Rotorua Electric Power Board. On formation, it was the 51% owner of Rotorua Electricity Limited with a shareholding valued at \$32m.

The trust, since its establishment, has followed a long-term strategy of gradual disengagement from the electricity industry but in a manner designed to maximise the value of its investment. It supported the merger that created Trust Power Limited and the subsequent growth of that company but has gradually exited from the company on a basis which has allowed it to attract a control premium.

Its balance sheet as at 31 March 2000 discloses net assets of \$113.2m with an investment of less than \$1m in Trust Power itself. It also holds interest-bearing convertible notes in AGL NZ Capital Limited that can be converted at the trust's option into ordinary shares in Natural Gas Corporation Holdings Limited; the notes were consideration for the sale of Trust Power shares to AGL.

The trust operates through a series of five sub-committees for the purpose of considering and approving donations. Each sub-committee is required to 'bid' to the trust itself for a donations budget and in doing so to spell out the outcomes it expects to be achieved as the result of its donation programme.

South Canterbury Power Trust

This trust is a part owner (40%) of its related energy company, Alpine Energy Ltd. As noted in the body of the report, the trust has been and remains supportive of the company taking initiatives in the conduct of its business with the intention of supporting activities with a regional economic development impact.

Southland Electric Power Supply Consumer Trust

This trust was not formed until 1 January 1998. On that date it acquired 100% ownership of the Power Company Ltd which had previously been a state-owned enterprise. As the Southland Electric Power Board, the original business had got into financial difficulties in the late 1930s as the result of which it passed into government ownership. Following the restructuring of the distribution industry as a result of the Energy Companies

Act 1992, there were strong representations from the people of Southland to the government that their power distributor should be treated in the same way as other power boards. The main argument put forward was that, although the distributor had been in government ownership, its equity had been built up in exactly the same way as that of other distributors – through the prices charged to consumers. Southland people argued that government should recognise the substance of this, rather than the formal legal ownership rights of government, and return the Power Company Ltd to the people of Southland. After some resistance, this argument was finally accepted.

This trust now operates in much the same way as other energy trusts. One point of interest, which precedes the formation of the trust, is that its network is jointly managed with that of Electricity Invercargill Ltd (the Invercargill City Council-owned distributor serving the bulk of the city area).

Taranaki Electricity Trust

This trust was formed as part of the joint establishment plan which merged New Plymouth's MED with Taranaki Electric Power Board. That company, following a series of further mergers is now the listed public company PowerCo Limited, whose principal shareholders are New Plymouth District Council (which is the beneficial owner of approximately 50% of PowerCo) and the Taranaki Electricity Trust with approximately 8%.

The trust distributes grants to a wide range of community groups in a manner broadly similar to the general donations policy of a Community Trust. It is able to distribute approximately \$3 million per year.

Tauranga Energy Consumer Trust

This trust began as a 50% owner of TrustPower Limited (the balance of whose shares were distributed through a give-away to consumers with the company itself then being listed on the Stock Exchange). Currently it holds 22.7% and had a net asset value as at 31 March 2000 of \$176.5m represented primarily by its investment in TrustPower Limited, valued at \$164m on the basis of a share price of \$3.65 (currently TrustPower shares are trading at \$3.20, giving the holding a value of some \$20m less than at 31 March 2000).

This trust is one of quite a large group whose trust

deeds provide that they may distribute income by paying, applying or appropriating it in such a manner and in such proportions as the trustees think proper for the benefit of the consumers but with a provision that they may (in some deeds shall) seek a report from directors on how any dividends should be distributed to consumers, giving the directors the opportunity of recommending a distribution based, for example, on consumption. One or two deeds require the trustees to follow directors' advice but most give a discretion.

This trust has taken the view that it is indeed a discretionary trust and has no obligation either to seek a report or to restrict its distribution to payments to consumers (its deed provides that trustees may have regard to any report from directors and that they may request the directors to produce such a report). A number of other trusts take the view that provisions of this type oblige them to distribute dividends to consumers broadly in accordance with directors' recommendations – the difference in approach apparently being partly a function of receiving legal advice from different sources.

It appears also to reflect a view that came through the establishment process for TECT that a proportion of the trust's income should go for purposes beneficial to consumers generally, rather than as a cash distribution to individual consumers. Certainly this trust's deed is more expansive in setting out options for distribution than is typical of energy trusts that feel bound to distribute all of their income to consumers individually.

The trust's distributions are generally made in four categories:

- consumer rebates (the single largest category);
- community organisations seeking funding for electrical equipment;
- major community amenities;
- major community events (cultural and sporting).

In respect of support for economic development, its Chairman has commented that "impact on local economic development is not a specific distribution criterion and has raised concerns that such a criterion might be outside the power of trustees". However, the Chairman also notes that many of the grants the trust makes will have a direct or indirect impact on economic development although that is not the main purpose of the grant. A

review of grants that the trust has made for what are broadly energy-related purposes suggests that there is in fact very broad discretion to contribute to activities with a specific economic development purpose if trustees considered that appropriate.

The trust puts considerable effort into determining community priorities through means such as on-going market research and informal discussions with other key community funders – particularly Tauranga District Council and the Western Bay of Plenty District Council in respect of the trust’s major community amenities fund.

WEL Energy Trust

This trust is now the 100% owner of WEL Energy Ltd. The company itself was corporatised before the Energy Companies Act was passed and had a mixed ownership structure. The trust was established as a result of the Act and spent its first few years in a battle for control of the company with the American utility, Utilicorp (now the majority owner of United Networks Ltd).

This trust holds its income for community purposes and its capital ultimately for the Hamilton City Council (63%), Waikato District Council (35%) and Waipa District Council (2%).

PART TWO

Remaining Energy Trusts

All the trusts listed in this part own 100% of their related energy company. The majority effectively confine their role to negotiating the statement of corporate intent with the company, monitoring performance and overseeing the process under which the benefits of ownership are returned to consumers. In the majority of cases this actually happens through either an explicit rebate paid by the company to consumers or through the company setting prices for distribution services which result in little or no taxable profit. In order to provide some information on the value of the wealth held by these trusts, the list which follows includes for each the amount of shareholders’ equity in the lines business as reported in its most recent disclosure statement. This will not be the same as (and typically will be less than) the total value of the trust’s ownership interest in its energy company as the value of non-lines interests are not

disclosed. These trusts include:

TRUST	LINES EQUITY
	\$M
• Bay of Islands Electric Power Trust (the owner of Top Energy Ltd which is starting to play a potentially significant role in regional economic development with support of the trust)	74.85
• Buller Electric Power Trust	15.3
• CHB Consumer Power Trust	32.95
• Counties Power Trust	38.4
• King Country Electric Power Trust (which is now the joint owner, with Waitomo Energy Services Consumer Trust, of the Lines Company Ltd)	10.3
• Main Power Trust	89.94
• Marlborough Electric Power Trust	21.65
• North Power Electric Power Trust	105.76
• Scan Power Consumer Trust	4.73
• Tasman Electric Power Trust	80.0
• Waipa Power Trust	37.94
• Waitaki Power Trust	42.9
• Waitomo Energy Services Consumer Trust (which is now the joint owner, with King Country Electric Power Trust, of the Lines Company Ltd)	30.9
• West Coast Electric Power Trust	40.33

Endnotes

- ¹ All trusts argue, correctly, that much if not all of their donations expenditure contributes to social and/or economic development even though that may not be the stated purpose of (say) a grant to a social service agency or assistance with the construction of a major sporting facility. The focus of this project is on activity which has the overt objective of supporting the social or economic development of a trust's area of benefit as opposed to activity for which that may be an incidental outcome but not a principal purpose.
- ² Energy trusts which see their role as essentially one of enabling the surplus earned by their related energy company to be paid back to consumers might argue that rather than inheriting the wealth represented by the investment in the energy company, they inherited a cash flow with an obligation to pass it on.
- ³ Trustees of community trusts, in particular, argue that a major contributor to the scale of the wealth they now hold is the success they and their predecessors had in growing that wealth through a series of changes, first as the majority divested themselves of bank shares and then through the way they have continued to manage their investments.
- ⁴ Some are now distancing themselves from this origin, as they no longer hold bank shares, preferring to describe themselves as holding funds on behalf of the community for the benefit of the community.
- ⁵ The removal needs to be seen in the context of the withdrawal of the government at the time from a range of exposures to the banking sector, not just the Trustee Savings banks, which were a relatively small part of the government's total exposure. Trustees also argue that, to the extent that the trustee banks were "relatively weak and potentially non-viable", this was a direct consequence of the way successive governments had regulated their deposit taking and investment activities.
- ⁶ Some, such as the Whanganui Community Foundation, do report their donations policy publicly. Most will make the information available to potential grant applicants.
- ⁷ In one case, in response to the separation requirements of the Electricity Industry Reform Act 1998, two trusts, King Country Electric Power Trust and Waitomo Energy Services Consumer Trust, combined their ownership interests to form a single entity, the Lines Company Ltd.
- ⁸ More details of the scheme can be found on SIT's website (www.sit.ac.nz).
- ⁹ Note: the financial information in this appendix is generally from the 1999/2000 year as this was the latest available when the work for the paper was actually done.

IPS POLICY PAPERS

- **Number 1**

**Governing Under MMP:
The Constitutional and Policy Challenges**

by Jonathan Boston, Simon Murdoch, Marie Shroff, Rt Hon. Sir Michael Hardie Boys
1999 • ISSN 1174-8982 • ISBN 0-908935-35-8

- **Number 2**

Partnership - From Practice to Theory

edited by David Robinson
1999 • ISSN 1174-8982 • ISBN 0-908935-41-2

- **Number 3**

Stability of Retirement Income Policy

edited by Arthur Grimes and Conal Smith
1999 • ISSN 1174-8982 • ISBN 0-908935-41-2

- **Number 4**

**Counting the Beat:
Culture, Democracy and Broadcasting**

edited by Arthur Grimes and Jo Tyndall
1999 • ISSN 1174-8982 • ISBN 0-908935-43-9

- **Number 5**

**South Korea-NZ Relations at a Watershed:
Impact of the Financial Crisis**

by Gerald McGhie
2000 • ISSN 1174-8982 • ISBN 0-908935-45-5

- **Number 6**

**The Tomorrow's Schools Reforms:
An American Perspective**

by Edward B Fiske and Helen F Ladd
2000 • ISSN 1174-8982 • ISBN 0-908935-49-8

- **Number 7**

Funding Our Culture

by Colin James
2000 • ISSN 1174-8982 • ISBN 0-908935-50-1

- **Number 8**

On Three Arguments For the Efficiency Criterion

by Paul Calcott

- **Number 9**

Defence Objectives and Funding

by Arthur Grimes and James Rolfe

- **Number 10**

Charity, Charity Law and Civil Society

by Richard Fries