Rethinking Governance

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Abstract

Ensuring efficient markets and remaining among the best places in the world to do business has been at the heart of New Zealand's economic and fiscal policies for many years. There is growing and research-based evidence that market-based strategies need to be complemented by a new understanding of governance as a perspective which encourages collaboration between the public, private and non-profit sectors. Outcomes include the more cost-effective targeting and delivery of government-funded services and greater legitimacy for decision-making. New terms such as co-design are entering the language. The potential to build a 'governance perspective' amongst the general population opens up the opportunity for significantly better utilisation of public resources. New Zealand case studies will demonstrate this.

Introduction

The purpose of this presentation is to consider the place of governance in public management and in the agreement on and delivery of the outcomes the public sector seeks to provide. The presentation will draw extensively on international practice and the lessons which New Zealand can learn. Its basic premise is that increasingly polities such as New Zealand need to find ways of dealing with a set of decisions which neither market arrangements nor conventional hierarchal government arrangements are capable of accommodating. Typically these are decisions with one or more of the following characteristics:

- They depend on access to information, knowledge and networks held by or involving individuals or groups whose participation in the decision-making process requires that they trust the entity or entities which hold the formal decision right, and have confidence in the robustness of the decision-making process.
- Effective decision-making and implementation involves multiple entities and interests so that issues of coordination and collaboration, including a willingness to share the decision right, are paramount.
- Although in some instances they may apparently deal with market-based issues (as with the case studies below dealing with energy trusts), they are in practice outside the conventional market, and turn more on individual and collective decisions about how best to promote collective interests.
- Often the effective decision right is not the formal legal right to take specified decision, but the affected community's willingness to grant the formal decision maker the necessary 'licence to operate' - in other words the central issue is the legitimacy of the decision and the ability of the formal decision maker to generate the support required if the decision is to be implemented.

The presentation begins by considering different understandings of governance, including the New Zealand status quo, then looks at how other jurisdictions are starting to apply a governance approach to the design, targeting and delivery of services, including the associated fiscal implications, and to developing the 'licence to operate' for major public interventions. It then goes on to consider how the greater interest in governance is manifesting itself and finally discusses the importance of bringing a governance understanding to organisational design and its implications for the better utilisation of public resources, drawing on case studies from New Zealand's electricity distribution sector.

Governance

At a meta-level, there would be general agreement that the term governance is concerned with the institutional arrangements for the making and implementation of decisions, and for holding people accountable. That, though, is very much a generalisation covering an enormous number of different arrangements and, for that matter, understandings.

New Zealand

In New Zealand it has been traditional to conceive of governance as concerned with the processes through which a controlling body takes decisions which are then implemented largely through some form of hierarchical arrangement. Two reasonably contemporary illustrations of this approach can be found in the Institute of Directors' description of what governance is about (www.iod.org.nz) and from a paper on the SSC website discussing post-NPM themes in public sector governance (http://www.ssc.govt.nz/resources/3057/all-pages) . The IOD description is:

> Governance is about:
>
> - ensuring there is accountability and oversight of a company's operations
> - having a defined vision for the future of the company
> - making good decisions with a clear view of the big picture
> - identifying opportunities
> - identifying risks and implementing strategies to manage them.
>
> Governance encourages boards to step back from the operational side of the business and ensure all bases are covered in order to lay the foundations for a smooth future.

From the SSC paper:

> While governance is about the acquisition and distribution of power in society, corporate governance denotes the manner in which corporations are governed and managed. It is usually taken in contrast with public sector governance, which refers to management of public sector agencies although the principles of corporate governance are also quite applicable in the broader State sector where non-Public Service agencies are clustered.

Both of these descriptions clearly envisage governance as involving a decision right held by a relatively small group whose responsibility is to set the direction for an organisation both in terms of how the organisation itself performs, and in terms of how it relates with its stakeholders and others who may be affected by the organisation's activities and who, in turn, may exercise influence over them.

Internationally

Internationally, there has in recent years been a rethinking of the nature of governance with an emphasis on determining who needs to be involved in good decision-making, and why. Agencies such as the World Bank and the OECD played an important role in this rethinking as part of a focus on how to improve economic performance in developing countries. The OECD identifies the following characteristics of good governance:

> It is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It assures that corruption is minimized, the views of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making (OECD, 2001).

Much of the recent focus has been on the place of governance at the sub-national level and driven by considering circumstances in which a conventional 'command and control' approach to the making and implementation of decisions is no longer effective. This is a focus which draws a distinction between government in the sense of formal institutions of the State, and the broader decision-making approaches now seen as an integral part of coping with complexity. Robin Hambleton, Professor of City Government at the University of the West of England, draws what is now an often used distinction between government and governance:

> *government* refers to the formal institutions of the state. Government makes decisions within specific administrative and legal frameworks and uses public resources in a financially accountable way. Most important, government decisions are backed up by the legitimate hierarchical power of the state. *Governance*, on the other hand, involves government *plus* the looser processes of influencing and negotiating with a range of public and private sector agencies to achieve desired outcomes. A governance perspective encourages collaboration between the public, private and non-profit sectors to achieve mutual goals. Whilst the hierarchical power of the state does not vanish, the emphasis in governance is on steering, influencing and coordinating the actions of others. (Hambleton 2011).

Applying a Governance Approach to Services

The case of England: devolution

In England, from where much of our practice of governance is drawn, this thinking from the research and academic community was paralleled by a change in emphasis on the part of central government. The Tony Blair-led labour government came into office in 1997 with a strong although occasionally conflicted interest in devolution. The devolved assemblies in Scotland and Wales were established in 1998; the Greater London Assembly with its elected executive Mayor came into being in 2000.

The English Local Government Act 2000 gave local authorities the power to promote community well-being, but tied it into an obligation to develop a community strategic plan and to establish a local strategic partnership (LSP) linking together public sector, private sector and third sector interests. Unelected regional assemblies were established in an attempt to give a voice to English 'regions' (these were later disestablished by the present coalition government).

LSPs were intended to provide a means of coordinating local public sector expenditure, but proved ineffective against a number of systemic barriers – different regional boundaries for different departments; different spending authorities; different departmental agendas.

In its last years in office, the Labour Government promoted what it termed 'Total Place' through a series of pilots designed to demonstrate the potential of 'joined up' government in the delivery of specific services. A total of 13 pilots were put in place, although informal Total Place arrangements operated in a much larger number of localities. Initial evidence suggested the potential for savings in the order of 10%-15% through the benefits of closer collaboration, and tapping in to the better knowledge and networks of local people especially local government (see Keohane in McKinlay and Samson (eds) forthcoming).

In an endeavour to influence government thinking, and demonstrate the potential of devolving the governance of social services to a more local level (English local authorities are substantial deliverers of centrally funded social services but typically under close control in terms of what is delivered and how), London Councils, a body linking the 32 London boroughs and the City of London for a combination of advocacy and policy/research on behalf of its members, produced 'The Manifesto for Londoners' (http://www.londoncouncils.gov.uk/manifestopdf/). This document, based on research by PWC in conjunction with London Councils, argued cogently that greater devolution, through enabling London boroughs to draw on their networks, local knowledge and capability, could potentially reduce the cost of services by something in the order of 10%[1].

Total Place, at least in terms of nomenclature, was replaced by the present coalition government with the 'Big Society' and a move to community budgeting to:

- give communities and local people more power and control over local services and budgets, [and]
- develop outcomes, service solutions and a single budget, or options for pooling and aligning resources, comprising all spending on public services in an area' (quoted from Keohane op. cit).

More generally, the present UK coalition government has determined that one of its responses to the fiscal stresses it currently faces is greater devolution to local government, and beyond local government to communities. Community budgeting is one such initiative. What are termed City Deals is another. Options set out in the government's policy statement *Unlocking Growth in Cities (http://www.dpm.cabinetoffice.gov.uk/sites/default/files_dpm/resources/CO_Unlocking%20GrowthCities_acc.pdf)* include, among other policy areas: devolved major transport funding; a single capital pot; devolved Homes and Communities Agency assets and funds; City Skills Funds; and aggregated apprenticeship programmes. The government's motivation was the recognition that getting the outcomes it wanted required devolving power and creating the opportunity for local initiative, skills, knowledge and resources to add value to what government itself could provide. In theory, though perhaps not always in practice, one objective was to move to much more of a partnership basis, involving co-design and essentially shared governance.

It is fair to say that the English experience, despite more than a decade of different attempts at devolution, is still very much 'work in progress'. Successive endeavours have highlighted the deeply entrenched centralisation of England's government, and the extreme difficulty in moving to a new way of working even when there is generally a will to do so. Barriers range from the constitutional (ministerial accountability for public expenditure) to entrenched silo-based working, to an inherent distrust of the competence of localities - distrust which has some substance because for so long so much has been dictated from the centre. Nonetheless, the research evidence is becoming increasingly clear:

[1] The actual estimate as stated in the manifesto itself is: "Analysis undertaken by PricewaterhouseCoopers for London Councils has uncovered potential savings to the public purse of £1.6 billion a year by devolving services to manage chronic health conditions, tackle anti-social behaviour and reduce worklessness in London. Applying the same principles more widely in the capital, PwC conclude, has the potential to save the public purse around £11 billion per year."

devolution, and sharing the governance of the design, targeting and delivery of services can offer real benefits both in terms of fiscal impact, and in terms of outcomes.

A recently released report by the Comptroller and Auditor-General evaluating experience with the four Whole-Place Community Budgeting pilot projects sponsored by the Department of Communities and Local Government (National Audit Office, 2013) underlines the 'work in progress' nature of this approach, but presents some promising conclusions, emphasising in particular the importance of closer working between central and local government:

> The four local areas involved in Whole-Place Community Budgets and central government have collaborated effectively in assessing thoroughly the evidence base for local service reforms. In particular, while having much in common with previous similar initiatives, a number of important lessons have been built into the current approach:
>
> - Allowing local practitioners to identify and propose areas where outcomes could be improved through greater integration.
> - Sponsoring more sustained and direct interaction between local and central government officials.
> - Using cost-benefit analysis to link the benefits that different public bodies might receive to the resources they commit.
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> The Whole-Place Community Budget areas have undertaken the kind of robust project design and appraisal that is a necessary first step in testing potentially significant and beneficial changes to how public services are provided. Longer term, achieving value for money will require the Department and local areas to sustain commitment to careful implementation and robust evaluation to identify the actual costs and benefits of new, more integrated, ways of working.

Other jurisdictions: Canada and Australia

Other jurisdictions, less encumbered by a tradition of centralism, are proving to be more innovative in responding to changing understandings of governance. Canada's Public Policy Forum has for some years been leading substantive work on the changing relationship between governments and their publics. The Forum's Public Engagement project, working with provincial governments in Canada and with Federal, State and local government in Australia, has been demonstrating the potential of new approaches such as co-design - where the users of services become partners in service design.

In Australia the Forum has partnered with the Federal Department of Human Services in testing the co-design process. The following extract from an article jointly authored by the leader of the Forum's Public Engagement project, and a senior official of the Department, sets out the rationale for co-design both from the perspective of a government service provider, and from the perspective of the community in receipt of those services:

> For the purposes of this paper, the principal lesson here is that, if governments fail to move to a partnership approach to client services, they will become increasingly ineffective at achieving the goals of those services. As we have just seen, goals such as safe streets, a healthy population, sustainable development, life-long learning, or a highly skilled labour force all require **working together and alignment** between the government (ES), citizens, communities and stakeholders. Governments cannot achieve them on their own. Everyone has a role to play. Co-design can encourage and provide an opportunity for this participation to begin.
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> Yet the traditional model for delivering client services actually discourages the public from assuming its share of the responsibility for the goals. Indeed, the very

> idea that government **delivers** client services already positions government as the principal decision-maker, problem solver and service provider. In this relationship, there is little room for the kind of dialogue that is necessary for real interaction or a real partnership. In short, the relationship is conceived as transactional. If the next phase of the service delivery revolution is about client services, co-design and partnerships in delivery, the primary challenge will be to realign the relationship in a way that rewards the public for working together with service providers, both at the individual and collective levels. For its part, government must learn how to engage the public as a partner, rather than treating them as passive consumers of its programs and services. (Lenihan & Briggs 2011).

Experience, including a pilot project undertaken in the State of Victoria jointly by the Department of Human Services and the Public Policy Forum in partnership with The Municipal Association of Victoria, suggests that local government has a vital role to play in bringing together government agencies, communities and individuals. As Lenihan and Briggs themselves observe:

> When it comes to client services, we think local governments may have a special role to play. In particular, they are often well positioned to assume a lead role on public engagement, for at least three reasons. First, their proximity to the public, and to community-based organisations, positions them as the most effective platform from which to launch engagement processes. Second, the public's strong sense of membership in and commitment to their communities is often a powerful incentive for citizens to participate in dialogue and, ultimately, commit to action.
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> Third… every community is different and effective solutions must reflect such differences.

The 'licence to operate'

Applying a governance approach is important not just as a means of improving the design, targeting and delivery of services, but also in legitimating major government decisions in areas such as infrastructure. Traditionally governments both central and local have relied on consultation – outlining what government proposes to do, inviting public submissions, considering those and then making a decision – and on education and information programmes to seek the mandate – the 'licence to operate' – they require.

The effectiveness of this approach is increasingly being challenged. Research on the outcomes of the traditional consultation process suggests that it can divide rather than unite communities, and promote distrust rather than trust in the decision-making body[2].

Education and information programmes also appear ineffectual, on their own, as a means of garnering public support. In July 2006 the City of Toowoomba in Queensland held a referendum on a proposal to introduce recycled waste water into the city's water supply as a means of addressing what then appeared to be a pending critical long-term water shortage. The city provided substantial information publicly to establish that there would be no health risk - that recycled water would be indistinguishable in its impacts from normal potable water. A

[2] Lenihan (2012), who has undertaken extensive research in this area, observes: "Unfortunately, the old style of public engagement is also part of the problem. I'm referring to the well-worn practice of governments staging stilted stakeholder consultations with citizens that include the usual suspects and interest groups trotting out their often predictable positions and tired advocacy to bored elected representatives and public officials who have likely heard it all before. This is actually the opposite of engagement and effectively serves to turn off and squeeze out those citizens who genuinely wish to participate in a public dialogue. And too often, that's where it ends." P 13.

strong campaign was mounted against the proposal (and arguably was less than robust with some of its claims). The referendum proposal was soundly defeated.

A year previously, the CSIRO had released findings from a substantial research project "designed to systematically investigate, identify, measure and test the major factors that govern people's decisions about whether to use recycled water for different uses or whether to reject the schemes." (Po et al 2005)

Interestingly, the project found that knowledge did not emerge as a factor in people's decisions on whether to accept recycled water, strongly suggesting that relying on education and information programmes (as with Toowoomba) was basically irrelevant other than as part of a process of building trust in the sponsoring institution. Instead, the research concluded "Past international experience and the results of this research support the need for authorities to start talking with communities early in the planning phases of recycling schemes. It is essential for trust to be developed and this will only occur through a genuine partnership with the community where their concerns are listened to and addressed to their satisfaction. There will be no short cuts available given the influence of emotions and "others".

Essentially, the CSIRO research supports taking a co-governance approach, sharing responsibility for decision-making between the promoting institution and the affected community or communities.[3]

How is the greater interest in governance manifesting itself?

How, then, is the greater interest in governance – perhaps in the public management context best thought of as a greater interest in shared decision-making – manifesting itself?

First, in a growing although often inchoate shift in the nature of public expectation. Quite extensive research in Europe, looking at local government, shows a shift from regarding voting for councils as the principal way in which to express your interest, to much more of a demand of to participate in decisions which affect where the individual lives and works (Haus & Sweeting 2006; Schaap et al 2009). Recent Australian experience shows a growing demand to be involved in decisions (McKinlay et al 2011).

Next is the growing shift in the practice of public management. In England this has manifested itself in the endeavours of successive governments to promote devolution, and more of a practice of partnership working with local government and with communities themselves, culminating in the current community budgets initiative, and the government's Localism Act. It needs to be noted that practice is still evolving, and evidence of the extent to which this is a genuine shift to shared governance is very mixed, as are the views of informed observers. This is very much a function of the fact that the change has a number of different drivers ranging from ideology to fiscal pressure, to an apparently genuine commitment to the view that central government has overly intruded into the lives of individuals and communities and it is time to pull back.

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[3] In a keynote address to the 2011 National Congress of Local Government Managers Australia, the Infrastructure Coordinator for Infrastructure Australia observed that one of his reasons for accepting the invitation to speak was that government needed local government to help establish the mandate for undertaking major works because local government was much closer to its communities than government.

A more coherent approach can be seen in the initiatives[4] taken by the current New South Wales state government to reform both local government, and the way in which the state government itself operates. Briefly:

- The Independent Local Government Review Panel, established jointly by the state and the local government sector, is focusing not simply on reform of local government, but of the local government sector broadly defined as councils, state agencies which deal with councils, employee organisations and the local government association itself.

- The Panel sees local councils not just as some form of subsidiary governing entity restricted to a set of core functions, but as "catalysts for improvement across the whole public sector. They can demonstrate how to tackle complex problems by harnessing the skills and resources of communities, and how effective place-shaping can boost the State's economy and enhance people's quality of life."

- A separate Task Force established to review the New South Wales Local Government Act has proposed that "The role of local government is to lead local communities to achieve social, economic and environmental wellbeing through working in partnership with the community, other councils, State and Commonwealth governments to achieve outcomes based on community priority as established through Integrated Planning and Reporting" (other components of the role include infrastructure, services and regulation and "exercising democratic local leadership and inclusive decision-making").

These initiatives are complemented by the proposal in the just released NSW White Paper on planning for greater accountability to the community, and more opportunity for community involvement (albeit within a structured approach to planning), including the development of a community charter to be binding not just on councils, but on the Department of Planning itself.

The approach is a markedly different one from that being taken within the New Zealand government's Better Local Government initiative and appears to reflect a different view on the need for and benefits from collaborative working between different tiers of government, and between those tiers and the communities they serve. Perhaps fortuitously, for those of us interested in the nature of governance, the opportunity to compare the New Zealand and New South Wales experiences provides an invaluable learning opportunity.

A 'governance perspective' in the wider community

The next theme I want to explore is the significance of developing (enabling?) what I have termed a 'governance perspective' in the wider community.

Much of our organisational design in recent years, in both the public and the private sector, has drawn substantially on public choice theory and agent-principal theory. Core assumptions have included the significance of information asymmetry, and that individuals are self-interested, and will act opportunistically. This has led to a presumption that organisational design should reflect a

[4] For the Independent Panel's consultation papers see: http://www.localgovernmentreview.nsw.gov.au/ for the Acts Task force discussion paper go to: http://www.dlg.nsw.gov.au/dlg/dlghome/documents/information/A%20New%20Local%20Government%20Act%20For%20NSW%20-%20Discussion%20Paper%20-%20April%202013.pdf for the planning White Paper go to: http://www.planning.nsw.gov.au/a-new-planning-system-for-nsw

particular understanding of human nature – rational , opportunistic, self-interested economic man.

In the public sphere, it has seen an increasing emphasis on 'consumer democracy', with political parties in a number of advanced democracies concentrating on short term measures with economic appeal to interest groups whose support they believe they can 'purchase'.

There is an alternative way of thinking about the conditions that have created 'consumer democracy'. The combination of a belief in representative democracy, and the complexity of modern societies, creates a situation in which the typical elector is essentially irresponsible in the sense that he or she does not have the information to understand the implications of the choices those contending for political power are offering, including the trade-offs which might be involved.

An anecdote from recent experience in New South Wales will make the point. It is received wisdom that ratepayers will almost invariably, and certainly by a significant majority, prefer lower rates to higher rates, and that this preference will be manifested in electoral outcomes. New South Wales operates what is known as a rate peg - Councils by law are restricted in the amount by which they can increase their general rate, to a stated percentage. Both the setting of the peg, and the granting of any exemptions, used to be a matter for ministerial decision. Several years ago this was delegated to an independent body, the Independent Pricing and Regulatory Tribunal (IPART). It now sets the peg annually, and administers the exemption process.

Councils wanting to set a rate higher than permitted by the peg must apply to IPART, and demonstrate that there is community support for the proposal – a requirement that effectively forces councils to have a dialogue with their communities about not just the level of the rate they wish to strike, but the rationale for what the community will get in return. Recently one Sydney council was able to approach IPART with evidence, following consultation with its community, of support for a rates increase of 10% – for seven years in a row. The critical element was sharing responsibility with the community, enabling an informed decision based on the level and quality of services the community wished the Council to provide.

This is an example of a community applying a 'governance perspective', taking a whole of community view, and considering the trade-offs involved, rather than simply a narrow self-interested approach that would typically favour minimising the rates burden. It also illustrates one of the critical elements in enabling a 'governance perspective': a structure/process design which consciously supports the development and application of such a perspective. It is different from the conventional market perspective that leaves it over to rational, opportunistic, economic man to make choices based on self-interest.

The proposition I wish to put forward is that both perspectives need to be taken into account in institutional design where the public is involved. In passing, I note that increasingly this seems to be the case in the corporate sector with a growing emphasis not just on maximising shareholder wealth, but on the nature and quality of the relationship between the corporate and the communities impacted by its activities. There is now a clear sense that whether or not communities have any formal decision-making rights in respect of a corporate's activities, increasingly they have a governance capability in the sense of being able to influence the operating environment for the corporate in the pursuit of a better alignment between what it does and what the community seeks.

Turning back to the arena of public or quasi-public institutions, I want to use two case studies from the reform of New Zealand's electricity distribution sector to illustrate the significance of taking not just a market but also a governance perspective.

New Zealand's electricity distribution sector: the history

Briefly, the Energy Companies Act 1992 required the restructuring of the electricity distribution sector which at the time was a combination of council owned distribution businesses (typically part of core council in legal terms) and special-purpose local authorities known as electric power boards. All distribution businesses were to be restructured as companies. Those already council owned would remain council owned after restructuring. This recognised that those businesses already had owners.

Electric power boards, however, were ownerless. One of the issues for the restructuring was how to allocate the ownership of their distribution businesses once those were corporatised.

As part of the restructuring process, directors for the future energy companies were chosen through a government-run process, and put in place as the governing bodies of the power boards, pending restructuring. The elected members were side-lined as 'interim trustees' (a term which owes its origins to 1990 legislation, promoted by the then labour government, which proposed corporatising the distribution businesses, but vesting the ownership of the resultant companies in community trusts whose initial trustees would be the former elected members).

The immediate task for the new directors was to develop an establishment plan for the future energy company. One of their responsibilities was to propose future ownership. The legislation gave them carte blanche subject only to securing the agreement of the interim trustees, and the approval of the Minister[5] (with a default option of local government ownership if agreement between the trustees and the directors could not be reached). Some boards opted for privatisation through a share giveaway, some opted for trust ownership, some for a combination. In one case agreement was not reached and the company was vested in the local authority within whose district it operated.

Those cases in which a board opted for a combination of share giveaway and trust ownership resulted in listed public companies with a trust as a significant but usually minority shareholder. Those opting for 100% trust ownership have by and large retained that status, with the single exception of the Auckland Energy Consumer Trust. The establishment of that trust was bitterly contested between a Board of Directors wanting immediate privatisation through a share giveaway, interim trustees who wanted 100% trust ownership and the local authorities within the district of the former power board (Auckland, Manukau and Papakura) who wanted local authority ownership. The compromise was 100% trust ownership with a tightly drawn trust deed requiring that 100% of income be distributed to income beneficiaries within 12 months of receipt (income beneficiaries are consumers connected to the network of the previous power board), a provision that capital be vested in local authorities on the termination of

[5] The legislation also required the directors to seek public input on their proposals following the then recently adopted special consultative procedure provisions applying to local government as though they were a council. In practice this process turned out to be largely ineffectual as a means of determining community views or, for that matter, of enabling community views to influence the directors' proposals.

the trust at the end of the 80 year perpetuity period, and an understanding that the trust would facilitate listing of the company.

Of those cases where the Board of Directors opted for a share giveaway, and a resultant listing of the company, only one company remains listed: Trust Power, in which the Tauranga Energy Consumer Trust holds approximately 1/3 of the capital, with more than 50% of the balance being held by the Wellington infrastructure investor Infratil. The remaining companies all disappeared as the result of takeover activity.

At the time of the restructuring, much of the advice for Ministers was provided by the Electricity Distribution Reform Unit, a specialist entity within the Treasury. Its advice included consideration of the impact of trust ownership. Here, it is important to note that the Energy Companies Act made no specific provision in respect of trust ownership. As a consequence any trust established to own an energy company was effectively no different from a conventional private trust – there were no provisions regarding accountability which differentiated them from a conventional family trust or similar entity, and no provisions giving the 'owners' (consumers as income beneficiaries; capital beneficiaries who might be future consumers, or might be local authorities) any ability to influence trust decisions, other than the right of consumers to elect trustees.

The one potential control was a requirement, embedded in their trust deeds as a condition of ministerial consent, that all energy trusts, other than those which had specific capital beneficiaries (the Auckland Energy Consumer Trust; the Eastland Community Trust – both examples where the ultimate capital beneficiaries were named in the deed as the related local authorities), should undertake a periodic review of ownership and the findings should be the subject of consultation with the trust's consumer beneficiaries. The expectation at the time, incorporated in official advice to Ministers, was that the reviews would canvass different options for ownership, including giving consumers ownership of the trust's shares in its related energy company through a share giveaway, and that this would almost invariably result in consumers choosing to take ownership of shares, rather than simply continuing as income beneficiaries.

This expectation was described by one of the key ministerial advisers at the time as:

> This consultation, unlike that undertaken for the establishment plans, is not governed by a legislative procedure and will require the trustees to meet their normal obligations under their trust deed, ie, they will have to consider only the financial interests of their beneficiaries and ignore any political or emotive aspects. If they fail to do this, then any aggrieved beneficiary could challenge their decision. If the Court upheld such a challenge, then the trustees could face a substantial personal liability.
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> The consequence of this process is likely to be a further substantial degree of privatisation in the next five years[6].

This was classically a judgement based on market understandings, completely overlooking the judgement likely from a governance perspective, as consumers based decisions not so much on their immediate financial advantage, as on their preferences regarding the future governance and control of their electricity supplier.

In fairness, it must be acknowledged that this view of the likely outcome of giving consumers the option was very mainstream at the time. There was

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[6] See Farley (1994) p 70.

simply no comprehension of the likelihood that consumers would put short-term self-interest to one side, and take decisions based on a different set of values, preferencing ongoing community control of an essential service over the undoubted short-term financial gain through a share giveaway.

Two case studies: Auckland Energy Consumer Trust and the Tauranga Energy Consumer Trust

I want to use a couple of case studies of individual energy trusts as a way of illustrating the extent to which failing to factor in the implications of what I have termed a 'governance perspective' can lead to a sub-optimal use of very significant resources. While doing so, I want to make a brief comment on the term 'governance perspective' itself.

It is very easy to see consumer rejection of the share giveaway option as based on ignorance, or the result of manipulation by others (in this case the trustees of the energy trust responsible for commissioning ownership reviews and presenting the outcomes to the consumer beneficiaries). Although there is some substance in this view, it misses two fundamental points:

- Ignorance or not, the underlying motivation is typically one of preserving community control – in other words a view, however ill-informed, on the most appropriate form of governance for what is seen as an essential service.
- Judgements about alternative forms of governance are best made when people have good information about the trade-offs involved, and the costs and benefits from their perspective of different options, and are given the opportunity of sharing in the responsibility for the decision, including the lost opportunities.

The consequences of the failure to make proper provision for the impact of a 'governance perspective' has been profound in terms of the optimal use of significant capital resources. Because no specific provisions had been made regarding the long-term governance of energy trusts (a later legislative intervention at least provided for an annual meeting of beneficiaries, and audit by the Auditor General) no mechanism exists permitting a review of the highest and best use of the capital resources held by trusts, unless trustees themselves so decide. If they do, they are constrained by the terms of their trust deeds which for many severely limit the options they have.

Most energy trusts[7], even if they remain as owners, which virtually all of them are in effect constrained to do, have the opportunity of encouraging their energy companies to diversify their activity, and to do so in ways that could promote local economic development or other complementary objectives. In practice however, because of the nature of the trusts themselves, and the way in which most trustees come in to office, they are not well designed as proactive managers of significant local capital resources.

The two largest energy trusts, the Auckland Energy Consumer Trust (AECT) and the Tauranga Energy Consumer Trust (TECT) both illustrate how the failure to take a 'governance perspective' into account in their design has effectively side-lined very significant capital resources in communities which are capital constrained.

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[7] Those which are 100% owners of the related energy company which in all 100% ownership instances are lines businesses, not generators or retailers.

Both hold as their principal asset (the only long-term asset in the case of the AECT) an interest in their related energy company. In AECT's case the interest is 75.1% of the capital of Vector Limited with a present market value of approximately $2.125 billion. The capital beneficiary is the Auckland Council which in terms of the trust deed will receive the capital in 2073. In the meantime, the trust distributes dividend income to consumers connected to the network of the previous power board.

TECT holds 33% of the capital of Trust Power with a present market value of approximately $750 million. In practice, the company is a subsidiary of Infratil which holds a little over 50%. Income is distributed to a mix of consumer beneficiaries (defined as consumers who have a power supply contract with Trust Power) who are the principal recipients, and community purposes. Capital beneficiaries are consumers who will be in place at the end of the trust period, 2073.

Neither trust is able to exert any direct influence over its related energy company. A combination of the provisions of the stock exchange listing rules, and of the provisions of the Companies Act, means that even the AECT, as a majority shareholder, cannot require Vector to act in ways which might privilege trust beneficiaries at the expense of minority shareholders. The trust does have the power to appoint all of the directors (and has actually, with the assistance of the Institute of Directors, adopted a protocol designed to ensure that generally directors are 'fit for purpose') but, once appointed, directors are bound to act in the best interests of the company, not of the appointing majority shareholder.

TECT, as a minority shareholder in a company whose major shareholder holds more than 50%, is even further constrained.

Both trusts, by virtue of the provisions of their trust deeds, face significant constraints on how they deal with their shareholdings, or with the proceeds of any sale of those shareholdings. The AECT is at liberty to sell part or all of its shareholding in Vector at any time, but its deed restricts its investments to debt or equity securities of the company, bank deposits, New Zealand government stock and investment in companies with a credit rating of at least A-. TECT's investment powers are less constrained, but any sale of more than 5% of its shareholding must go through a complex public consultative procedure which would almost certainly result in such a proposal being rejected.

Neither trust currently has any means of bringing its beneficiaries together for a 'governance perspective' discussion around the best use of the capital it holds. The immediate impact is that their respective communities, both of which are capital constrained, lack any means of tapping into a very substantial resource.

In each case the present situation is a direct result of a failure to apply a governance understanding to the arrangements being put in place for the establishment of the trusts and the restructuring of the related energy business.

Conclusion

In this presentation what I have sought to do is demonstrate that there are a series of decisions confronting polities such as New Zealand which require a different approach to decision making than is available through either conventional market processes, or the conventional processes of government.

Instead, they require approaches based on the recognition that, where ever the formal decision right may be held, in practice the real decision right – or the capability for ensuring that the decision can actually be implemented effectively and at reasonable cost – is held elsewhere, often by a range of individuals, interests and entities who need to be collectively engaged. This leads to a twofold challenge for modern governments.

The first is to understand how to manage their own affairs so that they are able to ensure effective decision-making on complex issues which require a governance rather than a government approach – developing ways of building partnerships with communities, and understanding the importance of trust in government as decision-maker, and the preconditions for the legitimacy required to implement decisions and gain the cooperation of other parties whose involvement is often needed and cannot be coerced.

The second is to understand the nature of the 'governance perspective' which both underlies a lot of public and community response to government initiatives and plays a critical role in the nature of the decisions which result when the 'public' has the opportunity to make decisions on significant resource allocation or institutional control issues.

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