THE DEFORMATION: "REFORMS" CONTINUE TO WRECK THE ELECTRICITY INDUSTRY[1]

Bill Rosenberg

In the last *Watchdog* ("Power Frenzy: the takeover of the electricity industry", no. 90, April 1999) I pointed out that the prices that were being paid for electricity assets – especially retail operations – were so inflated that price rises were inevitable. The only surprise has been that it has happened so quickly. The result has been chaos. Not only has the government been made to look utterly foolish over its failed objectives for the "reforms", but it has been forced to react by regulating, creating a split with its coalition partner, ACT – and in the eyes of most people, regulating the wrong part of the industry.

But while the court jesters perform in Parliament, tragedy continues in the real world, with the continuing sale overseas of much of our electricity sector (see accompanying table). In this case, it really does mean "our" sector quite literally – most of it was central or local government owned, or owned by community trusts. Not only will it mean further unnecessary price rises for consumers, but it is likely to lead to power shortages in future as companies fail to invest in generating capacity due to heightened competition and voracious extraction of profits.

While Edison of the U.S.A., which has gained notoriety in other operations overseas, bought Contact for an extraordinary price, TransAlta, which failed in its bid, is trying to recover by buying up any generating capacity it can lay its hands on and hiking its retail prices. The third major foreign purchase of our electricity assets, Utilicorp, is amassing lines operations and charging some of the highest prices in the main centres. And those are only the headlines.

The continuing story…

Edison buys 40% of Contact Energy – with approval for 100%

The Big One of the electricity deformation. In March 1999, **Edison Mission Energy Taupo Ltd**, a **79%** subsidiary of **Edison Mission Energy Company** of the **U.S.A.** (the other **21%** is owned by "unknown third party shareholders" of the U.S.A.) gained Overseas Investment Commission (OIC) approval to acquire 100% of **Contact Energy Ltd** from the **Crown of New Zealand**. Note that, though it has only been sold **40%** of Contact, as the "cornerstone" shareholder, Edison has OIC approval for a full takeover. It paid **$1,208,000,000** for the 40%. The remainder was sold through a public offering, of which more below.

The sale is controversial for a number of reasons:

- First there is the failure of the electricity deformation, of which it is an integral part, and that includes loss of control of substantial parts of our electricity resources.
- Second, the price that Edison paid was so high that further power price rises seem highly likely. It also raises concerns as to whether there will be sufficient investment in future for required increases in generating capacity.
- Third, the public offering became effectively a handout to some of the wealthiest New Zealanders and overseas investors.
- Fourth, Edison is surrounded by scandal in its operations elsewhere.
- Fifth, the OIC decision highlights a largely overlooked side effect of the sale: it includes **almost nine thousand hectares of land** – most of it rural, and often sensitive either environmentally or in terms of its location.

Before going into these, what did Edison buy? (Unless otherwise stated, the following information comes from Contact's "Investment Statement" or prospectus for the public offering of its shares.)

Edison's prize: what is Contact?

Contact was the first splinter from Electricity Corporation of New Zealand (ECNZ). It was broken off in 1996 with the intentions of creating competition, and eventual privatisation. It was given a number of generation plants, plus ECNZ's gas purchase contracts. Since then it has bought further assets in Australia and has been a major competitor in the race to buy retail customers after the split of lines networks and electricity supply in the

[1] The *Concise Oxford Dictionary's* definition of "reform" is "make better by removal or abandonment of imperfections, faults, or errors". This is so obviously inappropriate in the present context that I hesitate to use the term. Under "deformation", the dictionary notes that it has a meaning of "change for the worse", and was used as an opponent's name for the Reformation. Without entering into a debate into that particular historical era, it seems entirely appropriate here.

Electricity Reform Act. It is the largest electricity generator in Aotearoa (following the more recent split of ECNZ), and has the largest number of gas customers of any gas retailer.

In the year ended 20/9/98, Contact generated approximately 26% of the country's electricity and owned about 25% of its generation capacity. Its stations and their capacities are:

Hydro:
- Clyde (432 MW)
- Roxburgh (320MW)

Geothermal:
- Ohaaki (104MW)
- Wairakei (165MW)

Thermal:
- Otahuhu A (85MW, Gas Turbine)
- Otahuhu B (395MW, Combined Cycle Gas Turbine, to be commissioned)
- Te Rapa (44MW, Co-generation at the Te Rapa Dairy Factory, under construction)
- Whirinaki (162MW, Gas Turbine)
- New Plymouth (580MW, Gas)
- Stratford (198MW, Gas)

In Australia it owns 28% of the Southern Hydro partnership, which bought a privatised hydro generator in Victoria. It operates stations at Dartmouth (160MW), Kiewa (193MW), Rubicon (14MW), Eildon (120MW) and Cairn Curran (2MW). However, it may have to divest itself of this interest because Edison also has interests in Victoria that may give rise to "regulatory issues" – presumably lessening competition. In addition, Contact owns 17% of a 282MW distillate and gas-fired power station under construction at Oakey in Queensland. Contact is managing its construction, and when it is completed in November 1999 will operate and maintain the station.

It also has bought up retail customers in a big way. These include the retail operations of (to date):

- Alpine
- Counties Power
- Dunedin Electricity
- Eastland
- Electra
- Electricity Invercargill
- Enerco (gas only)
- Hawke's Bay Power
- Kaiapoi
- Mainpower
- Tasman Energy
- The Power Company
- Top Energy
- United Electricity Ltd

It claims 345,000 retail electricity customers, making it second largest after TransAlta. That is 19% of the retail market and equates to 48% of the power it generated in the year ended 30/9/98. Added to that is gas retailing, where it bought the retail operations and brand name of Enerco from Christchurch's Southpower (now Orion) to give it a total of 105,000 customers in Auckland, Wellington, Hawkes Bay, Horowhenua and Manawatu.

Excessive price paid means higher prices, further expansion, or cutting investment

Edison paid $1.2 billion for 40% of this. That compares with the next closest bidder, TransAlta, which reportedly tendered under $1 billion – perhaps as low as $800 million – for the 40% share (*New Zealand Herald*, 24/3/99, "Power of difference between big bids", by Mark Reynolds), though TransAlta puts the difference at $200 million (*Press*, 30/3/99, "TransAlta $200m light", p.22). Edison's bid works out at $5.00 a share and puts a value of $3 billion on the whole company – double the $1.5 billion the government was reportedly hoping for. However, Contact's book value at 30/9/98 was only $883,766,000, and it expected that to rise only modestly to $895,400,000 by the same date in 1999 and $911,300,000 in 2000. In other words, Edison paid about 3.4 times book value.

Earnings were 13.3 cents a share in 1998, projected to fall to 10.8 cents in 1999 and 13.0 cents in 2000. Dividends are expected to be 7.9 cents, 8.7 cents and 10.3 cents respectively per share. So Edison is looking at earning less than 2% (tax considerations aside) on its investment unless it can radically cut costs (including investment - see below), raise prices, or find some efficiencies by grabbing more of the market. It is unlikely to be satisfied with that rate of profit for long, but none of those remedies seem likely to be sufficient – particularly if the New Zealand dollar falls.

An extraordinary light was put on this scenario when, less than a month after the public share issue, Contact announced that its profit had nearly trebled to $54.4 million for the six months to the end of March 1999 – well above the estimates in the prospectus. All of the increase will go to the new owners, despite them having not owned the company when the profit was earned, because the government was paid a dividend before sale based on an estimate of the half year's profit of about $36 million. The increase was due to high wholesale market prices, and a $23 million damages payment because the new Otahuhu B plant was not ready in time (last November). One explanation of the high price that Edison paid is that it was aware that profits would be higher than the prospectus estimated. However, the higher rate may well not be sustained, being inflated by the damages payments.

According to Mark Reynolds, "Edison paid about 17 times the value of Contact's earnings before interest, tax, depreciation and amortisation (ebitda) for the holding… Internationally, a company could be expected to pay 12-13 times ebitda for a company such as Contact Energy – but that would usually be to secure full control, not just a 40 per cent holding."

There is little surprise then that Contact will plough very little of its profits back into investment: it has announced a dividend policy of paying out an avaricious 80% of its profits in dividends, putting it almost down in the Telecom league for reinvestment. A major concern here interacts with another significant long-term problem with the deformation. If electricity generators compete as the government hopes, prices may be cut to the extent that there are insufficient funds or incentive to build new generating capacity in time for when it is needed. That will continue until a supply crisis forces up prices – but that may well hit consumers very hard and suddenly, and bring insecurity of electricity supply while the market waits for new capacity to be built. Contact's policy of minimal reinvestment of profits adds to the risk of this occurring.

A government handout to wealthy New Zealanders and overseas investors

Edison must sit on its current shareholding for six months before either selling or (as is expected) buying more shares on the market to increase its holding past 50%. That will presumably hold the price of shares higher than they would otherwise be. On the other hand, to the extent that the prices remain considerably under the $5.00 that Edison paid, purchasing more shares gives it an opportunity to dilute the price it has paid per share, lowering the pressure for higher profits.

The high price Edison paid put the government in a dilemma. It had indicated a public issue price of $2.40-$3.00 for the remaining 60% of the company. At $2.40 it would be giving away the opportunity for literally doubling the price it would receive for the 60%: that works out at $936 million less available for debt repayment. At $3.00 the loss would be "only" $720 million. In the end it offered the shares at $3.10. The issue was heavily oversubscribed, implying a higher price could easily have been obtained. Effectively the government robbed the rest of the country – those who could not buy shares – of $680 million it could have obtained by selling the whole company at Edison's $5.00 per share.

Those who did buy shares had a handy windfall – 12.9% or 40 cents a share after the first four days of trading, by which time the share price had risen to $3.50. The *Press* (15/5/99, "Contact holders realise 13% gain", by Gerald Raymond, p.21) valued the paper gain at about $36 million in the first week. Though shares fell below issue price a month later, these shareholders may well have a greater windfall when Edison enters the market.

According to Brian Gaynor (*New Zealand Herald*, 15/5/99, "Govt should encourage local investing", p.E2), overseas institutions bought 18% of the company, and "New Zealand/Australian institutions" a further 14.4%. Assuming 25% of the latter's allocation went to Australia, Gaynor estimates that Contact was nearly 62% overseas owned on the day after the float. He estimates that half, or 65 million, of those overseas owned shares were sold to make a quick profit in the first three days. A further 39 million were also traded. The overseas investors' windfall would have been $21 million – and some were sold before the institutions had even paid for them.

The price was defended in terms of allowing thousands of New Zealanders to buy shares in what was formerly their – and everyone else's – company. Those who responded did so with huge enthusiasm: Contact ended up with 227,346 shareholders according to its web site. Of these 99.87% or 227,040 had less than 5,000 shares, and were therefore likely to be individuals rather than institutions. They owned just 27% of the company. Yet this

6% minority of the population is likely to come from the well-off to wealthiest sections of our community. Why should they be favoured with a handout worth about $300 – the windfall profit on most share parcels after the first week's trading – at a time when we are told cuts in government spending – which inevitably hit the poorer parts of our community hardest – are essential to reduce debt? That does not seem a sensible or equitable reason to reduce the selling price of the shares. It is money that should be benefiting the public purse.

Neither will the lower price prevent the power price rises that are heralded by the share price that Edison paid: Edison still wants a good return on its high-price investment, and is in the driving seat. The small shareholders may well benefit from its desperation to raise the return on its $5.00 shares. As Gaynor says rather obtusely, "the high price/earnings ratio and low yield will become a concern only if the company fails to outperform its prospectus forecasts". In other words, the company has to do considerably better than it has predicted if it is to keep its shareholders happy.

Trying to mix a "cornerstone" shareholder with a public offering brings the worst of both worlds: high incentives to price gouge and skimp on investment, but a lower price to the country for the company than would otherwise be obtainable. As Gaynor points out, the public issue didn't even maximise the local shareholding, as it gave preference to overseas institutions for a large percentage of the publicly offered shares. Even what local shareholding did come about may well disappear if Edison launches a full takeover.

What the success of this share offering – and others like Auckland Airport – does show is that there is plenty of local money available for sound, productive investment. It is a pity it is being wasted on takeovers of existing assets at hugely inflated prices.

The unpleasant reality of Edison

So what is Edison Mission Energy that controls Contact, and may well end up owning all of it? Contact's prospectus (p.27) describes it as follows:

> Edsion Mission Energy was formed in 1986 and currently owns interests in 55 projects, including 48 operating projects, five projects in construction and two projects in advanced development. In total these projects represent more than 13,400MW of capacity comprising 11,273 MW thermal plant fuelled by gas, oil and coal, 2,174 MW hydroelectric consisting of limited storage, run of the river and pumped storage and 1MW geothermal plant… Edison Mission Energy is a wholly owned subsidiary of Edison International Inc., a corporation with approximately US$25 billion in assets, which is also the parent holding company of Southern California Edison, one of the largest electric utilities in the United States. As of 31 December 1998, Edison Mission Energy had consolidated assets of approximately US$5 billion, total liabilities of approximately US$4 billion, and total shareholders' equity of approximately US$958 million."

Edison Mission is therefore highly indebted itself – creating further pressure for profit-taking.

The company is highly active in the growing number of privatised electricity markets around the world. It has investments in the U.K., Spain, Indonesia and Australia, with a total 3,724MW outside the U.S.A. It is involved in constructing new projects in Indonesia, Italy, Puerto Rico, Thailand and the Philippines.

Its involvement in Indonesia has led to investigation and criticism even by the *Wall Street Journal* (23/12/98, "Wasted Energy: How US Companies And Suharto's Circle Electrified Indonesia. Power Deals That Cut in First Family And Friends Are Now Under Attack. Mission-GE Sets The Tone", by Peter Waldman and Jay Solomon, p. A1).

The Indonesian venture was the construction of the country's first private power station. A joint venture between Edison Mission Energy and General Electric (GE) eventually won the deal after securing crucial contacts within the then ruling Suharto family and their close associates to get the project approved. Deals with the Suharto family and associated senior government figures included commitments to purchasing excessively priced coal supplies and boilers from companies associated with them, and giving some an essentially free share in the project. The company got President Suharto to personally approve its high prices. His successor, B.J. Habibie, then Research and Technology Minister, personally intervened to rescue the deal at one stage.

There was no competitive bidding, and there is evidence that Edison overruled its partner, GE, to waive a requirement that its Indonesian partners sign a "no corruption" clause in the contract.

The result was that the project, Paiton One, is one of the most expensive power deals of the decade, anywhere in the world. Adjusted for local purchasing power, Indonesia's privately supplied electricity is 20 times the price of

the U.S.A., 60% higher than the Philippines, and 30% dearer than Indonesia's only competitively bid private power project. PLN, the state-owned electricity company, says that it doesn't want to buy any electricity at all from the Edison-GE plant in 1999. The U.S. government, whose agencies provided loans for it, has been pressuring PLN to buy the power at the high contracted price.

Though many Indonesian Government advisers, both local and foreign, argued the power wasn't needed and was too expensive, Edison applied heavy political pressure to get the deal. Current and former US politicians lobbied for it, including former Vice President Dan Quayle, Clinton's Treasury Secretary Robert Rubin, and former Secretaries of State Warren Christopher and Henry Kissinger, the last two as Edison-GE lobbyists.

The deal was consummated during the 1994 APEC Leaders' Summit, in Indonesia, personally overseen by President Clinton.

And then there is Edison's carefully nurtured environment-friendly image. Its Chief Executive, John Bryson helped start a law firm that lobbied U.S. corporations to adopt clean air and water laws, and co-authored a book criticising the way in which U.S. nuclear power plants handled their nuclear waste. He joined Edison in 1990. But the Sierra Club describes the company's San Onofre nuclear power plant as "the worst, most destructive marine industrial facility ever constructed… It's killed 20% of all the fish in the Southern California Bight – more than all the commercial fishermen in southern California". Sierra Club's Coastal Campaign Coordinator told the *New Zealand Herald*, "if I was New Zealand I wouldn't let this company anywhere near my country." A coal-fired power plant in the Mojave Desert of Nevada has also been attacked for its pollution of the air around the Grand Canyon, and the company had to write off US$18 million in Mexico after pollution from a power plant in Chihuahua caused problems (*New Zealand Herald*, 6/4/99, "Image of power greenie queried", by Peter Huck, p.A11).

Huck also quotes consumer groups in the U.S. describing sister company, Southern California Edison, as being "overly aggressive in hunting market share", and "defending their desire to milk as much money from consumers as possible". Its "modus operandi has always been to use its resources, its size and its political influence to beat up anyone who gets in the way." The companies have benefited to the tune of several billion U.S. dollars through handouts given by the State Government in a deregulation process in California.

Almost nine thousand hectares of land sold

Finally there is the issue of the several thousand hectares of land sold as part of the privatisation. There are **8,631 hectares** of freehold land handed over as part of the sale. These include areas surrounding major rivers, such as the Clutha, and lakes, such as Hawea, which are treasured for recreational and environmental reasons. The long term issues of access and environmental effects have not been addressed in the sale:

- **7,247 hectares** in **Central Otago**, at **Lake Hawea, Clutha, Luggate, Lake Dunstan, Cromwell, Clyde, Alexandra, Roxburgh, Queensbury** and **Tuapeka**;
- **1,264 hectares** near **Taupo**, at **Forest road, Mokai**; **Ohaaki Road, Broadlands, Reporoa**; and **State Highway 1, Wairakei**;
- **82 hectares in Taranaki** at **Breakwater Road, New Plymouth** and **East Road, Stratford**;
- **33 hectares** in **Auckland** at **68A Bairds Road, Otara**; and
- **five hectares in Hawkes Bay** at **State Highway 2, Bay View**.

In addition, there are **785 hectares** of **leasehold land** – at **Ohaaki Road Broadlands, Reporoa, Taupo**; **State Highway 1, Wairakei**; and **Te Rapa Dairy Factory, State Highway 1, Te Rapa, Hamilton, Waikato**. Finally, **189 hectares** of easements and licences at **Aokautere, Manawatu** are included.

Meanwhile TransAlta tries to consolidate its position with generator grabs and price hikes

Under the 1998 electricity industry deformation, TransAlta (67% owned by TransAlta Energy Corporation of Canada) chose to sell its lines operations and concentrate on power generation and retailing. In doing so, it was counting on being the successful bidder for the "cornerstone" shareholding in Contact Energy in order to have a guaranteed electricity supply and price. It lost out to Edison's extraordinary bid (see above), so it is trying to amass generation capacity by other means. By December 1998, it claimed it had 12% of generation capacity, including Power New Zealand's stake in the 24MW Rotokawa power station, Stratford (see below), and 47.5% of the 122 megawatt gas-fired Southdown plant in Auckland, which it operates. These give it 500 megawatts of generating capacity, and it also has two small generating plants at Silverstream Landfill and the Upper Hutt Leisure Centre. Since then it has purchased the small (32MW) and old (Second World War) Cobb hydro power station in Golden Bay, Nelson, for $84.1 million from Meridian Energy, the predominantly South Island slice of ECNZ (TransAlta media release, 27/5/99, "TransAlta buys Cobb Power Station").

In March, the OIC gave approval to TransAlta's subsidiary, TransAlta Generation Ltd, to acquire Stratford Power Ltd from MEL Stratford/Fletcher Challenge Gas Power Ltd. Stratford Power Ltd owns the Stratford combined cycle power station at Stratford, Taranaki. MEL Stratford/Fletcher Challenge Gas Power Ltd is owned equally by the Auckland Energy Consumer Trust (the owners of Mercury Energy's lines operation, now called Vector) and Fletcher Challenge Ltd. NZPA reported that TransAlta paid $80.3 million: $37.4 million to Fletcher Challenge and $42.9 million to Mercury (*Press*, 10/3/99, "TransAlta buys partners", p.25).

The consortium of TransAlta Energy Corporation, Fletcher Challenge Ltd, and Mercury Energy Ltd were given approval to build the power station by the OIC in August 1995. They replaced an approval the previous month, which gave the station to National Power Plc, of the U.K. The gas-fired power station was the brainchild of Electricity Corporation, which put the station up for tender. It saw the sale of the project as a "major step in the creation of a competitive electricity generation market". The station was expected to cost "approximately $380 million".

The station attracted controversy: it was the centre of protests by Greenpeace in August 1995, who objected to the annual 1.5 million tonnes of carbon dioxide emissions that would come from the station. The protests were aimed at disrupting the construction of the station.

TransAlta had pre-emptive rights to the purchase of the two other partners' shares (as with Mercury's share of the Southdown station). It grabbed the opportunity in its bid to become a significant electricity generator:

> "From TransAlta Group's perspective the proposal assists in the formation of a national base of generation assets for the TransAlta Group. The acquisition will augment TransAlta's acquisition of Capital Power and Energy Direct's investment in two electricity facilities as well as TransAlta's existing generation assets."

However, even with these purchases, TransAlta's operations are still out of balance with its status as the largest electricity retailer, where it claims

> "approximately 555,000 electricity and gas customers. The electricity load of TransAlta's customer base is approximately 8,000 GWh per year, equivalent to approximately 29% of energy sales and 32% of customers in the retail electricity market." (http://www.transalta.co.nz/about/default.htm)

Of these customers, 530,000 buy electricity in Auckland, Wellington and Canterbury, and 25,000 buy gas in Wellington (http://www.transalta.co.nz/industry/services.htm). (Also in March, it sold its Wellington gas network to the Australian Gas Light Company of Australia for $112,000,000. Australian Gas Light at the time owned one third of Natural Gas Corporation Holdings Ltd and has since announced it will buy another third from Fletcher Challenge. See the OIC decisions for March, elsewhere in this issue, for more detail.)

The degree of imbalance is seen in the fact that while the company's customers use 8,000 gigawatt-hours (GWh) per year, it generates only 4,200 GWh annually. It therefore must buy around half its electricity on the spot market or by contracting with competitors. This means that it will be putting the pressure onto the government for further privatisation of the electricity generating capacity present in the three splinters of the still state-owned ECNZ.

Adding these factors to the enormous prices TransAlta paid for its customers outside Wellington must mean the company cannot survive in its present form without forcing up prices.

And force up prices it did. In April it announced increases of 3 to 10% in Auckland, 5 to 10% in Wellington, and 13% in Christchurch (*Press*, 7/4/99, "Govt queries power charges", p.1). It also introduced substantial new charges for previously free services, including reconnection, disconnection, and final reading fees. It also transpired that Southpower, under TransAlta's ownership, had been switching off hot water cylinders over summer and autumn, not for the well-accepted reason of managing peak network loads in winter, but simply to save itself money.

Particularly in Christchurch the news of the price rises received universal condemnation from all parts of the political spectrum, editorial writers, letters to newspapers, and community groups. The price rise even spawned new protest groups – though at least one in Christchurch had dubious credentials. It used its public support to join TransAlta in criticising Orion (the Council-owned lines company which was retained from the sale of Southpower), and to castigate the Council for not handing out the profits from the Southpower sale to reduce rates or power charges. It effectively wanted the Council to subsidise TransAlta's prices.

TransAlta initially blamed its price rise in Christchurch on Orion's pricing. Spokesman Nigel Morris said the company had no choice but to increase power prices because of Orion's "unfair and unreasonable" line charges. He did not explain why, if Orion was to blame, TransAlta had also increased its prices in Wellington and Auckland. He did promise that if Southpower changed its peak/off-peak pricing formula it would abandon its price increases.

Orion had changed its formula to raise prices at times of peak electricity use and lower them at off-peak times. It insisted that its average prices had dropped by 1%, and produced Ministry of Commerce data to show its prices were below the national average, and in particular below Wellington and Auckland. It pointed out that TransAlta knew the score when it bought Southpower from it; indeed Orion's managing director asserted that at the time of sale "Orion had consulted TransAlta over pricing to ensure prices would have no effect on residential customers".

Orion offered to abandon its peak/off-peak pricing scheme. TransAlta changed its line to blaming Orion for not dropping prices when it no longer had the cost of maintaining and reading the meters, which had been bought by TransAlta. Lines companies in other centres pointed out the same was true elsewhere. Orion responded by pointing out TransAlta knew all about the meters and Orion's proposed charges when it bought Southpower. It launched an aggressive campaign to encourage consumers to switch from TransAlta to other, cheaper suppliers. These include the state owned Meridian, and First Electric which offered power 15% below Southpower's pre-increase prices – and then raised prices 9%, following TransAlta's lead. Retailer TrustPower (15.6% owned by Australian Gas Light, and 43.74% jointly owned by Infratil and Alliant International of the U.S.A. according to a company announcement on 12/4/99) also raised its prices saying:

> "A less fortunate feature of the purchases we made is that they were from local trust owned power companies with very low rates of return on their assets.
>
> In a number of cases this left unsustainably low energy margins which did not cover the cost of servicing the customer. TrustPower has moved quickly to correct this position in an open manner. Price rises, however even if from a low base, are not what the Government has promised …"

(Company preliminary result announcement, 14/6/99. For more on TrustPower, Alliant and Infratil, see the article on Infratil elsewhere in this *Watchdog*.)

The only public figures taking pressure off TransAlta were government spokespeople. The Minister of Energy, Max Bradford, who had predicted in December that wholesale prices should fall 10% by April, remained sublimely confident that if consumers waited long enough, prices would begin to fall. He implicitly backed TransAlta by focusing his criticism on the lines companies, and particularly on Orion – happily ignoring the price rises by retailers throughout the country. He even was "prepared to wager a small bet" that prices would come down within a year. He didn't say whether they would come down below their pre-deformation levels.

Confronted with responsibility for what was rapidly becoming a major re-election killer, instead of attacking TransAlta, he desperately tried to divert the debate by attacking Orion for profiteering, even though its target rate of return at 7% was lower than the government's target for its transmission company, Transpower. He diverted further by complaining that the profits from the sale of Southpower should be used to reduce power charges or put aside for future Council debt rather than used, as the Council was proposing, for investment in new ventures. None of this was consistent with his pleas (in another context) for more investment rather than consumption. He was not helped by fellow senior cabinet member, John Luxton, Minister of foot-in-mouth diseases, blurting out that "it was not promised that householders would necessarily get cheaper power". Luxton said "Christchurch residents should never have expected to get cheaper power bills from electricity reforms".

As I have already modestly pointed out, we predicted price rises in our commentary on the OIC's October 1998 decision to allow TransAlta to buy Southpower – though hadn't expected support from John Luxton. Our only surprise is how quickly retail electricity prices have risen. We expected a decent interval to elapse to allow the government to claim success and allow TransAlta to consolidate its position before it raised its prices. It is interesting to speculate why it has happened so quickly.

While TransAlta was in a bad position managerially, it was not in immediate trouble financially. Organisationally it was in strife: from the start of 1999, seven of its eight top managers resigned, and given another left had earlier in 1998, it had a completely new senior management team (*Press*, 26/5/99, "High turnover among TransAlta managers", p.26). However, in cash terms the dealing due to the electricity deformation actually enabled it to pay off debt. It received considerably more from the sale of its electricity lines and gas network assets in Wellington (see below) than it paid out for Southpower and Power New Zealand's retail operations, its increased generating capacity, and the costs of restructuring. It was able to repay debt of $237 million. Nonethe-

less, while it maintained its dividend, its return on total assets fell a third to 8.3% in the year to 31/3/99 compared to 12.8% the previous year, and the adjusted return on shareholders' funds fell a quarter to 12.1% from 15.4%. The falls were primarily due the company's increased shareholders' funds and asset base according to its chairman, Derek Johnston (TransAlta media release, 27/5/1999, "TransAlta reports adjusted net earnings of $33.3 million for the year to 31 March 1999").

A more machiavellian explanation is that TransAlta wanted to force the government to regulate the lines companies, leaving the retailers and generators a freer hand to take profits. This is consistent with TransAlta's unbelievable public explanation for its price increases: that it was the fault of the lines companies for not lowering their prices. It was in the knowledge that the government had already announced that it recognised the monopoly position of the lines companies and stood ready to regulate. And TransAlta explicitly challenged the government to regulate when defending its price rises. If that was TransAlta's tactic, then it certainly has succeeded. Max Bradford introduced legislation into Parliament on 25 May, giving such powers to the Commerce Commission. He immediately ran into further trouble with his erstwhile brethren in pursuing privatisation and free markets, ACT, showing all the flexibility of their usual doctrinaire stance, in opposing the legislation on principle. But TransAlta would have been doubly happy: the legislation is unlikely to have any affect on retail prices (most line companies have declared price freezes anyway), and it leaves TransAlta with its price rises intact and other retailers following its lead.

(References: *Press*, 5/4/99, "Power prices to rise 13%"; 7/5/99, "Caution on power fund urged"; 6/4/99, "Storm over power", p.1; 9/4/99, "Heat put on TransAlta to cut price", p.1; 10/4/99, "Orion plans price war", p.1; 14/4/99, "Southpower switches off hot water", p.1; 17/4/99, "Power price plea spurned", p.4; 20/4/99, "Chch in for power bill rise", p.3; 21/4/99, "Power gaffe upsets Nats", p.1; 1/5/99, "More hit by SI power price rises", p.4; 4/5/99, "Orion consults lawyers over claims", p.6; 15/5/99, "First Electric raises prices", p.1.)

Utilicorp expands its lines operations – at a cost to consumers

Although the only substantial privately owned lines company, Utilicorp-owned United Networks (formerly Power New Zealand), claims to have lowered its prices, it stands out as having the highest prices in the five main centres. In the continuing battle of words with Bradford, Orion quoted Netherlands-owned bank, ABN Amro to show that, once the transmission charges of national grid operator, Transpower's, were excluded, for a typical domestic consumer using 8,000 kWh a year, United Networks in Auckland had the most expensive line charges at 4.70c per kWh. It was followed by WEL Energy (94% owned by the WEL Energy Trust) at 4.65c, United Networks in Wellington (where it bought TransAlta's network) at 4.41c, Vector (majority owned by the Auckland Energy Consumer Trust) in Auckland at 3.82c, and Orion at 3.71c. By far the cheapest was Dunedin City Council owned Delta Utilities Services (formerly Dunedin Electricity) at 2.39c.

As mentioned above, in December 1998, Power New Zealand, then 78.65% owned by Utilicorp, bought TransAlta's lines operations in Wellington. It paid TransAlta $590 million and borrowed $1.05 billion from a syndicate of banks to pay for this and the TrustPower purchase (see below). The TransAlta business was valued at $340 million in its 1998 annual report (*Press*, 14/11/98, "TransAlta NZ powers ahead", p.23; 9/12/98, "Power NZ earnings may double", p.28).

Shortly after this acquisition, it paid $485 million (twice book value) for Tauranga-based TrustPower's network. That made it the largest network operator in the country with 470,000 customers or about 30% of the market (*Press*, 21/11/98, "Energy companies scramble for position", p.26; *New Zealand Herald*, 27/11/98, "Where to now for rationalised new-look electricity companies?", by Mark Reynolds, p. C2).

Both Power New Zealand and Utilicorp required OIC approval for the takeover of TrustPower's lines operation because TrustPower didn't trust Power New Zealand's shareholders to approve of the deal:

> "TrustPower required UCU (Utilicorp United Inc) to enter into a backup agreement with TrustPower on the same terms as that entered into with Power New Zealand, except that the UCU agreement is not conditional upon UCU shareholder approval. That agreement will only come into effect in the event that Power New Zealand fails to satisfy the shareholder approval condition on its agreement."

TransAlta's sale was opposed by the Hutt Mana Energy Trust, which represents 83,000 people in the Hutt Mana region and has 12% ownership of TransAlta New Zealand. It had been "pushed by TransAlta into bidding for the lines business with a partner suggested by them", but had been unsuccessful. The Trust sought a High Court injunction to stop TransAlta from holding a shareholders' meeting to vote on the sale, including full page advertisements in Wellington newspapers saying the power would be delivered by Canadians over lines owned by Americans. It wanted to force TransAlta to negotiate a new deal with Power New Zealand that would give the

Trust a 26% stake in a company owning lines in the Hutt and Wellington, to give it some influence to protect consumers. It said the sale of the lines business was contrary to the terms of a shareholders' agreement with TransAlta which required TransAlta Canada to consult with the trust – and this had not happened. Power New Zealand said the nationality of the companies' owners were irrelevant. It made a commitment to hold line charges for consumers for three years (*Press*, 10/12/98, "Energy trust seeks help to block sale", p.28; *Dominion*, 11/12/98, "TransAlta vows to fight trust", p.11).

The original sale of local body owned power companies to TransAlta roused bitter local opposition and a series of broken promises from the local authorities. The Trust was a last remnant of local influence, but one that seems to have been outmanoeuvred once more.

And the sale of smaller operations continues:

Pacific Hydro and Todd Energy buy Bay of Plenty Electricity…

In March 1999, Pacific Hydro Ltd of Australia and the U.S.A., and Todd Energy of Aotearoa, gained OIC approval to acquire the electricity retail business and generating assets of Bay of Plenty Electricity Ltd for $100,000,000.

This price was less than the book value of the assets. This is extraordinary: most electricity assets have been changing hands at several times book value. The remaining lines company, which remains with Bay of Plenty Electricity's holding company, Horizon Energy Distribution Ltd, reported a loss of $5.93 million following the sale. This was because the assets were sold at $11.59 million below book value – though the chairman, Colin Holmes, described the price as a "very good result in the current market" (Pacific Hydro announcement, 18/12/98; *Press*, 12/6/99, "Horizon waits for $100m payout OK", p.24).

The OIC says that Bay of Plenty Electricity is owned 32.28% by Utilicorp United Inc of the U.S.A., 25% by the Bay of Plenty Electricity Consumer Trust of Aotearoa, and 42.72% in other shareholdings. However, the *Press* (*ibid*.) puts Utilicorp's holding at 52%. Effectively, the transfer is from one overseas owner to another – but out of the hands of the local consumer trust. The purchase includes 420 hectares at Galatea Road, Black Road, Kopuriki Road and Pokairoa Road, Bay of Plenty.

According to Pacific Hydro, its new acquisition, which kept the name of Bay of Plenty Electricity, has a total generating capacity of 41 MW, plus a 50% interest in the 25MW Kapuni co-generation joint venture. These include the 25MW Aniwhenua hydro electric station, the 9.8MW Edgecumbe co-generation plant, and 6.5MW in two geothermal plants. It also has approximately 22,400 retail customers in the Bay of Plenty region (company announcements 18/12/98, and 31/3/99).

Pacific Hydro is a relatively young company, listing on the Australian Stock Exchange in 1993. Its assets include the Ord River Dam hydro in Australia (completed in November 1997), which has a capacity of 40 MW. It also has built three small hydro schemes in Victoria, under incentives provided by the Victorian Government. It is involved in two hydro projects in the Philippines: the 70MW Bakun A/C, and the 68MW Tagoloan II. In each case, Pacific Hydro is in a consortium with Aboitiz of the Philippines and Pacific Corp of the U.S.A. (in the case of Bakun the consortium is the Luzon Hydro Corporation). Both schemes are still under construction, Bakun due for completion in 2000, and Tangaloan II in 2004. They are "Build, Operate, Transfer" projects, in which the private companies operate them for 25 years under preferential conditions and then return them to the Philippines Government's National Power Corporation. The preferential conditions are "take or pay": the National Power Corporation has to pay for all the electricity generated, even if it cannot use it (from Pacific Hydro's web site, http://www.pacifichydro.com.au).

Pacific Hydro's largest shareholders are AMP Nominees (34.08%) and American Electric Power (AEP) of the U.S.A. (19.79%) (ref: Pacific Hydro web site: 20 largest shareholders as at 26/3/99, http://-www.pacifichydro.com.au/shareholders.htm; and company overview, http://www.pacifichydro.com.au/-overview.htm). It describes AEP as

> "a major US power utility with total annual operating revenues of more than $US1.7 billion from a total generating capacity of approximately 24,000MW at 38 power plants, that produce more than 120 billion kWh per annum providing energy to 2.9 million customers. Of these 16 are hydro electric plants with a combined capacity of 834 MW including 552MW of pumped storage… AEP has investments in the United States, the United Kingdom and China. Wholly owned subsidiaries provide engineering, consulting and management services around the world with offices in Columbus; Ohio; Beijing; China; Toronto; Canada; London; England; Singapore and Sydney, Australia." (Company announcement, 6/2/98.)

…and Natural Gas Corporation buys Waikato Electricity's retailing business

In December 1998, the Natural Gas Corporation of New Zealand Ltd gained OIC approval to acquire the WEL Energy Group Ltd's electricity retailing business for a suppressed amount. WEL Energy Group is owned (94.17%) by the WEL Energy Trust, and the remainder in public shareholdings.

The OIC suppressed the amount paid, even though it was made public before the OIC released its censored decision on 29/1/99: $89.9 million (*Press*, 20/1/99, "NGC pays $89m for supply firm", p.27).

The Trust has fought desperately to maintain local control of its electricity resources, first to get rid of Utilicorp's "cornerstone shareholding" (one of the first overseas investments in electricity in the country), then to disentangle itself from the battle between Mercury, Power New Zealand, and Utilicorp for control over electric power distribution in the northern North Island. Having finally achieved those aims, it has found itself with a pyrrhic victory – undermined by the Electricity Reform Act, which forced the sale of part of its assets.

The purchase includes WEL's customer base, meters and metering equipment, billing system, debtors, call centre, staff, meter reading contracts, and "certain existing electricity hedge contracts". It also includes a licence over the WEL brand.

Natural Gas Corporation has not been a large contender in the scramble to control electricity assets, though it was clearly relishing the concept. In a sense it was forced to enter the market by Contact Energy, at time of writing one of the big three in electricity retailing. Contact purchased the Enerco gas retail operation from Southpower shortly before Southpower's electricity retail operation was itself sold to TransAlta. Contact is therefore competing head-on with Natural Gas Corporation, but with a much larger number of customers. (Natural Gas Corporation had 42,000 customers in 1996; Contact 430,000 at the end of 1998.) Paradoxically, Enerco is Natural Gas Corporation's largest wholesale customer. The Corporation is the biggest wholesale gas supplier in the North Island.

Nonetheless, Natural Gas Corporation is no stranger to electricity. It jointly owns a 25MW cogeneration plant at Kapuni with Bay of Plenty Electricity. Its controlling shareholder, Australian Gas Light (AGL), which has managed the company's gas retailing operations since 1993 and bought TransAlta's Wellington gas network (see above), has significant electricity interests in Australia, where it is Australia's largest publicly listed utility. Indeed AGL sought Commerce Commission clearance to buy 40% of Contact Energy, and in February 1999, took 15.6% of TrustPower with a view to forming a "strategic alliance".

Natural Gas Corporation is also working quickly to accumulate more of the gas retail market, including those operations of Powerco (New Plymouth), and BP's share of Liquigas. In a move that paralleled the electricity deformation, the company planned to split its operations into three: gas processing and co-generation (tentatively called Taranaki Production Services), gas transmission (TransGas), and energy marketing and distribution (NZ Gas Light). However this was discarded as too complex and expensive when Australian Gas Light bought out Fletcher Challenge's share.

(*Press*, 20/8/98, "Lower interest charges key to sharp profit increase by NGC", p.21; 16/10/98, "NGC seeks business", p.31; 12/11/98, "Electricity attracts interest from NGC", p.32; 7/12/98, "AGL looking for efficiency", p.13; 30/1/99, "TrustPower issue to AGL", p.23; 24/6/99, "AGL buys Fletcher stake in Nat Gas", p.33; 25/6/99, "Infratil answers TrustPower", p.31; *New Zealand Investment Yearbook 1998*, Datex, p.75; *The New Zealand Company Register*, Vol 35, 1996-97, p.74).