The Privatisation of New Zealand's Electricity Services

Bill Rosenberg and Jane Kelsey[1]

Prepared for
INTERNATIONAL SEMINAR ON THE
"IMPACT OF PRIVATIZATION OF THE ELECTRICITY SECTOR AT THE GLOBAL LEVEL"

SEPTEMBER 20-27 1999
MEXICO CITY

New Zealand is made up of two main islands – the North and South Islands – and a number of smaller ones, in the South Pacific. Its land mass is about twice the size of Baja California, and the population just 3.8 million people.

Since 1984 the country has undergone a textbook process of structural adjustment. What has distinguished this programme is that it was carried out not as a condition of creditors but unilaterally through democratically-elected governments.

The programme was started in 1984 by a Labour government, whose party had traditionally embraced a social democratic philosophy, and was continued after 1990 by a purportedly free-enterprise, but traditionally interventionist, conservative National government.

The policies were driven by pure theory that was delinked from the economic, political and social conditions of the country. There was no empirical research to support it.

The 'fundamentals' of the programme—market liberalisation and free trade, limited government, a narrow monetarist policy, a deregulated labour market, and fiscal restraint—formed an ideologically coherent package that was consciously embedded to make it extremely difficult to reverse.

[1] Bill Rosenberg researches and writes on foreign investment and New Zealand's economic relationship with the world for GATT Watchdog and the Campaign Against Foreign Control of Aotearoa, P.O. Box 2258, Christchurch, New Zealand. Jane Kelsey is Professor of Law at the University of Auckland, Auckland, New Zealand, and has written four books on the restructuring of New Zealand, including "Reclaiming the Future", publishing in August 1999.

Privatisation

Privatisation has been central to New Zealand's free market programme. Beginning in 1986, any potentially commercial government operations, and later state housing, the public hospitals and government research bodies, were converted into a corporate form. These were governed by private sector boards of directors, often drawn from the highly influential corporate lobby called the Business Roundtable. Despite public protestations to the contrary, their job was to prepare these operations to be privatised.[2] Staffing levels were reduced, social obligations removed and unprofitable activities terminated. Provision to subsidise those activities explicitly was only used twice, for very limited purposes of short duration. In social infrastructure of hospitals and schools, the state's capacity and funding was progressively reduced, as was staff.

Formal privatisation began in 1987. State operations and assets were sold as soon as commercially possible, irrespective of the economic returns and frequently of the political consequences. Decisions to privatise were based on scoping studies carried out or commissioned by the Treasury and supported by reports from investment analysts. The key players in this process were a select group of merchant bankers and consultants for whom privatisation was especially lucrative. They collected a transaction fee for advising on potential privatisations; there were brokerage and underwriting fees if the sale proceeded (which they invariably recommended); afterwards, the buyer would need financial and other investment services, which the broker would often provide. Sometimes they blurred the boundaries by advising the government and also acting as buyers.

As of March 1999 some 39 assets had been sold for about $19 billion[3]. At no stage has there been any independent, balanced audit of the economic, let alone the social costs and benefits of the privatisation programme—although specific inquiries of limited scope have been conducted following the controversial sale of the Government Printing Office, and the electricity blackout of Auckland's central business district in early 1998 (of which more is said below).

[2] See J. Kelsey, *The New Zealand Experiment: A World Model for Structural Adjustment?*, Auckland University Press/Bridget Williams Books, Auckland, 1997, Ch.6.

Until the late 1990s, almost all privatisations of assets and businesses were by tender, rather than by share floats. This made transnational investment inevitable. State railways went to Wisconsin; telecommunications to US companies Bell Atlantic and Ameritech; the major banks passed into Australian and British hands; steel ended up with Australian mining giant BHP; state forests were shared among the US, China, Japan and Malaysia, as well as New Zealand-based but foreign-owned transnationals.

Other forms of privatisation, especially contracting out, attracted transnationals to information processing (EDS), waste disposal (Waste Management and Onyx) and water supply (Vivendi and Thames Water). Transnational security firms and corrections corporations such as Serco and Group 4 secured a foothold in policing and prison services. State housing was privatised through a means-tested voucher system for people to buy public or private rental accommodation or finance mortgages; public housing charged full market rentals in a highly speculative residential housing market. New funding arrangements meant health care services were shared between the Crown Health Enterprises (formerly public hospitals) and private providers (like Aetna Health).

In 1999 there are few central government owned assets and businesses left to privatise. The no-fault system of workplace compensation has been opened to competition, but the state corporation has not yet been sold. After selling most of the state radio network, the government has regularly threatened to sell thefully- commercialised state television company. But that and other privatisations have recently been deferred. Plans for a user-charge system for all the country's roads, with new roading based on private build, own and operate schemes have been put on hold pending the end-of-year election. Proposals to convert the universities to state-owned enterprises have also been officially withdrawn, although privatisation through equal tuition subsidies for the private sector will begin in 2000. Tenders for the cell-phone and regular radio wave frequencies have also been delayed due to legal action and a report from the Waitangi Tribunal upholding Maori claims to a share of the airwaves. (This is part of an ongoing battle over Crown obligations to protect the land, property, culture and language of New Zealand's indigenous Maori people, which were the subject of a

[3] All monetary values in this paper are in New Zealand dollars unless otherwise stated. Currently,

founding document, the Treaty of Waitangi, in 1840.) In the local government area, however, there remains considerable scope for further privatisation, as cash-strapped local authorities continue to sell their air and sea ports and transport operations and contract out their public utilities.

New Zealand's Self-Regulatory Regime

This extensive privatisation programme occurred in a largely self-regulatory environment, which was most unusual in international terms.

With New Zealand's limited capital base, sale by tender had to involve foreign owners or one of New Zealand's transnationals, almost all of which, in legal terms, are also foreign owned. To facilitate this the threshold for approval of foreign direct investment was progressively raised to $50 million or 5 acres of land. The legislation allows foreign buyers of assets other than land to invest as of right, provided they can show business experience and acumen, are financially committed to the investment, and are of good character. There is no national interest test. Instead, successive governments instructed the Overseas Investment Commission to apply a presumption in favour of granting applications. Between 1991 and 1995 no applications were rejected. It declined one in 1996, and six each in 1997 and 1998, all related to land. Applications for approvals were, as a matter of policy, not scrutinised in depth by the Commission. As a result, foreign ownership goes well beyond privatised industries. For example, all New Zealand's major banks are now foreign owned, as are about two-thirds of shareholdings listed on the Stock Exchange.

The share-market is basically self-regulating. Insider trading controls are ineffectual. There is no take-overs code, the result of effective long-term lobbying by the ideologically-driven Business Roundtable.

The tax system is highly favourable to foreign investors. There is no capital gains tax. Laws on thin capitalisation and transfer pricing were introduced only in 1995, and are weaker than initially proposed, thanks to strong and effective lobbying from the American Chamber of Commerce.

NZ$1=US$0.52.

Many of the privatisations involved natural or effective monopolies. New Zealand's competition laws are extremely weak, allowing claims for efficiency gains to outweigh detriments from the loss of competition. Efficient monopolies are acceptable as long as there is the possibility of market entry. As a result the Commerce Commission has approved takeovers and mergers that have involved up to (and over) 70 percent market share.[4]

There are no official regulators for any of the privatised entities. The Commerce Act provides the only consumer protection. Although the government retains power in the Act to impose price restrictions, until this year it has refused to do so. The government relied instead on regular reporting, backed by the threat of regulation if pricing appears 'inefficient'.

The other regulatory measure of particular relevance is the Employment Contracts Act 1991. This replaced a system of national awards and effective compulsory unionisation with a regime of individual contracts. Any collective enterprise agreements require employer approval, and unionsare banned from striking in favour of multi-employer contracts. The word 'union' was removed from the legislation. Since then, membership of trade unions has declined from 41.5% of the employed workforce in May 1991, to 19.9% in 1996[5]. National and other multi-employer employment contracts, which covered most workers prior to 1991, have almost disappeared. Strikes have fallen from 210 in 1986 to 69 in 1996. Lockouts by employers have increased, from fewer than 1% of stoppages prior to 1991, to a peak of 11% in 1992, and 4% in 1996[6]. The threat of unemployment undoubtedly also contributed to the lack of militancy by workers.

Benefits and costs of privatisation

Has New Zealand's privatisation programme been a success? From a buyer's viewpoint, the system of light-handed regulation provided perfect opportunities to enter the

---

[4] 'Review of the Competition Thresholds in the Commerce Act 1986 and Related Issues: A Discussion Document', Ministry of Commerce, April 1999.

[5] New Zealand Official Yearbook 1998, p, 323, quoting "Unions and union membership in New Zealand: Annual Review for 1996", Industrial Relations Centre, Victoria University of Wellington, Working Paper 1/97.

New Zealand market, maximise profits, and exit once the easy profits were made. One of the most notable examples is Telecom.

Telecom New Zealand was created as a state-owned enterprise when the Post Office was dismembered in 1986. The government turned it into a profitable business by removing its social obligations, and absorbing the costs of staff cuts and new technology. It was sold a consortium led by Bell Atlantic and Ameritech in 1990. Six years later their combined net investment of $1.15 billion for a 49.5 percent share was worth $7 billion at the current market price. A further buy-back of shares by the company, announced in late 1996, meant they had recovered 85 percent of their original investment. In addition, Telecom regularly took around 70 percent, and in 1994 some 90 percent, of its profit as dividend. At the end of 1998, Bell Atlantic and Ameritech announced they were selling all their shares and moving on to new pastures.

From the viewpoint of New Zealand's highly ideological policy makers, *any* privatisation was a success. However several other financial indicators show serious consequences for the economy which can be attributed directly to privatisation. New Zealand's balance of payments is in serious difficulty. The deficit in the external current account at May 1999 was 6.4 percent of GDP; it has been hovering between 6 and 7 percent for several years. That has two main causes. One is the serious deterioration of New Zealand's trading position, due to internal deregulation, unilateral trade liberalisation and the Reserve Bank's monetary policy on trade. The second is the net investment deficit. Between 1996 and 1998, accumulated profit on foreign direct investment was $10.6 billion, 92 percent was paid to the owners as dividend. In the year to December 1998, foreign direct investors in New Zealand earned $2.79 billion in profit, all of which, *plus* another $11 million, was taken as dividend—there was *no* net reinvestment. The vast bulk of those investments involved privatisations.

The second, related indicator is the level of New Zealand's foreign debt. As at March 1999 this stood at over $100 billion or 103.4 percent of GDP, over three times the value of the country's annual exports of goods and services. While the government had reduced overseas borrowings significantly, largely through the proceeds from as-

---

[6] New Zealand Official Yearbook 1998, p, 329.

set sales, the private sector was responsible for all the increases in foreign debt. Interest and debt repayments impose a massive drag on the productive economy**.** Long-term servicing of the debt poses a major problem, because little of that borrowing has gone into building New Zealand's productive capacity.

The balance of payments and foreign debt situations are not sustainable. Nor is the current social malaise. There is no disputing the massive redistribution of wealth within New Zealand since 1984. A study released last year shows that between 1984 and 1996 the richest 5 percent of New Zealanders increased their share of national income by one quarter, and the top tenth of the population by 15 percent.[7] The share of national income for the bottom four-fifths of New Zealanders fell; the poorest proportionately lost most. The median personal income of all New Zealand adults fell by 13.4 percent between 1986 and 1996. The gap between indigenous Maori and non-Maori has widened.[8]

Promises of a high employment, high earnings economy have proved just as illusory. In November 1998 there were still 34,400 (or 3.2 percent) fewer full-time filled jobs, but 243,900 (or over 100 percent) more part-time filled jobs, than in February 1987, when the household labour force surveys began. The number of women in paid work increased, while men's participation rates declined, affecting families and social roles. A recent study showed that New Zealand's export industries are relatively intensive employers of lowly qualified rather than highly qualified people[9].

The social infrastructure of health, housing and education, where privatisation has centred on competitive neutrality between public and private service providers, face chronic breakdown.

In addition to the economic and social costs there are also signs of market failure. Telecom has maintained an effective monopoly over local services through control of

[7] S. Chatterjee & N. Podder, 'Sharing the national cake in post reform New Zealand: income inequality trends in terms of income sources', paper to the Annual Conference of NZ Association of Economists, Wellington, 2-4 September 1998.
[8] *Progress Towards Closing the Social and Economic Gaps Between Maori and Non-Maori*, Ministry of Maori Development, Wellington, 1998.
[9] "Trade and Factor-Market Effects of New Zealand's Reforms", by Alan Deardorff and Ralph Lattimore, June 1999 (accepted for *New Zealand Economic Papers*).

the call network. There are constant complaints that it has abused its dominant market position.[10] Perhaps the most blatant example was Telecom's decision to match, street by street, the price for residential services offered to Lower Hutt customers by a US cable television company. Using a contestability argument the Commerce Commission found this was not an abuse of Telecom's market power.[11]

The second example of market failure involves electricity privatisation, which we will now describe.

The privatisation of electricity

Origins: fully publicly owned

Until 1992, the electricity sector in New Zealand was overwhelmingly developed and owned by central and local governments. In 1984, virtually all electricity generated in New Zealand was produced by the Electricity Division of the Ministry of Energy. It was also responsible for designing, and building new power stations, and for the transmission of the electricity to electricity retailers.

The electricity retailers were either elected supply authorities or departments of local government (municipalities or counties). They were responsible for purchasing electricity in bulk from the Electricity Division, developing and maintaining the local lines networks and meters, and selling electricity to retail customers. A few generated small amounts of electricity; very little was generated from outside these sources.

An important feature of power prices under this government-owned regime was that prices for domestic (home) users were kept consistently lower than for commercial users, although large industrial users were able to negotiate lower rates. For example, in the year ended March 1984, domestic prices were 4.70 cents per kWh, commercial 7.54 cents, and industrial 3.78 cents[12].

---

[10] TUANZ media statement, 17 May 1999; *Independent,* 18 November 1998 and 5 May 1999; *NZ Herald*, 1 June 1999.

[11] *Foreign Control Watchdog*, no.88 (September 1998), pp.29-30.

[12] *Energy Data File January 1999,* Ministry of Commerce, p. 118.

New Zealand is fortunate in being able to supply most of its electricity needs from renewable sources – mainly hydro. In 1998, 66% was from hydro sources, and 6% from geothermal. However, most of the best sites for these have now been developed and new generating facilities are likely to be increasingly from thermal sources, although there is trial use of wind generators (14.5 GWh in 1998). Use of renewable sources has dropped from 78% as recently as 1996[13]. Historically New Zealand has had low production costs in relation to the rest of the world. Even in 1998, average cost per kWh was 6.6 cents for industrial supply and 11.9 cents for residential, compared to 22.5 cents and 32.3 cents respectively for Japan, 8.2 and 17.5 cents for Mexico, and 7.8 and 9.0 cents for the U.S.A.[14]

The government ownership of our electricity assets survived the 1984-1990 Labour government, but in 1987 they formed a state-owned corporation, the Electricity Corporation of New Zealand (ECNZ), from the Electricity Division of the Ministry of Energy. This was put under the control of some of the most enthusiastic business supporters of the structural adjustment programme. They urged the government to privatise the corporation and to encourage private power generators. Private generators would have to use thermal power at much higher costs. That would have allowed ECNZ to raise its prices. It started selling off its smallest, oldest and least profitable stations. In 1994 the national grid was separated from ECNZ, by the creation of the state-owned Transpower New Zealand Ltd. Later, as we will see, ECNZ was split into a number of smaller companies, and in 1999 one of these was privatised.

Corporatisation in 1992

However it was not until 1992 that changes began to be made that affected consumers significantly. In that year, legislation was passed that required corporatisation of the local supply authorities. It also required that the cross subsidisation of domestic users by commercial users should end. The results were predictable.

---

[13] *Energy Data File January 1999,* Ministry of Commerce, p. 104, which tabulates electricity generation by fuel type in GWh.

[14] *Energy Data File January 1999,* Ministry of Commerce, p. 135, quoting the International Energy Agency's *Energy Prices and Taxes, 2nd Quarter 1998*).

Firstly, power prices for domestic users rose rapidly, while those for commercial users fell[15]. The average inflation-adjusted price of electricity for residential (domestic) users was nearly the same in 1992 (9.9 cents per kWh) as in 1983 (9.8 cents). However the price rose steadily from 1992 until it was 11.9 cents, or 20% higher, in 1998. Meanwhile commercial prices, which had fallen steadily since 1980, *fell* 15% from 12.6 cents in 1992 to 10.7 cents in 1998. Industrial prices remained almost constant over the period (apart from a sudden rise in 1998) tracking the national average prices. There was therefore a significant redistribution of the costs of electricity from corporate users to people in their homes.

Secondly, though some local authorities retained ownership of their electricity supply companies, other local authorities created community trusts to own the new commercially run companies, while a few began to sell their companies. This had far-reaching consequences.

One of the first power supply companies privatised was in the Waikato area, south of our largest city, Auckland. WEL Energy Group, the former Waikato Electricity Authority, was privatised in 1993, but not until the process had been challenged in the High Court by the Hamilton City Council. Half the shares were put into a community trust. The rest were sold to institutional investors, and at cut rates to electricity customers – many of which were almost immediately sold to institutions at a quick profit. Additional shares were issued to Utilicorp United of the U.S.A., as the "cornerstone" shareholder, giving it 33.3% and effective control at a price 13% less than other institutions paid. The community trust began a hard-fought campaign to get back control.

Catastrophe in Auckland

In Auckland, the result was even more extraordinary. The central government wanted the main Auckland power company, Mercury Energy, to be privatised. Local authorities resisted. Instead, the government forced on Mercury Energy a structure whereby it was owned by a community trust, but control rested with one of the country's largest law firms, which had exceptionally close relationships with many of the private corporations and individuals benefiting from the structural adjustment programme and

---

[15] The data in this paragraph comes from *Energy Data File January 1999,* Ministry of Commerce, p.

privatisations. Thus the community trust was unable to control the asset it owned, and Mercury Energy began an aggressive programme of taking over neighbouring power companies. It took on a prominent corporate raider and union basher from Australia, Wayne Gilbert, as its chief executive.

Mercury entered into a battle against Utilicorp for control of the other Auckland power company, Power New Zealand. The battle lasted four years, each side steadily raising its offer price to shareholders, accompanied by court cases, agreements, and broken agreements. In 1996, the High Court found that UtiliCorp had broken the Securities Amendment Act by failing to disclose deals it had done with local councils to buy their shares. A truce was declared in 1997 with Utilicorp and Mercury agreeing to take joint control of Power New Zealand. This was bitterly opposed by other shareholders and independent directors. At a shareholders' meeting the two companies were described as "Australian crocodiles and American alligators". Power New Zealand's deputy chairman, a former government minister from the same conservative National Party that had brought this about, attacked Utilicorp's behaviour, suggesting the company should withdraw from New Zealand's electricity sector[16]. He, the chairman and the chief executive were all sacked by the new owners. Mercury and UtiliCorp then used their combined strength to consolidate control of WEL in Waikato.

However that was only the beginning of the disaster for Aucklanders. From February to May 1998, the entire central business district of Auckland – the main business centre of New Zealand – was completely blacked out by a failure of the main power feeds. For Mexico, this would be as if the whole of the central business district of Mexico City lost its power for three months. First one of the three supply cables failed, then the second and then the third, all of which followed the same route, in a cascading sequence of failures. Businesses lost income, and had to use portable power generators or relocate, and many workers were told not to come into work. Mercury paid $128 million to compensate its angry customers and to carry out the work to remedy the power supply problems permanently. It announced in July 1998 that it could not afford to pay a dividend, having gone from a profit of $82.1 million in 1997

119. The costs are in March 1998 cents and exclude Goods and Services Tax (GST).
[16] Christchurch *Press*, 12/09/97, "Power play companies compared to alligators", p.25.

to a loss of $25.3 million in the year to March 1998[17]. An official inquiry showed that the company and its engineers had known about the vulnerability of the power feeds for several years, but the company had been too preoccupied by its takeover mania to do anything but make plans for an alternative feed.

Taking advantage of this weakness, Utilicorp grabbed control of Power New Zealand in August 1998. At the same time it sold its 40% share in WEL Energy back to the Waikato Energy Trust, the community trust – at over twice the price it had paid.

Meanwhile, struggles were going on for the control of other power supply companies, notably those around New Zealand's capital, Wellington and the nearby Hutt Valley. In 1994, TransAlta Corporation of Canada (also a co-owner of two thermal power generation plants in New Zealand) built up shareholdings of 20% in Hutt Valley power company, EnergyDirect, and then 49% in Wellington City Council's Capital Power. EnergyDirect was controlled by a community trust, which had imposed a 20% maximum on any shareholder to ensure it did not lose control. This was sabotaged by the New Zealand Stock Exchange which ruled that companies had to remove any cap to list on the Exchange. In 1995 TransAlta gained control by buying 20% of EnergyDirect from Power New Zealand.

The City Council handed TransAlta effectual control of Capital Power with only a 49% shareholding through a secret management agreement that gave TransAlta "the right to appoint the managing director or chief executive, [and] a right of veto on Capital Power's business plan, valuation, line charge, and statement of corporate intent."[18] Though it paid $20 million more than the nearest bidder, at a nominal $120 million, "capital restructuring" paid $32 million back to TransAlta and $33 million to the WCC on the date of settlement[19].

TransAlta then began work to push out the Wellington City Council and merge EnergyDirect and Capital Power. The Wellington City Council, headed by a mayor who had been a minister in the 1984-90 Labour Government, began a process of "consulta-

[17] *Press*, 4/7/98, "Power crisis costly", p.27.
[18] *Press*, 7/12/94, "Canadians buy Capital Power", p.51.
[19] *Press*, 9/12/94, "TransAlta Sweetener", p.20.

tion" with its citizens to see whether they wanted to sell the remaining 51% of Capital Power or merge it with EnergyDirect. The consultation was a sham. A "citizen's jury" that was set up by the Wellington City Council to hear the case for and against the sale came down unanimously against it and 12-2 against the merger. In addition to a public meeting in protest, 12 Wellington ratepayers unsuccessfully tried to block the sale in the High Court[20]. Ignoring the results of the "consultation", in 1996 Wellington City Council sold its share of Capital Power to TransAlta, and TransAlta then proceeded to merge the two companies. The merged company was owned 63% by TransAlta and 12.5% by the community trust.

By then, the Wellington company was the sixth largest power company in New Zealand with 8.5% of the national electricity market. Despite rapidly rising profits, it laid off 200 of its 530 staff[21]. It also raised its debt levels from 51% to 60% by moving all of TransAlta's New Zealand assets and debts into the company. The two electricity companies prior to privatisation had close to zero debt[22]. As we shall see, worse was to come.

Success of anti-privatisers

Not all councils and communities were being as rash or so short-sighted. In the South Island's two main centres, both the Christchurch and Dunedin City Councils retained ownership of their now corporatised electricity supply companies. Though domestic users still suffered from the new pricing policies forced on them, the Councils benefited enormously. Southpower, the electricity company of New Zealand's second largest city, Christchurch, diversified by buying a large North Island gas retailer. As market values of all energy companies rapidly inflated, Southpower made large windfall capital profits. These have enabled the Christchurch City Council to become debt free and about 25% of its income comes from companies it owns. It regularly wins prizes and polls for being the most popular and best run city in New Zealand (in 1996, Wellington rated least popular).

---

[20] *Listener*, 7/9/96, "A tale of two cities", by Brian Easton, p.50; *Press*, 1/8/96, "Power sale not stopped", p.36; *Press*, 20/3/96, "Cap power sale opposed", p.28.
[21] *New Zealand Herald*, 22/5/97, "Power NZ deal raises distribution ownership issues", p.C2; *Press*, 29/5/97, "Merger benefits drive TransAlta profit higher", p.31.
[22] *Press*, 6/9/97, "TransAlta assets", p.26.

The government and business lobby groups such as the largely transnational controlled Business Roundtable, detest the Christchurch City Council for continuing to own businesses, and for its popularity. Douglas Myers, the former head of the Business Roundtable, beer baron and richest man in New Zealand (he has now sold his beer empire to Mitsubishi), tried to attack Christchurch as being "the People's Republic of Christchurch". The Mayor and councillors silenced him by welcoming the description and printing the slogan on tee-shirts.

A further step towards the full conversion of the industry into a market was taken in 1996 with the formation of a wholesale electricity market, operating through a newly formed company, the Electricity Marketing Company Ltd. By 1999, it had been taken over by a subsidiary of the Rand Merchant Bank of South Africa, which had earlier entered the market as an electricity trader. Also in 1996, about a quarter of the Electricity Corporation's generating capacity was split off into a separate state-owned corporation, Contact Energy, to create competition in electricity generation. The government denied it was a forerunner to privatisation, but it was.

So by 1998, while corporatisation of New Zealand's electricity industry was complete, privatisation was only partial. Most of the electricity supply companies were still owned by community trusts and local government. Much of the privatisation was to overseas interests. Another huge step towards the sector's privatisation and overseas ownership was taken by the government that year.

The fiasco of the power blackout in Auckland – though caused by the government's own inept forced corporatisation of Mercury Energy – gave it the momentum for further changes. Using the blackout and the promise of reduced cost of electricity supply, the Electricity Industry Reform Act was passed in July 1998. At about the same time the government announced the split of the Electricity Corporation into three competing companies, intending to create further competition in electricity generation. It also announced the privatisation of Contact Energy.

The Electricity Industry Reform Act 1998

The new legislation made radical changes to the industry. It forced the separation of three main parts of the industry: generation, retail supply networks, and electricity re-

tail sale. The Act banned any company from owning an electricity supply network (lines) operation as well as either an electricity retailing or generation operation. The sales had to be completed by the end of 1999. It therefore forced all existing companies to divest themselves of "illegal" activities. TransAlta complained loudly and threatened capital flight[23]. It was indeed an unusual action for a neoliberal government to take: under the Multilateral Agreement on Investment or NAFTA it would be classed as expropriation and would be cause for compensation. Officials in the Ministry of Energy reportedly advised against the legislation.

Most power companies chose to retain their network, much easier territory because of the natural monopoly position it gave. Since most were owned by community trusts or local government, most made little attempt to expand, although mergers began to occur.

Utilicorp was the most aggressive. It changed the name of its newly captured Power New Zealand to United Networks, and began acquiring lines operations. It bought TransAlta's lines in Wellington, paying $590 million – almost double the valuation of $340 million[24]. At the same time, it sold its retail supply operation to TransAlta. Shortly after, 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[25]. It also had the highest prices of the lines operators in New Zealand's five main centres, according to an analysis by bankers ABN Amro. The cheapest were City Council owned Delta Utilities in Dunedin and Orion (split from Southpower) in Christchurch.

Utilicorp's purchase of TransAlta's lines in the Wellington region was once again strongly opposed by the community trust, the Hutt Mana Energy Trust, which by now owned 12.5% of TransAlta New Zealand. 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 deliv-

---

[23] *Press*, 2/6/98, "TransAlta threatens to pull out of New Zealand", p.18.

[24] *Press*, 14/11/98, "TransAlta NZ powers ahead", p.23; 9/12/98, "Power NZ earnings may double", p.28.

[25] *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.

ered 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 region, 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[26].

As we write, TransAlta Canada is making a bid to buy out the minority shareholders in TransAlta New Zealand, including the troublesome community trust. The trust is furious because TransAlta is taking advertisements in Wellington newspapers telling consumers they will get a windfall profit if the trust is bought out, effectively asking them to put further pressure on the trust to sell. The trust has made a complaint against TransAlta to the Advertising Standards Complaints Board, calling the advertisements unethical[27].

Supply companies: the scramble for customers and generating capacity

Four companies opted to amass as many retail supply customers as possible. They were TransAlta, state-owned ECNZ and Contact Energy, and Trustpower. Trustpower is a partially privatised former electricity authority, originally owned by local governments in the Bay of Plenty region on the east coast of the North Island. By the end of 1998, TransAlta had 530,000 customers, or about one third of the market. ECNZ had 470,000 and Contact Energy 430,000. Trustpower was some way behind with 114,000, but has since built that up to 218,000. "Virtually all New Zealand's approximately 1.9 million electricity and natural gas consumers are being supplied from seven companies as opposed to 39 at the start of the year" wrote Dow Jones Newswires at the end of 1998.

The process by which these customers were purchased almost guaranteed the failure of the sector restructuring. Hugely inflated prices were paid for electricity supply operations, with TransAlta leading the way, in large part financed by the sale of its lines operation to Utilicorp. It bought the supply operation of Christchurch's Southpower

[26] *Press*, 10/12/98, "Energy trust seeks help to block sale", p.28; *Dominion*, 11/12/98, "TransAlta vows to fight trust", p.11.
[27] *Press*, "Transalta ads upset trust", 3/9/99, p.26.

for $171 million – an operation that had been valued in 1997 by independent consultants at about $13 million. That was $770 per customer. Contact Energy on the whole managed to pay less, but still paid over $40 million for Dunedin customers, when the City Council owners had a reserve price of just $6.5 million. (In between, a local entrepreneur made a capital gain of $25 million buying and selling the operation in a matter of three months). ECNZ, in a desperate effort to get in on the fast-disappearing opportunities, bought the retail operations of Mercury Energy, the largest in the country, and Wairarapa Electricity. It paid between $900 and $1,300 for each of the 343,000 customers – more even than TransAlta's excesses.

The result has been retail price increases. In April 1999, TransAlta announced increases of 3 to 10% in Auckland, 5 to 10% in Wellington, and 13% in Christchurch[28]. It introduced substantial new charges for previously free services, including reconnection, disconnection, and final meter-reading fees. In Christchurch it used ripple control, previously used only for management of peak loads in winter, to switch off residential hot water cylinders over summer and autumn, simply to save itself money.

TrustPower 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 …"[29]

It was quite right. Where before, prices had often been set for a low or zero profit by the community-owned supply companies, now a commercial rate of return was expected by investors new to the sector.

---

[28] *Press*, 7/4/99, "Govt queries power charges", p.1.

The only relief for the government was that ECNZ set up a cut-price electricity retailing operation, called First Electric. It offered prices initially 15% lower than TransAlta's, with many customers getting even better reductions. It managed to offer these reductions, partly because ECNZ[30] generated its electricity, but mainly because it was set up with minimal assets and staff. Customers reach it by telephone, Internet or mail. The telephone calls are answered by staff in a contracted call centre in Australia, 2,000 km away from New Zealand. Even First Electric raised its prices following TransAlta's lead, but still claims its prices are between 7% and 20% below those of other retailers. It is instructive that, even though there is no cost to the consumer for changing between retailers, only a few thousand actually changed. In Christchurch, there were long delays in changing customers from TransAlta to other retailers. The theory of competition between retailers remains only a theory.

Both TransAlta and the Minister of Energy blamed the price rises on the lines companies, which of course maintained their natural monopolies. They particularly singled out the Christchurch, local government owned, Orion. They claimed, but have yet to provide evidence, that although Orion had sold the residential power meters to TransAlta, it had not reduced its charges accordingly. This did not explain why TransAlta and Trustpower had raised their prices nationally and not just in Christchurch. Orion responded that TransAlta had known the situation when it bought Southpower, and in any case, Orion's rate of return was modest compared to other companies and to the return the government required of its own corporations. However, the debate did highlight a further problem with the design of the new structures: meters and meter reading constitute a monopoly activity, which now belonged to the first retail companies to buy into a region.

The dubious case against Orion did not prevent the Minister of Energy introducing legislation in May this year to regulate the prices charged by the lines companies: something that should have been done right from the beginning, but which ideological purity had prevented. However lack of support from his coalition government partners

---

[29] Company preliminary result announcement, 14/6/99.

[30] Later provided by one of the three companies into which ECNZ was split from April 1999, Mighty River.

and the Parliamentary Opposition has meant that he has been unable to pass the legislation, and lines companies remain unregulated. Opposition on the Right was to the very principal of regulation; opposition from the Centre and Left was because the Minister dogmatically refused to regulate the prices of the retail companies or address issues such as the meter monopoly.

Also in early 1999, the government privatised generator and retailer, Contact Energy. It first sold a 40% "cornerstone shareholding" by tender. TransAlta, in amassing its large retail operation, had obviously been counting on winning the tender. In the event it was outbid by a large margin by Edison Mission Energy of the U.S.A. Edison paid $1.2 billion for its 40% shareholding. TransAlta was the next closest bidder, reportedly tendering under $1 billion – perhaps as low as $800 million – for the 40% share.

Edison's bid worked out at $5.00 a share and put a value of $3 billion on the whole company – double the $1.5 billion the government was reportedly hoping for, and about 3.4 times book value. That means that, on projected profits, Edison is looking at earning less than 2% on its investment (tax considerations aside) unless it can radically cut costs or investment, raise prices, or find some efficiencies by grabbing more of the market. The remaining 60% of shares were sold in a public offering at $3.10 – either implying future windfall profits for the wealthy individuals and (largely foreign) institutions that were allocated them, or underlining the excessive price that Edison paid.

Meanwhile, TransAlta and Trustpower were hastily attempting to accumulate generating capacity. The degree of imbalance for TransAlta is seen in the fact that while its customers use 8,000 gigawatt-hours (GWh) per year, it generates only 4,200 GWh annually. It must buy around half its electricity on the spot market or by contracting with competitors. It will therefore very likely be putting pressure onto the government for further privatisation of the electricity generating capacity present in the remaining three splinters of the still state-owned ECNZ. It seems likely that the combination of competition and excessive prices paid for generating capacity will lead to shortages of generating capacity in the next decade, with obvious consequences for security of supply.

Conclusions

The full consequences of a decade of changes in the New Zealand electricity industry are still not obvious. But some outcomes are clear.

Firstly, from being an entirely New Zealand owned industry, it now has a substantial private – and largely foreign – ownership. Contact Energy, controlled in the U.S.A., TransAlta, owned in Canada, and Trustpower – which is currently undergoing competing takeovers by Australian Gas Light of Australia, and Alliant of the U.S.A. – now generate over 40% of the country's electricity. Transmission is still state owned, but about 30% of the supply network is owned by UtiliCorp of the U.S.A. TransAlta, Contact Energy and Trustpower between them have almost two thirds of the electricity retail market.

Most of the new foreign owners have histories of aggressive advocacy of deregulation at home. TransAlta led deregulation in Alberta, Canada, which resulted in power blackouts in its first winter last year[31]; UtiliCorp deliberately creates and seeks out opportunities in the U.S.A. (on the basis of rulings of U.S. regulators and courts, Utilicorp has been described as "belligerent, dangerous, incompetent, litigious and given to price gouging" by Gregory Palast, a New York energy consultant who has testified as an expert against their price increases); and Edison Mission Energy has been expanding rapidly internationally, and has been involved in scandals in Indonesia where it was a partner in the first private electricity generation plant, established only after payoffs to the Suharto family, and is now producing electricity too expensive for the state-owned Indonesian distribution company to buy[32].

Secondly, while the various "reforms" were intended to increase competition and reduce prices, their results have been quite different. There is now considerably greater competition in electricity generation, through the creation of competing companies and a spot market, although the long term results of that are yet to be seen. It is likely they will lead steadily away from renewable forms of generation, and may well lead

---

[31] *Winnipeg Free Press,* 2/11/98, "Albertans prepare for winter in dark Blackouts imminent in energy-rich province".

[32] *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.

to under-capacity, either due to pressures on profits or to deliberate actions taken by companies to push up prices.

Competition in transmission and lines is non-existent, and it is not clear yet whether the necessary regulation will be put in place. The private owner of the largest segment of the lines networks has the highest prices; so a return to community ownership would seem a logical resolution which is unlikely to happen without a political struggle. The issue of ownership and design of power meters has yet to be properly resolved.

In electricity supply, prices rose continually for domestic consumers while falling for commercial users until this year's changes. They now have risen for most users and highlight the difficulty in creating competition in this part of the industry: consumers have not moved between retailers in anything like the numbers that would bring real competitive pressures.

Finally, there are the effects on workers and communities. You will have noticed little resistance from New Zealand unions in the events we have described. That is in large part because of the greatly weakened state of the New Zealand union movement generally. One of the largest unions representing workers in this sector – the Communication and Energy Workers Union – collapsed in the middle of the decade and its members were absorbed into other unions. Yet the affect on workers has been devastating at times, with more to come. Many jobs have been lost, and many workers are under stress due to insecurity and constant restructuring.

Local communities have also been affected, and the strongest resistance has come from them. Citizens have pressured their local government representatives to retain ownership of electricity infrastructure, municipal councils themselves have had heated debates, community trusts set up to own corporatised power authorities have struggled to retain the control of their assets, and small shareholders of the newly created companies have fought for local control. Specific features of New Zealand law have – often deliberately – made it difficult for communities to succeed. The most successful have been those who have retained local government ownership of their electricity infrastructure.

We are left with a dysfunctional electricity industry. Further changes are inevitable. What those will be, depends on community pressures and political developments within New Zealand.