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**Scanpower Limited Ownership Review Report**

Presented to

**The Trustees of the Scanpower Customer Trust**

27 June 2006

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## **Introduction**

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Scanpower Limited (“Scanpower”) was incorporated on 7<sup>th</sup> May 1993 with all shares in the company held by the Scanpower Customer Trust (“The Trust”) under the terms of the Trust Deed dated 30<sup>th</sup> April 1993.

It is a requirement of the Trust Deed (clause 4.1) that an ownership review be undertaken within three years of this establishment date and every five years thereafter. This review must include the preparation of a report which covers the following:

- a) A comparison of Scanpower’s performance relative to other electricity lines businesses and benchmarking thereof.
- b) A statement relating to the consideration of ownership views held by members of the public.
- c) An analysis of the performance of the Trust including an assessment of:
  - i) The advantages and disadvantages of Trust ownership.
  - ii) The benefits, or otherwise, to consumers of Trust ownership.
  - iii) The advantages and disadvantages of individual share ownership.
- d) An analysis of other ownership options.
- e) A statement of the conclusions of the Trustees as to the most appropriate form of ownership.
- f) A statement of the conclusions of the Directors of Scanpower Limited.
- g) A share distribution plan if required.

- h) A statement of changes required to the Statement of Corporate Intent if required.
- i) A summary of any professional advice received.

The purpose of this document is to fulfill the reporting requirements associated with the ownership review, and to present these to the Trust. A compliance summary is provided in the table below.

*Figure 1 – Trust Deed Compliance Matrix*

<b>Requirement</b>	<b>Clause</b>	<b>Met</b>	<b>Report Section</b>
Benchmark Scanpower Performance	4.1.3	✓	Section 1
Consideration of Public Views	4.1.7	✓	Section 2
Trust Performance Assessment	4.1.1	✓	Section 3
Analysis of Ownership Options	4.1.2	✓	Section 4
Conclusions of the Trust	4.1.4	✓	Section 5
Conclusions of the Directors	4.1.6	✓	Section 6
Share Distribution Plan	4.1.5	✓	Section 7
Changes Required to the SCI	4.1.9	✓	Section 8
Summary of Professional Advice	4.1.8	✓	Section 9

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## Section One – Scanpower Limited Performance

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The Trust Deed requires that the Ownership Review Report contain “a comparison of the company’s performance with the performance of other companies engaged in energy distribution”.

In March 2005 PricewaterhouseCoopers (PWC) undertook a benchmarking review of Scanpower’s performance at the request of the Chief Executive and Board of Directors. In that review, PWC selected the following peer group of companies for comparison:

*Figure 2 – Performance Benchmarking Company Group*

<b>Company</b>	<b>Location</b>	<b>Asset Value</b>	<b>Connection Density</b>
Scanpower	Dannevirke	\$20.3m	7.8
Alpine Energy	Timaru	\$85.7m	7.6
Buller Electricity	Westport	\$20.1m	7.0
Centralines	Waipukurau	\$32.3m	4.6
Eastland Networks	Gisborne	\$87.5m	6.8
Horizons Energy	Whakatane	\$73.2m	9.9
Network Waitaki	Oamaru	\$45.7m	6.2
Waipa Power	Te Awamutu	\$58.5m	10.5
Westpower	Greymouth	\$69.8m	6.0

*Notes:*

*Asset value represents the disclosed value of electricity distribution assets only.*

*Connection density represents the number of customer installations per square kilometre.*

*Data Source: “Electricity Line Business 2005 Information Disclosure Compendium”*

There are currently 28 electricity lines businesses in New Zealand. Excluded from the benchmarking group are predominantly the larger companies such as Vector (Auckland), Orion (Christchurch), Aurora (Dunedin), WEL Energy (Hamilton) etc. Where appropriate, comparison of Scanpower performance to the entire industry will be provided.

The following areas of performance have been considered in this review:

- a) Return on investment
- b) Cost efficiency
- c) Network reliability
- d) Returns to customers (discounts)
- e) Network Pricing

It is suggested that this combination of measures reflects the major components of over all company performance, including cost and return to shareholders and quality of outputs (i.e. reliability and efficiency).

### **Return on Investment Performance**

Return on Investment (ROI) is the most frequently referenced rate of return measure and the measure which the Commerce Commission uses as its preferred performance measure. Due to the impact of discounts it is necessary to utilise an adjusted ROI that shows returns prior to the deduction of customer rebates.

*Figure 3 – Adjusted ROI Performance Sorted Descending*

<b>Company</b>	<b>Adjusted ROI</b>
Alpine Energy	7.2%
Scanpower	7.1%
Horizons Energy	7.0%
Eastland Networks	6.4%
Westpower	4.6%
Centralines	3.6%
Buller Electricity	3.1%
Waipa Power	0.9%
Network Waitaki	0.5%

Average	4.5%
Median	4.6%
High	7.2%
Low	0.5%

All of the above data is based on disclosed 2005 financial results and is sourced from the “Electricity Line Business 2005 Information Disclosure Compendium” published by PWC.

As is evident, prior to payment of discounts, Scanpower’s ROI performance is strong relative to the peer group, ranking second highest at 7.1% and significantly above average of 4.5%. This suggests that Scanpower is generating a superior rate of return on investment for its shareholders when compared to similar companies. Furthermore, Scanpower performs better than the industry average of 5.8% across all 28 companies.

Unadjusted ROI reflects rate of return after payment of customer discounts. The table below summarises ROI performance of the peer group.

*Figure 4 – ROI Performance Sorted Descending*

Company	ROI
Alpine Energy	7.2%
Horizons Energy	7.0%
Eastland Networks	6.4%
Westpower	4.6%
Buller Electricity	3.1%
Centralines	2.6%
Waipa Power	0.9%
Scanpower	0.1%
Network Waitaki	-1.0%

Average	3.4%
Median	3.1%
High	7.2%
Low	-1.0%

After payment of discounts, Scanpower’s ROI is 0.1% which is at the lowest end of the scale.

This reflects Scanpower’s practice of distributing company profits to customers via the network discount mechanism. At 0.1%, the company is retaining only a small level of funds and paying the remainder out to the local community.

It is suggested that this combination of ROI performance measures is optimal from a shareholder’s perspective; i.e. Scanpower is achieving a relatively high rate of return and distributing the vast majority of it to shareholders / customers.

### Cost Efficiency Performance

Cost efficiency performance has been benchmarked on the basis of total direct and indirect costs per customer connection. This is a standard industry cost measure which again is available from the “Electricity Line Business 2005 Information Disclosure Compendium” published by PWC. The results are as follows:

*Figure 5 – Direct and Indirect Line Costs per Customer Connection*

<b>Company</b>	<b>Cost per Connection</b>
Buller Electricity	\$398
Westpower	\$366
Centralines	\$207
Horizons Energy	\$175
Network Waitaki	\$173
Eastland Networks	\$169
<b>Scanpower</b>	<b>\$165</b>
Alpine Energy	\$162
Waipa Power	\$160
Average	\$227
Median	\$173
High	\$398
Low	\$160

At \$165 per customer connection, Scanpower’s cost structure is relatively low in comparison to the peer group results ranking third lowest and below average and median comparatives.

This suggests the company has achieved a relatively efficient level of cost performance. The industry average across all participants is \$197 and Scanpower outperforms this by 16%.

### Network Reliability

A standard measure of electricity network reliability performance is SAIDI which stands for “system average interruption duration index”. SAIDI measures the average number of power outage minutes experienced per customer per year. 2005 performance for the peer group was as follows:

*Figure 6 – Network Reliability Performance 2005 SAIDI Results*

Company	SAIDI
Scanpower	71.3
Alpine Energy	79.0
Network Waitaki	104.9
Buller Electricity	134.0
Centralines	171.4
Waipa Power	278.7
Eastland Networks	282.5
Westpower	372.1
Horizons Energy	987.0

Average	275.7
Median	171.4
High	987.0
Low	71.3

As is evident, Scanpower produced the best SAIDI result for 2005 at 71.3 minutes lost per customer during the year.

A second key reliability indicator is SAIFI (system average interruption frequency index). As opposed to duration, SAIFI reflects the frequency, or number of interruptions experienced per customer during the year. Performance figures for the period are shown below.

Figure 7 – Network Reliability Performance 2005 SAIFI Results

Company	SAIFI
Scanpower	0.8
Alpine Energy	1.0
Buller Electricity	1.3
Network Waitaki	1.4
Eastland Networks	2.1
Horizons Energy	3.5
Westpower	4.2
Waipa Power	4.3
Centralines	4.4

Average	2.6
Median	2.1
High	4.4
Low	0.8

As with SAIDI, Scanpower produced the best SAIFI results for the year of the peer group at 0.8 interruptions on average per customer.

Taking into account both reliability performance measures, Scanpower was the most reliable network of the group for the year.

### Returns to Customers

Scanpower’s primary mechanism for returning financial benefit to customers is the annual network discount. This is applied as a credit to customers’ power accounts and is typically distributed in February and March.

Analysis of industry customer discounts is published on a quarterly basis by the Ministry of Economic Development. Industry results for the 2005 period are shown below.

*Figure 8 – Network Company Discount Analysis 2005*

<b>Company</b>	<b>Discount</b>
Scanpower	\$376
Mainpower	\$215
WEL Networks	\$207
Top Energy	\$200
Counties Power	\$176
Vector	\$170
Marlborough Lines	\$160
Network Tasman	\$150
Network Waitaki	\$150
Waipa Networks	\$137
Northpower	\$120
Buller Electricity	\$92
Electra	\$80
Electricity Ashburton	\$77
The Power Company	\$56
Alpine Energy	\$54
Centralines	\$52
The Lines Company	\$49
Aurora Energy	\$0
Eastland Networks	\$0
Electricity Invercargill	\$0
Horizon Energy	\$0
Orion	\$0
OtagoNet	\$0
Powerco	\$0
Westpower	\$0
<i>Average of Those Paying Discount</i>	<i>\$140</i>
<i>Average of Those Paying Discount (ex Scanpower)</i>	<i>\$126</i>

The discount amounts shown are those applicable to a “typical” residential consumer using 8,000 units of electricity per annum.

As the figures suggest, the Scanpower customer discount in 2005 was the largest in the country and significantly higher than other companies.

*Figure 9 – Network Company Discount Analysis 2005 (Peer Group Companies)*

<b>Company</b>	<b>Discount</b>
Scanpower	\$376
Network Waitaki	\$150
Waipa Networks	\$137
Buller Electricity	\$92
Alpine Energy	\$54
Centralines	\$52
Eastland Networks	\$0
Horizon Energy	\$0
Westpower	\$0

In comparison to the peer company group, Scanpower was well ahead with over double the discount of the next nearest performer, Network Waitaki.

Comparative figures for 2006 are not currently available. Scanpower’s discount for residential consumers was \$350 and it is anticipated that this would continue to place the company at the highest level in the industry.

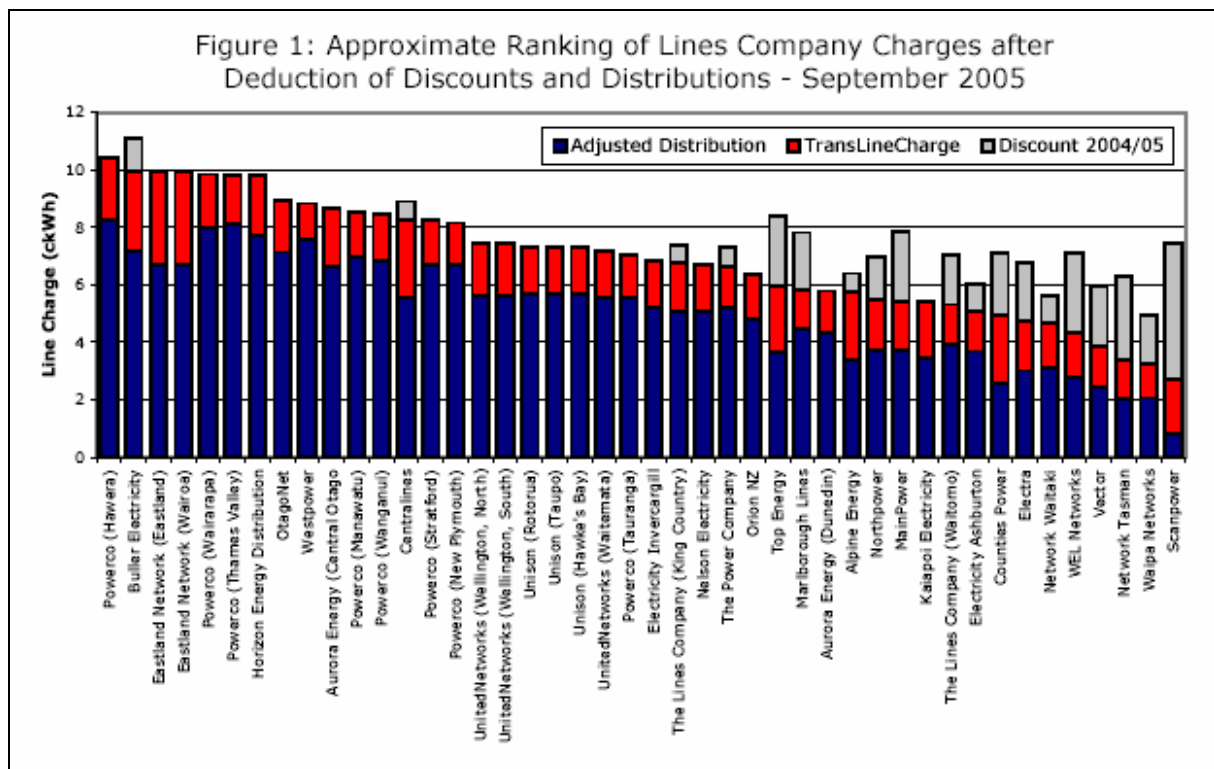
### **Network Pricing Performance**

Network company pricing is monitored and analysed periodically by the Ministry of Economic Development. In analysing the pricing of all companies, they publish adjusted, or effective, price rankings (i.e. adjust for network discounts and transmission pricing).

For several years Scanpower has held the position of lowest line charges in the country, after adjustment for discount. The graph below highlights the price rankings as at September 2005 with the effective charge rate represented by the navy blue component of the bar chart.

As is evident the impact of Scanpower’s large customer discount amount (represented in grey) is significant.

Figure 10 – MOED Ranking of Network Company Pricing



At the time of writing this report, Scanpower charges have again not been increased for the 2006/07 financial year, and the company continues to offer the lowest charges in the industry.

### Scanpower Performance – Concluding Comments

Based on the objective data available, it is possible to assess Scanpower’s performance relative to peer companies and the distribution industry in general. This performance is summarised as follows; Scanpower

- Offers the highest level of reliability in comparison to similar companies.
- Has the lowest network charges in New Zealand after deduction of discounts.
- Provides customers with the highest levels of discount in New Zealand.
- Maintains a good level of cost efficiency relative to similar companies.
- Earns a relatively high rate of return (ROI) for investors

On this basis it is suggested that Scanpower is currently performing very strongly.

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## Section Two – Consideration of Views Expressed by the Public

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Clause 4.1.7 of the Trust Deed requires the Ownership Review Report to include a statement as to whether the Trustees have had regard to any views expressed by the public with respect to ownership.

In relation to this, The Scanpower Customer Trust conducted a survey of network customers to ascertain their views on a range of possible ownership options. This survey was administered by Scanpower Limited and carried out in early June 2006.

The survey forms and instructions were the same as those used for the previous ownership review. They were checked and approved at that time by market research expert Ron Garland of Palmerston North. Returned survey forms were counted under supervision and checked for accuracy.

New Zealand Post was contracted to deliver survey forms to all customer premises within the Scanpower area, amounting to approximately 5,500 sites. 1,103 valid survey responses were received representing a 20% response rate. The survey results are summarised as follows:

*Figure 11 – Summary of Customer Survey Results*

<b>Ownership Option</b>	<b>Votes</b>	<b>% Votes</b>
Customer Trust (as at present)	1,063	96.4%
Direct customer ownership of all shares	27	2.4%
Outright sale of Scanpower Limited	2	0.2%
Mixed Ownership (Trust has controlling share)	8	0.7%
Mixed Ownership (Trust has minority share)	3	0.3%
<b>TOTAL</b>	<b>1,103</b>	<b>100%</b>

### **Section Three – Performance of the Trust**

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Each year the Trust approves a Statement of Corporate Intent (SCI) prepared by Scanpower Limited. This contains the objectives and operating principles for the company for that period. It also includes financial forecasts and key performance indicators. Through Trust approval of the SCI, these financial and performance forecasts become the annual operating targets for the Board and Management of Scanpower Limited.

The Trust is not able to directly manage Scanpower's performance, however it does have an overall influence on this through the SCI process. The SCI allows the Trust to establish a desired direction for the management of Scanpower Limited and over the course of the year the Trust may conduct broad monitoring of actual performance against this. Trust feedback to the Board of Directors provides a key level of influence over the strategic direction and operating practices of the company.

Therefore, on one level, the performance of the Trust may be considered in the context of the performance of Scanpower Limited. The SCI directs Scanpower to provide a reliable electricity supply at the lowest possible sustainable prices while having regard for environmental, community and employee values. As noted in Section One, performance in this regard may be characterised as follows:

- The Scanpower network has the best reliability performance results of its peer group.
- Scanpower network charges are the lowest in the country after deduction of the customer discount.

In addition to this, the SCI establishes a vision for Scanpower as “a locally owned business providing opportunities for growth”. This is underpinned by the following set of strategic objectives:

*Figure 12 – Statement of Corporate Intent Strategic Objectives*

*“To deliver a reliable and safe supply of electricity to our customers”*

*“To provide a cost effective supply of electricity to our customers”*

*“To earn a commercially appropriate rate of return on our assets”*

*“To generate additional earnings from other commercial activities”*

*“To deliver financial benefits to our community via the network discount”*

*“To add value to our region through our operating practices and community initiatives”*

These objectives as set out in the SCI are laudable from the points of view of the community and the economy of Southern Hawkes Bay, as well as Scanpower’s customers and owners. It is suggested that there can be no grounds for criticism or dissatisfaction with the objectives set out and approved by the Trust.

Section One covers the issues of reliability, price, network discount and rate of return performance, with strong results achieved in all areas. In regard to the matter of growth and generation of earnings from new commercial activities, attention is brought to the following:

- Scanpower has doubled its number of employees over a four year period as a result of continuing profitable growth. This has provided additional valuable employment and training opportunities to the community.
- New business initiatives developed over the period include establishment and growth in Plumbing & Electrical Contracting, establishment of a Meter Reading Division, establishment of the Treesmart Division, and growth in the Network Contracting Division.

The company appears to maintain an ongoing desire to seek out new business ventures and investment projects. It is suggested that Scanpower has been successful in pursuing a growth strategy as directed by the SCI.

In conclusion, it appears reasonable to maintain that:

- The Trust has developed a set of appropriate strategic objectives and performance measures via the SCI process; and
- Scanpower, with the approval of the Trust, has been successful in pursuing these objectives and performance targets.

The Trust's performance may be considered to be effective and satisfactory on this basis.

### **The Advantages and Disadvantages of Trust Ownership**

The key advantage of Trust ownership is that the Trust can set whatever objectives it wishes for Scanpower Limited and then follow through to ensure that these objectives are achieved. The Trust has decided upon a set of customer-related and community related objectives as set out in the SCI.

The fact that these objectives are customer and community focused, rather than profit-focused as would be the case for an investor-owned company, is evidence of this central advantage of Trust ownership. In establishing performance requirements the Trust has developed a set of objectives that it regards as economically and socially important to the Southern Hawkes Bay Region. In practical terms, the primary requirement is to deliver the best possible service at the lowest cost to Scanpower customers.

This pricing feature illustrates the principal disadvantage of an investor-owned company. An investor-owned company must pursue the interests of its owners; these interests require that the company pursue profits or a high rate of return on the owners' investment. The inevitable consequence of pursuing this objective would lead to higher prices for Scanpower customers.

An important feature available to a Trust owned lines business is the ability to use network discounts to effectively reduce pricing to the lowest level consistent with a sustainable business.

This mechanism is available to Scanpower and has been used to the extent that network pricing is the lowest in the country. It is noted that an alternative method of achieving this would be to set list prices at a low level, however this provides less flexibility for the company to deal with unexpected events or to manage risk.

The discount mechanism has substantial tax advantages over other means of managing profits, such as dividends, that are available to investor-owned businesses. Dividends are paid from after-tax earnings whereas discounts reduce pre-tax earnings. Accordingly the benefits to customers from discounts is approximately 50% (corporate tax effect and personal income tax effect) more than if those same customers had received the profit as dividends. Customer owners therefore gain a significant advantage from the policies adopted by the Trust.

There are several possible disadvantages to Trust ownership. These involve the cost of operating the Trust, potential difficulties in raising new capital, diversion of profits to special interest groups, and inability to achieve economies of scale. These issues are discussed below.

The cost of operating the Scanpower Customer Trust is covered by a dividend paid by the company on an annual basis. It is typically in the region of \$45,000 per annum, with an increase to \$75,000 in years when high cost activities such as Trustee elections and ownership reviews are undertaken. At an average of \$50,000 per annum, the costs of running the Trust amount to 2.5% of the typical annual network discount. This level of cost is immaterial in comparison to the financial benefits to customers arising from Trust ownership.

It is often stated that trust-owned businesses can find it problematic to raise new capital, for example to finance acquisitions. There is some truth to this assertion as trust ownership can be inimical to generating a competitive rate of return on new capital. However, it is suggested that these dangers do not apply to Scanpower. The company has little need for new capital, as it is not currently involved in acquisitions and funds network asset replacement from working capital. Scanpower has no long term debt and given the strength of its balance sheet and cash flows could readily raise substantial funds if the appropriate investment project were identified.

Another common criticism of trusts is that trustees, for whatever reason, spend a disproportionately high amount from the business on activities of benefit to narrow or special interest groups, and not to the benefit of the broader base of beneficiaries. This criticism has some merit in the context of the electricity distribution industry as whole where it is not uncommon for large donations to be made to particular projects of interest to the trust, or to placate special interest groups in the community.

Whether or not this risk eventuates depends on the leadership of the trust and on the procedures that the trust chooses to follow. In the case of the Scanpower Customer Trust the risk is minimised. This is because the Trust has chosen to use the Statement of Corporate Intent process to manage its ownership of the business and to include in the Statement the requirement that network discounts be distributed to customers on an equitable basis, as so that excess profits are not made. In this way, no excess profits are generated in the first place, so there is no flow of surplus cash to the Trust that could be used for special interest purposes.

Scanpower is a relatively small utility business, operating one of the smallest networks in New Zealand. In theory this would suggest that the company is not able to benefit from economies of scale which might be achievable in a larger, amalgamated network business. In fact, this does not necessarily appear to be the case. As the benchmarking analysis in Section One suggests, Scanpower operates relatively efficiently in regard to direct and indirect costs. Review of broad industry data shows no obvious correlation between cost efficiency and size, with some of the largest lines businesses showing relatively high costs. This may suggest that increasing scale may generate diseconomies of scale and therefore the optimal company size is not necessarily obvious.

Trust ownership in general has advantages and disadvantages. How these work out in practice depends very much on the policies and procedures of the specific trust under consideration. It is suggested that the Scanpower Customer Trust has adopted appropriate policies and followed procedures to maximise these advantages while avoiding potential disadvantages.

## **The Benefits to Customers of Trust Ownership**

Electricity consumers are interested essentially in two features – a reliable supply and a low price. The benefits or otherwise of trust ownership must be evaluated against these two criteria.

The SCI sets out objectives regarding reliability and pricing. Scanpower has delivered against these objectives, notwithstanding the impact of exceptional weather events on network reliability from time to time. As the benchmarking study has shown, in most recent results Scanpower provides the most reliable electricity supply of its peer group, and at the lowest price in New Zealand when discounts are taken into account. The results provide prima facie evidence that the current ownership structure has performed well for consumers.

How much of this is due to the Trust ownership structure? The Trust has set the direction and objectives for Scanpower through the SCI. The emphasis placed on the importance of local consumers by the Trust has undoubtedly had an effect in securing low priced, reliable services from Scanpower. It is suggested that this focus would not exist to such a great extent under an investor-ownership model. The specific policy of network discounts has had an enormous effect on delivered prices and is central to the Trust ownership philosophy. It must be concluded therefore that a major part of Scanpower's success in providing a reliable supply at a low price is directly associated with its Trust ownership structure.

## **Individual Ownership of Shares by Customers**

At present customers own Scanpower indirectly via the Scanpower Customer Trust. The Trust nominally owns all shares in Scanpower, with the beneficiaries of the Trust being the electricity customers of the day.

A different possible ownership structure is that in which the customers directly own the shares in Scanpower Limited. This would require the shares to be allocated to customers on a specific date, which is referred to hereafter as the “vesting” date.

From that date, those customers would own the shares and would be free to manage these assets as they wished, including the possibility of selling the shares. Essentially, vesting the shares with individual customers at a given date would be equivalent to shifting to an investor-owned model. The only unique feature would be that at the vesting date, the shareholders and the customers are one and the same. Thereafter however, there would be no necessary relationship between shareholders and customers due to sale of shares and relocation to areas outside of the Scanpower network.

There are both advantages and disadvantages associated with individual share ownership.

The advantages are those typically associated with investor ownership and include windfall gains to customers at the vesting date, potential access to more capital, pressure to increase rates of return via merger / acquisition and cost reduction initiatives.

Customers on the vesting day would receive title to the shares in Scanpower Limited. They would not have to purchase these shares. When and if they sold their shares however, they would receive the market price for the shares (assuming that a market and a demand for the shares in fact existed). Therefore they would generate a significant profit on the sale. In other distribution companies around New Zealand where this has occurred, gains have been in the order of \$1,000 to \$3,000. This is a substantial benefit to those customers in place at the vesting date. Were the shares retained, financial benefit would flow to these customers in the form of dividends.

The other potential advantages of individual ownership do not appear to be particularly applicable to Scanpower's situation; as previously noted there is little or no need for additional capital, and rates of return and cost structures are favourable compared to peer companies. On this basis therefore, the one-off windfall at the vesting date is the primary advantage associated with a change to individual share ownership.

The primary disadvantages of individual ownership are that customers in general will become worse off, and that the financial benefits of the business go to an arbitrarily selected group of people.

It is indubitable that individual ownership would result in cessation of the annual network discount, likely combined with higher prices aimed at increasing shareholder returns. It would be a fiduciary duty of the Directors to maximise the return to shareholders in this manner. The financial benefits associated with this would flow to shareholders either in the form of dividends, capital gains on share value, or a combination of both. Removal of the network discount would see annual charges increase by the discount amount, most recently \$350 per annum, representing approximately three months of electricity accounts for typical residential consumers. In addition to this, there is potential for network reliability to deteriorate as there would no longer be an incentive to offer a high level of supply quality when an average level could be provided at a lower cost.

The identity of the beneficiaries is a subtle yet important disadvantage to the community of investor ownership. The initial owners would be the customers who happened to be connected to the network on the vesting date. These people would receive the benefit of the business built up over many years and expected to continue into the future. Customers who left the area or disconnected their supplies immediately before the vesting date would receive no benefit. Similarly, customers connecting immediately after the vesting date would receive no benefit. It is considered somewhat arbitrary that the entire benefit of Scanpower ownership would pass to a group of current customers on one specific day.

The trust structure, in contrast, does not single out any one particular group of customers. Instead the beneficiaries are the customers in every year in the present and future; i.e. the benefits effectively accrue to customers in perpetuity.

The balance between the advantages and disadvantages of individual share ownership, in Scanpower's case is readily apparent. On a simple utilitarian basis, the disadvantages of individual ownership outweigh the advantages for ongoing customers, new customers, and the community over time. The trade off is essentially a one-off windfall gain for current consumers versus a stream of ongoing benefits to the entire community over time. It is suggested that the value of the one-off windfall could quickly be offset by increasing prices, cessation of network discounts and diminished network reliability. On this basis it is concluded that the disadvantages of individual share ownership outweigh the advantages.

## **Section Four – Review of Ownership Options**

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In terms of ownership options, the following possibilities are identified:

- Trust ownership
- Share distribution to customers
- Sale of shares to the public
- Sale of shares to institutional investors
- Sale of the business to another electricity distribution company
- Merger with another trust-owned electricity distribution company

The summary features of each of these options are discussed below.

Trust ownership, the present system, has proved extremely beneficial to customers as well as reflecting the interests of the Southern Hawkes Bay community. As had been evidenced, the current structure continues to deliver reliable and efficient services at a very low cost.

The option of vesting shares with individual consumers would change Scanpower into an investor-owned business as has been discussed above. Whilst customers at the time of vesting would make a significant gain, all future customers would suffer the cost of this through increased real prices and reduced reliability.

The sale of Scanpower to the public would likely lead to higher prices also for the reasons associated with an investor-ownership model. Whilst the Trust might retain the proceeds of the sale of shares and invest this on behalf of the community, the tax advantages associated with the network discount would be lost. Sale to an institutional investor would be the equivalent to a sale to the public, with the same likely results, as would sale to another electricity company.

The merger option is a complex one to assess. Whilst a round of industry amalgamation, merger and acquisition occurred around 1999 – 2001, this has now slowed.

It is theoretically possible that a merger may result in lower cost structures and potentially lower prices, however as previously noted, it is not clear when economies and diseconomies of scale kick in for electricity distribution businesses. It is noted that a merger option is not incompatible with ongoing Trust ownership. It is suggested that the advantages and disadvantages of any proposed merger would need to be carefully and specifically considered, should the situation ever arise.

### **Concluding Comments on Ownership Options**

Several ownership options are available for Scanpower. These range from the status quo to ownership by external investors, be they individuals or other companies. The operational, financial and tax benefits of trust ownership are significant and have been proved in practice for many years at Scanpower. It is further noted that the majority of electricity distribution companies in New Zealand continue to operate under a trust ownership structure for the same reasons (24 of the 28 distribution companies are currently members of Electricity Trusts of New Zealand).

The decision to move away from trust ownership, whilst offering a windfall benefit to current consumers, would deprive all future customers of the benefits identified. This has been seen, for example, in areas of the Wairarapa where assets were sold to Powerco; these customers now pay some of the highest prices in New Zealand with a deteriorating quality of supply. Therefore, at this time trust ownership is considered to be the best option for customers and the local community.

## **Section Five – Conclusions of the Trustees**

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In accordance with the Trust Deed, the Scanpower Trustees have reviewed the various ownership options for Scanpower Limited.

The Trustees met on 27<sup>th</sup> June 2006. At this meeting the Trustees agreed unanimously and resolved that the present Trust structure is the best form of ownership for the company. The Trustees will be making this recommendation to customers.

The Trustees will hold a public meeting on 1 August 2006 (also the annual general meeting) to receive customer responses to the review and recommendation.

## **Section Six – Conclusions of the Directors**

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The Directors of Scanpower Limited have considered the question of the best future ownership structure for the company. The Directors have concluded unanimously that the present Trust ownership structure is and will continue to be the best form of ownership. The Directors' conclusion is:

*“It is the unanimous opinion of the Directors that the present Trust Ownership of all of the shares in Scanpower Limited is not only the most advantageous form of ownership of all the shares now, but is also likely to continue to be the most advantageous form of ownership in future years”*

This was resolved by the Board on 27 June 2006 and is recorded in the minutes of that meeting.

## **Section Seven – Share Distribution Plan**

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No share distribution plan is required based on the opinion of the Trustees that the current ownership structure is the best for Scanpower Limited.

**Section Eight – Modifications Required to the Statement of Corporate Intent**

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On the basis of the conclusions reached by the Trustees, expressed above, no changes are required to the Statement of Corporate Intent as a result of the trust ownership review.

## **Section Nine – Summary of Professional Advice Received**

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The 2005 ownership report has been compiled and reviewed by Lee Bettles (Chief Executive) and Ben Van Der Spuy (Company Accountant) of Scanpower Limited.

The primary source of lines company performance and benchmarking information has been the “*Electricity Line Business 2005 Information Disclosure Compendium*” published by PricewaterhouseCoopers. In addition to this, material contained in a specific review of Scanpower Limited’s performance by PricewaterhouseCoopers has been included in this report, most notably the choice of peer group lines companies and benchmark performance measures.

The customer ownership survey was designed and approved by Mr Ron Garland, Market Research Consultant of Palmerston North, at the time of the previous ownership review in 2001. No reason was noted to change the format or contents of the survey material for current purposes.

Elements of the 2001 ownership review report completed by E-DEC Limited of Wellington have been replicated (in part) in this report (most notably Section Four). It was considered that the discussion of different ownership options provided by E-DEC Limited was still relevant to the current situation.