ISSUE 1315

"In Support of Progress"

Newsletter

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Dividend Policy

In the last newsletter I raised the issue of the Hydro dividend. It is well worth our while to also examine the arrangements for electricity transmission and distribution. The Treasury papers once again tell a story (in $'m):

Table 1

		2012-13	*2013-14*	*2014-15*	*2015-16*	*2016-17*
Transend	Dividend	28.9	26.9			
	Tax Equiv	31.7	18.4			
Aurora	Dividend	14.3	30.1			
	Tax Equiv	6.1	25.6			
New Entity	Dividend			57.6	51.6	45.7
	Tax Equiv			40.8	35.8	41.7
TOTAL		81.0	101.0	98.4	87.4	87.4

The separation of Aurora (see Newsletter 1304) into its three separate components means the poles and wires business will merge with Transend. There is absolutely NO reason why there needs to be a "new" entity – Transend should simply increase its spread. So much wasted effort (employees, consultants) and unnecessary expenditure (over $5 million so far and counting) is going into working out HOW this merger will take place before it does so.

Much simpler to simply bring them together and let them work it through as a going concern. No-one in their right mind, considering the SNAFU that Aurora has been, would contemplate Aurora management having any say – surely not!

Now when it comes to revenue, these entities are obliged, because of their monopoly, to have their charge base approved by the Economic Regulator. This position was established to ensure protection for consumers from market gouging. What a failure this exercise has been. And here is why.

These entities are awarded/rewarded their revenue based on the value of their assets. They cannot charge in excess of a predetermined formula. So, does this protect the consumer? Well, no it doesn't, because in order to increase revenue, all the entity has to do is increase the value of its assets. High levels of capital expenditure, what we now call gold–plating, ensure the assets improve in value. New and unessential assets are brought into the mix, and all assets regularly revalued. The Economic Regulator has NEVER questioned whether these expenditures and revaluations are necessary.

You can't blame the entities. After all, they are only following the rules. The government is not going to change these rules, because a higher income means a higher dividend. Just check the chart above. And who pays - the end user. Those whose interests the Regulator was appointed to protect have been sorely abused and abandoned by this process.

So what needs to happen is for the Regulator to conduct a review of *essential* assets, as a prelude to any further determination. I suspect there would be a significant devaluation, and a significant reduction in tariff. It would definitely enforce a degree of commercial rigour that has been sadly lacking until now. However, it would also be a significant heartache to the entities, and to their shareholder, the government.

However, the story does not stop there. Because the entities are assured a certain level of income.

Imagine for a moment an entity with 5 customers, who take respectively 30%, 25%, 20%, 15% and 10% of the power supplied. See Table 2. Imagine also that the take was $100 million (column 1), and the entity has been able to increase their income by 20%, based on an asset revaluation (column 2).

Table 2 (in $'m)

	Original	Asset reval.	Loss of 25%	Sum
30%	30	36	Add 12	48
25%	25	30	Lose 30	0
20%	20	24	Add 8	32
15%	15	18	Add 6	24
10%	10	12	Add 4	16
TOTAL	100	120	0	120

One of the customers (say the 25% customer) then says this increase has put it over the edge – I am packing up and leaving. The entity does not then lose the $30 million - NO. The rules say that the entity can now pass that cost onto the remaining customers. Column 3 tells the story - suddenly, <u>all</u> customers have to pay more - now all customers are at risk, and face the real threat of closure.

It was easy when times were good. But times are no longer good, and the sceptre of closure hangs on many an industrial enterprise. If they all close shop, there will be no-one to pay the bills. And that will mean the entities and the government are left with a significant set of stranded assets.

So, as Randy Jackson used to say on American Idol, "Here's the thing". Government policy must be directed at REDUCING these figures, not increasing them. To do that, there are a couple of options, not necessarily exclusive of each other. One is to reduce the value of the asset base. However, as we have seen, that hurts the entities - and the government. The other option is to increase the size of the pie. New entrants wanting lots of power.

New entrants will enable a greater sharing of the cost, and would make power cheaper for all. And yet NO-ONE is talking this talk. Growth and investment is the sure-fire way to ensure that the real value of these assets are realised, the economy strengthened, and jobs generated.

Old-fashioned maybe, but true none–the-less. And this is what the China-related trade missions should be seeking out –not just markets, but investment.

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