

To: The New Zealand Productivity Commission

From: Christchurch City Holdings Limited (CCHL)

Date: 27 February 2012

SUBMISSION ON DRAFT REPORT ON INTERNATIONAL FREIGHT TRANSPORT SERVICES

1. Executive Summary

- 1.1. We are concerned about the emphasis in the report on the inadequacy of Local Government ownership when there are good models which are efficient and effective
- 1.2. The issue at hand here is not local government ownership, but the operating model and structure used by many local governments to run their commercial operations
- 1.3. The report draws general conclusions from specific problem areas and disregards very effective Local Government models
- 1.4. Report has bias against local government ownership - when it can be made to work efficiently
- 1.5. There is no reason why a fully commercial board at arms-length from Council cannot be as efficient as a private or partially private company based on the appointment of professional directors with appropriate accountability
- 1.6. The report over-emphasises the listed company model as being the most effective way of ensuring a company is accountable and operates efficiently.
- 1.7. The report fails to recognise the difference between Ownership and Operations
- 1.8. The report makes wrong assumptions about the Christchurch City Holdings model and the effectiveness of its governance structures.

2. CCHL model

- 2.1. CCHL is a wholly owned subsidiary of the Christchurch City Council which is set up to hold the shares in a range of trading subsidiaries.
- 2.2. It has a board of 8 directors, 4 are commercially experienced directors and four are Councillors who have been selected from amongst all interested Councillors by a defined process which selects the best persons for the positions. This is defined in the Councils policy on the appointment of Directors (see attached)
- 2.3. The CCHL chair is one of the non-Councillor directors and under the overview of the Chair the company operates with commercial protocols whereby all directors must act in the best interests of the company and not the shareholder.
- 2.4. Councillor directors are appointed to give the Council confidence that it has the community viewpoint at the CCHL board table.
- 2.5. CCHL monitors its subsidiary companies through a well structured process of Statements of Intent, quarterly reports and regular meetings.
- 2.6. Subsidiary companies represented by their Chair, CEO and other staff as needed, meet the CCHL board at least twice a year to provide company updates, answer questions and consult on major issues.
- 2.7. CCHL does benchmarking of its companies against comparable industry companies and challenges its subsidiaries to explain adverse results/ (a copy of a recent review of ports was provided when I visited the Commission recently)
- 2.8. CCHL appoints directors to each of the subsidiary boards through a process described in the next section of this submission. The appointment of quality directors based on merit is one of the key strengths of the CCHL model. Because of the separation of the commercial operating boards from the Council (through the

- imposition of an intermediate holding company) CCHL attracts the highest calibre directors in the country.
- 2.9. Directors of subsidiary companies act professionally and take pride in governing their company to the best professional standards. While they are respectful of the Council as the ultimate owner, subsidiary company directors are not influenced to depart from professional standards and good commercial behaviour by Council outside of anything agreed to as part of the Sol process.
 - 2.10. CCHL has a strong policy of not interfering in the operations of its operating subsidiaries.
 - 2.11. Councillors and the Council are not allowed to direct trading subsidiaries on any matter.
 - 2.12. All enquiries from Council about trading company issues must go through the Chair or CEO of CCHL.
 - 2.13. CCHL acts as an effective buffer between the elected Council and the operating subsidiaries.
 - 2.14. CCHL reports formally to Council through written reports or workshop discussions at a high level while maintaining confidentiality on sensitive information provided by subsidiaries.
 - 2.15. Subsidiary companies have grown in confidence to share confidential information with CCHL since the early days of establishment in the 1990's because we have proved that they can share commercial information and it will not become public.

3. Director Appointment Process

- 3.1. The Council has adopted a policy of appointment and remuneration of directors as required by the Local Government Act. This policy was originally drafted by CCHL and apart from some minor changes initiated by CCHL it remains unchanged. The central premise of the policy is appointment of directors on merit.
- 3.2. Only in the case of the holding company is there a requirement for Councillors to be on the board. This has a specific purpose to help maintain the confidence of the Council. See points 2.2 to 2.4 above. CCHL Councillors are selected by a process assisted by an external management consultant.
- 3.3. Directors of subsidiary companies are appointed after consultation with the chair of the respective board. Services of a management consultant are used to search for suitable candidates who meet the board's needs. From this a shortlist is developed which is then interviewed by the CCHL governance committee.
- 3.4. CCHL recommends the appointment of new directors to the Council. The CCHL constitution requires that Council approve all new appointments.
- 3.5. There has never been a case in the history of the company where Council has rejected a recommendation from this selection process. This is in contrast to the SOE model where it is clear that the Minister has a strong influence on who is appointed to SOE's.
- 3.6. Directors once appointed act professionally and show real commitment to acting in the best interests of the company and its efficiency.

4. Listed Company Status not the only effective model

- 4.1. In the report there is a strong flavour that being listed on the NZX is the most effective method of ensuring that directors are accountable and act to ensure efficiency.
- 4.2. Stock Exchange listing adds a significant additional expense to the operation of the company because of need for continuous disclosure.
- 4.3. There is a risk that the focus on the listed share price can work against making long term decisions in the best interest of the company.
- 4.4. CCHL contends that listed company status is not the only way of ensuring efficiency and productivity.
- 4.5. CCHL would accept that if there was an ongoing need to raise capital, the listed status would be of benefit. This ongoing need for capital is not typical for companies

that hold infrastructure assets that are geographically constrained, where all asset replacement and maintenance comes from operating cash flows

- 4.6. The CCHL model described above, provides excellent accountability and protects operating subsidiaries from political interference. Directors have autonomy to make decisions in the best interests of the company but are still held accountable to CCHL.
- 4.7. A hybrid listed company with a majority stable single owner limits the degree to which the company can be accountable to the major shareholder because of the NZX rules which limit information flow to what is provided to all shareholders. This mixed model is not automatically a panacea.

5. Specific points of concern in draft report

- 5.1. The report is highly reactive to some examples of poor governance by local authorities in ownership of CCTO's and assumes that all Council owned arrangements are similar. In this way it argues from the particular to the general and unfairly assumes that all models of local government ownership are flawed.
- 5.2. The report has a strong flavour of the ideology that local government cannot act in a commercial way. This prejudice is unfair given the well developed operating model which applies to CCHL and also in other places such as New Plymouth.
- 5.3. The SOE model is lauded in the report as being a good model to follow. There are many good aspects to the SOE model and CCHL was originally set up using the SOE model as a guide but our observation of Crown behaviour as a shareholder partner in Christchurch International Airport is that the Minister is more involved with director appointments from time to time. In the CCHL model this does not happen.
- 5.4. The draft report quotes the arrangements for governance of CCHL with respect to the appointment of Councillor directors to CCHL and assumes that this is the same model which is applied to the operating subsidiaries and assumes that this provides opportunity for elected members to give direction to subsidiaries (page 149 of report). This is not the case. As noted above, the CCHL model appoints directors on merit to operating subsidiaries and gives autonomy of operations to the boards of those companies. There are currently no Councillor directors on any of the CCHL subsidiaries.
- 5.5. EVA and NZX listed status is promoted in the report as being the best means of improving governance performance. CCHL has some serious misgivings about this because:
 - 5.5.1. Some years ago commercial directors of LPC focussed heavily on EVA and ended up letting the assets run down because they were focussed in the short term. In time this necessitated a major catch-up on renewal expenditure.
 - 5.5.2. An example of this from the energy sector is the debacle when the Mercury Energy supply line into Auckland failed causing major economic problems for Auckland. This was caused by lack of attention to maintenance and renewal probably due to a focus on share value. Moderation is needed in such issues and they are not an end in themselves. Orion, a CCHL owned company took lessons from the Auckland experience and reinforced their network and it was this that enabled the Orion network to be reconnected relatively quickly following the recent earthquakes. This is a very important reason why stable long term ownership of infrastructure assets is important.
- 5.6. LPC, CIAL and our other subsidiaries are given commercially focussed objectives and it is inappropriate to assume that just because there is local government ownership that they will have confusing multiple owned objectives

6. Conclusions

- 6.1. CCHL believes that over its two decades of existence it has developed a good commercial model of governance which ensures its companies are governed to the highest commercial standards. Ownership by local government does not need to be an inhibitor of good governance and effective commercial operation. In fact, used correctly, it can provide the right balance between long and short term objectives.

6.2. The report needs to be significantly moderated to acknowledge that there are good models available without the need for ownership change.

On behalf of the board of Christchurch City Holdings Limited

A handwritten signature in black ink, appearing to read 'Bob Lineham', with a stylized flourish at the end.

Bob Lineham
CHIEF EXECUTIVE

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