



Trustees Report on the Ownership Review of Top Energy



Introduction

The Top Energy Consumer Trust ("the Trust") operates under the terms of the Trust Deed ("the Deed") established in 1993 when Top Energy Limited ("Top Energy") was created. The Deed sets out the Trust's obligations and powers, the objectives of the Trust, and who the beneficiaries of the income and the capital value of the Trust will be. Management of the Trust is carried out by the Trustees.

One specific requirement of the Deed is that the Trustees must, within certain time frames, conduct reviews of the Trust's ownership of the shares in Top Energy.

Background

In 1992 the (then) Bay of Islands Electric Power Board was required, along with all other power boards throughout New Zealand, to prepare an Establishment Plan which would set out how the Board intended to move from its power board structure to that of a company. The Plan was required to be published and public submissions sought on it. As a result of the Plan, and after consideration of the submissions, the Bay of Islands Electric Power Trust was created to hold the shares in the new company, Top Energy Limited. Originally named the Bay of Islands Electric Power Trust, the Trust changed its name to the Top Energy Consumer Trust in July 2002, to recognise the entire area that the Trust represented.

A requirement of the Trust Deed is that the beneficiaries be consulted, at not more than five yearly intervals, as to whether they wish to continue to own the shares in the Company, through the Trust. The Deed sets out the procedures which must be followed in this consultation process, including the information which must be gathered and provided to the public. The requirements are set out in Clause 4 of the Deed.

The major steps required to be completed are:

- (a) the preparation of a report by the Directors, which summarises the past performance of Top Energy and analyses various ownership options; and
- (b) a review by the Trustees of the Directors report and production of a report by the Trustees of their findings (this document).
- (c) After consulting with the public, the Trustees must decide which of the three options set out in clause 4.4 of the Trust Deed will be the one to be adopted until the next review.

A report from Directors was requested by the Trustees on 1 December 2021. The report from the Directors was received by the Trust on 3 May 2022.

In preparing their report, Directors engaged PricewaterhouseCoopers (PwC) to undertake extensive analysis of the Company's results over the last 5 years, including comparison with other lines companies. Like many lines' businesses in New Zealand, Top Energy has diversified from being a network/electrical contracting business. Most of those alternative activities are competitive businesses and thus it is only the network part of the Group's activities for which detailed information is publicly available and able to be compared to the other network businesses throughout the country.

What is trust ownership?

Trust ownership (for Top Energy) means that a group of individuals are selected to hold the shares of the Company, as Trustees. The role of Trustees is effectively to hold the shares for the benefit of the consumers, who are referred to as the beneficiaries of the Trust, and to exercise the role of overseeing the Board of Directors and to carry out the role of shareholder, on behalf of the beneficiaries.

The Trustees have no involvement in the day-to-day management or operation of the Company. The duties of the Trustees include appointing directors, monitoring the performance of directors, agreeing a Statement of Corporate Intent with the Board which sets out key philosophies and objectives of the Company, conducting the five yearly ownership reviews and otherwise performing the tasks of shareholders as required by law.

In exercising their duties, the Trustees are strictly bound to follow the requirements of the Trust Deed, the Trusts Act 2019, the Energy Companies Act 1992, the Companies Act 1993 and other duties imposed by law. Trustees must exercise their duties with diligence, taking account of all relevant considerations (of which the views of beneficiaries may be one), avoiding pre-judging decisions or being swayed by mere sentiment. Trustees must make decisions, not delegating decision-making to anyone else and must have considered all appropriate reasons for doing so.

The Directors' Report

The Director's Report, together with the appended analysis by PwC, is part of the documentation provided for submitters to consider in relation to this Ownership Review.

General

As noted in previous Ownership Review reports, the nature of Top Energy has changed significantly since 1993 when both the Company and the Trust were created. At that time, the Company was an integrated power supplier, which not only owned and operated the supply lines but also bought and sold the energy supplied to the local people. Following the forced separation of the lines and energy businesses in 1998, Top Energy has become a very different company. Issues of security of power supply and fairness of line charges remain very important.

Company Performance

As noted above, the electricity network business remains a significant part of Top Energy's operations. The performance of this part of the Company should be measured not only in terms of economic returns but also the service levels delivered to power consumers. In saying this, it is accepted that service levels are more of an issue to the beneficiaries in their role as power consumers than in relation to their ownership of the company, as beneficiaries of the trust. However, there is a connection between financial returns and the service levels provided to consumers.

The returns distributed to consumers through the line charge discount were increased during the review period up to \$250, from \$200 previously. This was the first increase since 2003.

The impact on consumers of loss of power (whether planned for maintenance work or unplanned arising from storms etc.) has varied over the years, improving because of the investment programme over the last 10 years. As noted in the Director's report, the introduction of diesel generators has reduced the planned outages for the Kaitia area over the last two years bringing overall performance comparable to the industry. Unplanned outages have also improved significantly over the past 3 years but remain above industry comparisons.

The Trustees continue to have a significant focus on the performance of the Company in providing appropriate returns and continuity of supply to consumers.

Alternative Ownership Options

The Director's Report, which includes the PwC Ownership Review, identifies a number of alternative ownership options (Section 6 of the PwC report). This analysis includes identifying the advantages and disadvantages of each. Trustees note, however, that although there are possible disadvantages with continued trust ownership, particularly in relation to the ability to fund expansion by way of equity injections, the results achieved by the Company since its inception, and particularly over the last 5 years, have illustrated that the theoretical constraint of trust ownership has not actually occurred. In fact, the Company has structured its activities to address this issue, delivering the largest project in the Far North with the 32MW generation expansion at Ngawha. In addition, the Company has continued the programme it started in the prior review period to strengthen its core electricity network business.

It is appropriate that alternative ownership structures should be considered whenever significant changes occur. However, the decision to take a different approach to that which already exists should sensibly only be embarked upon when there is a clear reason to do so and a strong belief that the new approach will deliver much improved results.

Ngawha Generation

Trustees believe that the people of the Far North also see power generation at Ngawha as an important local resource. Trustees consider the generator to be an important mechanism in providing security of power supply to the Far North. This is particularly the case following the recent 32MW expansion, where Ngawha now at 57MW provides 97% of the energy consumed in the Far North. This will continue to increase should the plant be expanded further as provided for in the consent.

Embedded generators such as Ngawha are good for the country, being helpful to the national electricity system both in financial terms and in terms of security of supply. In the case of the Ngawha generator, it is also placed at the furthest point from the bulk of power generation and the only baseload generator north of the main population centre of the country. Both of these points add to its value, not only economically, but also by adding to the security of supply to the region.

The Directors' Recommendation

The ever-changing nature of the electricity industry creates significant uncertainty, although what is certain is that the electricity industry, and therefore the Company, has a critical role to play in the country's decarbonisation goals.

Increasing carbon costs are likely to affect the profitability of the power generator until offsetting opportunities are implemented. As a renewable resource, it contributes to the

Government's decarbonisation goal and as such is a key contributor in reducing the reliance on fossil fuel generation.

The medium to long term plans developed by the Company will continue to deliver valuable and essential infrastructural assets to the Far North communities as well as identifying business opportunities which will arise during this period.

The Directors have identified that there are other ownership structures which can be considered, but that the future growth opportunities and Strategy aspirations can be achieved within the trust ownership model. Value maximisation is the goal and the responsibility of the Directors, and they see no impediment to achieving this goal under a trust ownership structure.

The Directors have recommended that the ownership of Top Energy Ltd remain with the Top Energy Consumer Trust.

The present Trustees will ensure that the public is fully informed should any material changes be proposed and that the appropriate consultation is undertaken.

The Trustees' Approach

One of the roles of the Trustees is to establish what the local people want to do with the Company. To be able to make an informed decision on what ownership structure beneficiaries prefer, it is important that beneficiaries understand where the value of their investment lies and how this might affect them personally. On many occasions Trustees have invited beneficiaries to contact the Trust or individual trustees, if they have any concerns. The Trust receives very few enquiries or complaints. As a result, Trustees interpret this to indicate that most beneficiaries are happy with what the Trust is doing. However, despite the Trust's efforts over the last 25 years, many power consumers still do not fully understand the structure of the industry and where Top Energy and the Trust fit into that structure. Over the years the Trust has taken a view that if beneficiaries were unhappy with the actions of either Top Energy or this Trust, they would have let us know.

Trustees see Top Energy as a large commercial activity, in a region challenged with lack of economic growth and employment opportunities. The financial results achieved in the past indicate to Trustees that the Company is being well managed and should be able to continue to create value or wealth for the owners of the Company. Over the last 5 years, the Company has paid discounts to consumers totalling \$28.3m. In fact, since Top Energy was forced to divest itself of the energy trading business in late 1998, the Company has distributed, by way of dividend or discount, over \$110m to consumers/beneficiaries.

The Trustees do not believe that it is the role of the Company to provide employment at any cost. Any development must add value to the investment of the owners, the power consumers. Therefore, any business opportunity must provide a level of return commensurate with the risk being taken on by the Company.

Performance of the Trust

The PwC report sets out details of the financial performance of the Trust over the last 5 years (Section 5). The information included makes it clear that the Trust maintains a very low-cost structure for its operations and PwC notes *"TECT costs are below the average of other trusts on all measures"*

It shows that the fees paid to Trustees are the second lowest in the group of trusts included and represent 60% of the average fees paid to trustees for that group. When compared to the cost per ICP (consumer) the Trust is below the average of the group as well.

Apart from the remuneration of the Trustees, the major costs relate to the occasional recruitment of new directors and the bi-annual requirement to call for nominations for trustee positions. At each trustee selection, at least two of the Trustees must stand down and nominations are called to fill those positions. The process used to select the trustees is

very cost-effective and seems to meet the objectives of appointing representative individuals, by using democratically elected people to make the final selection.

Paragraph 3.7 of the Trust's Deed states that the Objectives of the Trust include *"To encourage and facilitate the Company in meeting its objective of being a successful business by optimising the Company's return on its assets and to distribute to Consumers the benefits of ownership of shares in the Company"*.

The comparative (EBITDAF) profitability data included in the PwC report clearly shows that the Company has achieved improving returns since the commencement of the period. This is despite the regulated weighted average cost of capital (WACC), used by the Commerce Commission to set network line charges, dropping significantly in the last year. The Company's return on investment is aligned with that of the peer group.

In addition to the specific financial results achieved by the Trust, a number of other activities have been undertaken in fulfilling the role of the Trust.

Monitoring the performance of the Company

The Trustees receive a significant amount of information from the Directors concerning the performance of the Company. The Trust meets regularly to monitor that performance. The relationship between the Trustees and the Directors is appropriate as a working relationship, as is the relationship between the Trustees themselves.

Selection of Directors

At the Annual General Meeting of the Company each year, at least two directors retire, by rotation. In addition, the appointment of any director who has been on the Board for more than 7 years is considered by the Trustees every year. A performance evaluation process operates to assess the performance of the Company's Board and the individual directors that make it up. The Trustees consider the performance of the Directors and decide whether individual Directors should be reappointed. When vacancies occur, Trustees undertake a search for a new director, interview appropriate candidates and make appointments. Since the last ownership review, six new appointments have been made to fill vacancies.

Information continues to be gathered on other possible directors, should the need arise to make new appointments at any time.

Remuneration of Directors and Trustees

The Trustees approve the payment of total director's fees. The following table shows the amounts paid to Directors and Trustees for the financial year ended 31 March 2021.

	Directors \$	Trustees \$	%
Chair	108,200	27,050	25.0%
Chair of Audit & Risk Committee	66,000	N/A	
Common Director/Trustee	59,000	14,750	25.0%
Independent Director	49,700	N/A	

A recommendation as to fees is made by the Chairman of Directors for consideration at the Company's AGM. That recommendation is based on national survey data, reflecting the size and complexity of the Group.

The Trust's Deed contains a provision (Schedule 1, clause 4.1) that trustee's fees may not exceed 25% of the fees paid to directors.

Selection of Trustees

Every two years at least two Trustees must retire by rotation. Nominations are called, from members of the public in the area. The interviewing of candidates is undertaken by an independent personnel consultant, who prepares a shortlist. The final selection is made by a panel comprising the Members of Parliament for Northland and for Te Tai Tokerau and the Chairman of the Northland Regional Council. The Trustees are required to ensure that the selection process is properly conducted but have no involvement in the selection of trustees.

Statement of Corporate Intent

This is a document which contains the agreed targets and governing principles under which Top Energy operates. It is negotiated between the Directors and the Trustees every year. At the time of writing this report the Statement agreed at the last AGM of Top Energy in June 2021 is still operative. A copy is available on the Company's website (www.topenergy.co.nz).

For the last 5 years, the Company has paid line charge discounts directly to consumers, via their power accounts. This is a cost effective and secure way of making payments to the power consumers. The amount paid is also reflective of the volumes of power consumed and therefore more fairly reflects the contribution individual consumers make to the profitability of the Company.

The level of the rebates was increased for the last year of the review period following the commissioning of the latest Ngawha generator. This was despite the Company investing a significant amount on the generator and the continual improvements across the electricity network. The increase reflects the future cashflows expected from these investments and recognises the importance of intergenerational distribution of wealth.

The cash requirements which exceed the cash generated from trading (net of the discount) is met from the Company's debt funding facilities.

During the 5-year review period, the only dividends paid by the Company have been modest amounts to enable the Trust to meet operating expenses.

Invitation to make Submissions

Now that the Trustees have completed their evaluation of the Directors' Report, all of the information is made available to all members of the public in the local area. Anyone having an interest in the subject of the ownership of the shares in Top Energy is now invited to make submissions to the Trustees.

There are no particular forms or format for making a submission other than it must contain your name and address and your ICP number (available from your power account), together with an indication of whether you wish to make a verbal submission. After submissions close, copies of the submissions received will be available for viewing by the public. Hearings will also be held at which any person who has made a written submission and has indicated that they wish to be heard, may speak to their submission.

Results

Having received all submissions on the subject, the Trustees will then consider the submissions. Trustees will then decide which of the options available under clause 4.4 of the Deed will be adopted.

for and on behalf of the
Top Energy Consumer Trust



Yvonne Sharp
Chair