Chapter 11

The Role of Local Authority-owned Companies: Lessons from the New Zealand Experience

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This chapter explores the potential for greater use of local authority-owned companies and other council-controlled, arm's-length entities to manage local government assets and services. It looks at the opportunities, risks and implications for accountability and local democracy, with an emphasis on arrangements for post-incorporation governance. These are considered not just from the conventional perspective of good corporate governance including risk management, but also in terms of how they can contribute to strengthening local democracy and community participation in decision-making.

The chapter begins with a brief overview of experiences in Europe, England, Canada and Australia. It then discusses the unique model emerging within New Zealand, where there has been a particular focus on the post-incorporation governance regime. The origins of the New Zealand model are presented, together with a series of case studies and recent developments in the city of Auckland.

The considerable, and potentially beneficial, implications for the role of elected members and for enhanced local democratic accountability are also discussed. The chapter concludes with a discussion of the relevance of arm's-length entities to building local capability and strengthening community governance.

11.1 Local authority-owned companies: global examples

11.1.1 Europe

The use of local authority-owned companies in Europe varies widely between jurisdictions, as do attitudes towards the appropriateness of companies as vehicles for service delivery or other activity within democratically accountable organisations.

A 2005 survey by the European bank Dexia provided an overview of local government use of public companies within the then 25 countries of the European Union (Dexia 2005). It found that only in three countries – Luxembourg, Cyprus and Malta – did local governments not form companies as a means of undertaking part of their activity.

Some relatively common features emerge. It is usual for elected members and/or local civil servants to be appointed to the governing body of such companies. This can be seen as reflecting cultural and constitutional differences, identified by Torres and Pina (2002), between European and Anglo-Saxon jurisdictions, with Europeans being much more comfortable with the concept of elected members or senior managers sitting on the boards of council-controlled companies. Through European eyes this

can be a useful way of ensuring appropriate alignment between the council owner and the company. By contrast, through Anglo-Saxon and especially Westminster tradition eyes, current good practice sees appointing elected members to boards as creating an inherent conflict of interest: the performance of the local authority's companies is placed in the hands of the very people who should be responsible for monitoring that performance.

Grossi and Reichard (2008) provide an overview of governance arrangements and practice for local authority-owned companies in Germany and Italy, where it is common for local authorities to own a number of companies: on average, large German cities own nearly 90 companies and large Italian cities own 25. Councils have autonomy in the decision on whether to establish companies, and there are no public sector-specific governance requirements. Instead, governance of council-owned companies is a matter for the general law.

Portuguese local governments only gained the power to establish companies in 1988. Tavares and Camões report that:

> … in Portugal, it is generally accepted that these new forms of local governance are the result of an attempt to improve financial management, relax public procurement rules and circumvent civil service laws and their implications for personnel management, contract agreements and organization. Rigorous controls imposed by national institutions such as the Accounting Court, the General Inspection of Territorial Administration and the General Inspection of Finances, as well as the requirements of civil service laws are avoided by these new forms of governance, even though this does not mean the complete subordination to general labour laws applied to the private sector (2010: 588).

Swedish experience reflects Torres and Pina's (2002) observations on different cultural and institutional understandings. Take for example healthcare services, which in Sweden are the responsibility of county councils. The late 1990s saw a strong emphasis on restructuring health service delivery in order to improve efficiency, increase access and reduce waiting times (Hjertqvist 2002). Central to the process of change, which included both the corporatisation and in a number of instances the contracting out or privatising of the provision of individual services, was that the basic values and individual entitlements of Sweden's public healthcare system should remain unchanged. Reforms were about changing incentives for people working within the system, including opportunities for employees to set up their own healthcare businesses, not about changing values or entitlements. This offers a key lesson for other jurisdictions: it is most important to ensure public confidence that the values on which a service is based will be maintained through the reform process, and the purpose of reform should be to reinforce the core values of the system (Hjertqvist 2002).

11.1.2 British Columbia, Canada

In British Columbia, the *Community Charter 2003* empowers municipalities or regional districts to form or acquire shares in corporations, but only with the consent of the Inspector of Municipalities.[1] In 2006 the Ministry of Community Services published

Launching and Maintaining a Local Government Corporation: A Guide for Local Officials, prepared with the support and direction of the inspector. The purpose of the guide is to assist municipalities in deciding to form a corporation, including whether that is the best means of pursuing the municipality's objective. The guide notes that, over the 30 years until 2005, 78 requests for the formation of corporations were received, of which only two had ultimately been declined. Requests covered a wide variety of activities, as detailed in Figure 11.1.

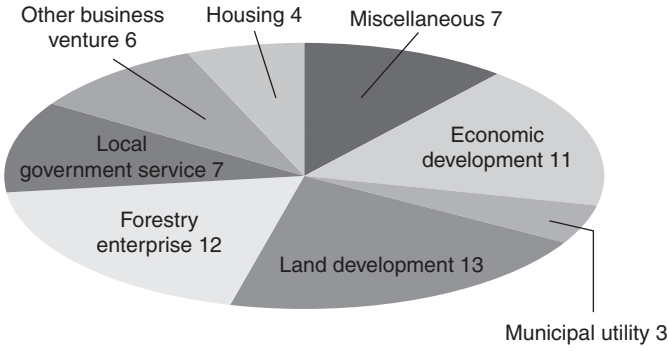
The guide is written primarily from a compliance rather than a policy/strategic perspective. It provides a useful counterpoint to the emerging New Zealand practice of treating council establishment and ownership of a corporation as fundamentally a matter of relationship management rather than legal compliance, albeit without understating the importance of compliance in its proper place.

11.1.3 England

In England, practice has varied significantly over recent decades. In the 1980s councils used provisions in the *Local Government Act 1972* to create companies for a wide range of purposes (Public–Private Partnerships Programme 2005). However, in the late 1980s the Conservative government established a complex regulatory regime restricting the use of companies, based on a combination of the nature of the company and a control test. The introduction of the 'well-being power', which authorised councils to do anything they believed would promote community well-being, by the *Local Government Act 2000* was seen as extending the ability of local authorities to create companies, but this was subsequently limited by the *Local Government Act 2003*, which restricted the power to form companies to those authorities meeting Best Value standards; in essence, the power to form companies became a reward for good performance. The power was also inhibited by litigation risk, as council decisions were subject to judicial review on the grounds of failure to follow due process.

The recently enacted *Localism Act 2011* includes a 'general power of competence'. This is described by the UK Department of Communities and Local Government as giving 'local authorities the legal capacity to do anything an individual can do that

Figure 11.1 Types of corporations considered by local governments, 1976 to 2005



Source: Ministry of Community Services (2006)

isn't specifically prohibited; they will not, for example, be able to impose new taxes, as an individual has no power to tax'.[2]

Notably, the focus in the different legislative and regulatory provisions in England has been on a combination of the power to form companies, and the implications for local government financial management (Public–Private Partnerships Programme 2005). Much less attention has been paid to the governance of those companies, including measures which might be seen as desirable to mitigate potential risks associated with carrying out activities through a company form.

11.1.4 Australia

In Australia the power to regulate local government is reserved to the individual states. Legislation covering the formation of council-owned companies varies from state to state but only one, Queensland, makes any provision for post-establishment governance.

In Queensland two legislative regimes operate, one for the City of Brisbane and the other for local government generally. Both now include a power to establish 'beneficial enterprises'.[3] This requires a judgement by the council on whether any particular activity is 'beneficial', raising the prospect of judicial review, as occurred with the well-being power in England. This may act as a disincentive to use of the 'beneficial enterprise' model, although the responsible state government department does provide extensive guidance, which should minimise the legal risk.

The Queensland legislation is not specific that an enterprise should be a company; indeed it is clear that the local authority has the discretion to choose what legal form a 'beneficial enterprise' should take. In terms of post-establishment governance, the Queensland framework follows in broad terms the long-established New Zealand practice of requiring a statement of corporate intent, which sets out the objectives, operating principles, and reporting and accountability obligations that the entity will observe. However, these provisions have only been in place for a short period of time and it is too early to assess practice and outcomes.

11.2 Local authority-owned companies in New Zealand

Between 1984 and 1990 New Zealand's public sector underwent massive structural, organisational and management changes (Boston et al. 1991). The government embarked upon a comprehensive process of reform across the entire public sector, which included restructuring government trading activities as companies, known as state-owned enterprises (SOEs). At the heart of the reform process for the entire public sector, not just trading activities, was a focus on accountability and on developing incentive arrangements that were both appropriate to the nature of the activity, and which minimised any inherent conflicts.

Government ministers for their part were concerned that they could continue to exercise influence, despite the transfer from departmental to company form. As a consequence, a set of arrangements was designed to ensure that the directors of state-owned enterprises remained strongly accountable to shareholding ministers,

and through them to the government. At the heart of these arrangements was what became known as a 'statement of (corporate) intent', negotiated between directors and shareholding ministers. The purpose of this document was to set out the business intentions, performance measures and reporting arrangements under which enterprises operate.

The role of the shareholding ministers is supported by a specialist monitoring and advisory unit located within the New Zealand Treasury.[4] The unit manages an annual cycle of monitoring and reporting (see Table 11.1). This begins with the outlook letter to each SOE board detailing the information requirements, the timing and any specific issues the company is expected to address during the business planning round. The board has to respond with first, a strategic issues letter outlining its perspectives, and later its business plan for the forthcoming financial year, plus a draft statement of corporate intent. Once those are agreed with the shareholder representative(s), the board is required to manage the business in accordance with the statement of corporate intent.

In the late 1980s, the government's reforming zeal turned to the local government sector. The same basic principles were applied, including legislating to enable the use of companies to manage trading activities. Three major categories of local government were affected: harbour boards and electric power boards, both of which were special-purpose authorities, and general-purpose local authorities.

11.2.1 Harbour boards and electricity distribution

The government's agenda reflected an economy-wide approach to reform based on a strongly held set of theoretical beliefs about the proper way of structuring and governing different types of activity. Its reforms of the two sets of special-purpose local authorities, harbour boards and electric power boards, were each part of a broader agenda of reforming a particular sector – transport and electricity respectively. In each case the government of the day was focused on putting in place a set of ownership, governance and accountability provisions which it believed would facilitate the effective governance and management of the business activities involved.

The commercial activities of both harbour boards and electric power boards were vested in new special-purpose companies for each. Ownership arrangements were complex, but for those that remained in public ownership, their governing legislation required broadly the same governance arrangements as for state-owned enterprises (McKinlay 1999).

11.2.2 General-purpose local authorities

The 1989 reforms of local government went much further than simply enabling councils to form companies: they included a substantial rationalisation of the number and scale of local authorities, a shift from cash to accrual accounting, marked changes in accountability and the introduction of a split between elected members, responsible for policy, and a chief executive (as the sole employer of staff), responsible for implementation.

Table 11.1 Accountability model for New Zealand state-owned enterprises

	Outlook letter	Strategic issues letter	Plan	Submit	Agree	Operate
Action	To SOE board From ministers (shareholders)	From SOE board To ministers (shareholders)	SOE completes internal planning	Business plan (draft) Statement of intent (draft)	Business plan Statement of intent	Manage business in accordance with the statement of corporate intent Quarterly reporting Other required meetings
Month	1	2	3 — 4	5	6: FY end	New FY start

Source: Adapted from the Owner's Expectations Manual, available at: www.comu.govt.nz/resources/pdfs/comu-oem12.pdf (accessed 17 February 2012), 18.

In respect of companies, new legislation provided for the formation of what were known as local authority trading enterprises (LATEs): council-owned companies that could undertake what were essentially the business activities of local authorities. The legislation required public consultation on any proposal to establish a LATE, and to transfer an undertaking to it. It also included basically the same requirement as existed for SOEs for the preparation of a statement of corporate intent, with which the board of directors must then comply.

For the most part, the government chose not to require local authorities to corporatise any activities. There were some exceptions, mainly in the transport sector. For example, councils that operated public passenger transport services, and wished to continue receiving government subsidy, were required to corporatise the services. This gave a greater assurance of transparency, which came from establishing the service as a separate entity with its own balance sheet and financial statements.

When New Zealand's Local Government Act was rewritten in 2002, the opportunity was taken to extend the coverage of the provisions affecting local authority-owned companies. Instead of LATEs, the new legislation uses the concept of council-controlled organisations (CCOs). These are defined as any entity in respect of which one or more local authorities owns 50 per cent or more of any equity, or is entitled to appoint 50 per cent or more of any governing body. This brought within the ambit of the legislation bodies such as local authority-controlled trusts, which had previously been established under the exercise of general powers to promote community development.

The SOE requirement for the preparation of a statement of corporate intent (termed simply 'a statement of intent' in the case of CCOs) was carried forward, but with some amendment. The members of a CCO board are required by legislation to run the entity in accordance with the statement of intent. In addition, the parent council or councils may amend the statement of intent by resolution at any time and the board is required to adopt that amendment. The statement of intent thus gives a council significant influence over any CCOs it owns.

11.2.3 Policy implications

Apart from setting the statutory framework, including the provision for the statement of intent, the government did not prescribe how local authorities should manage their relations with any companies that they owned or any other entities they controlled. Rather than requiring that councils should, for example, adopt the same general approach for monitoring and advisory support as the government itself had in place, it was simply left to individual councils to determine what they should do. Issues such as whether or not elected members could be appointed to the boards of council-owned companies or council-controlled trusts, the process for appointment of directors, the nature of dividend and other financial policies, and the nature of any reporting requirements over and above standard financial reporting, were all left to the discretion of individual councils.

With hindsight, this situation has been somewhat problematic. As will be clear from the brief case studies that follow, practice and understandings differed widely.

Few councils had available to them in-house the professional expertise and market knowledge needed to monitor the performance of what were often quite substantial businesses, notably some of New Zealand's largest ports and electricity networks. Instead, there has been considerable 'learning-by-doing', compounded by the fact that many of the most significant council-owned companies had come into existence not because of conscious decisions by councils that this was the appropriate way in which to run an activity, but because the government had directed restructuring as part of its own economic reforms.

Part of the learning process has been a gradual shift from the use of arm's-length entities purely as a presumed means of improving efficiency, to a greater understanding of the public value which different structures can add because of their inherent characteristics, so long as this value is properly understood and appropriate measures are put in place to secure the benefits sought. In this respect, the New Zealand approach can be seen as melding the presumed strengths of 'new public management' with 'public value' considerations.[5] This is emerging more clearly in respect of major local government activities as the result of recent experience in Auckland's CCOs, discussed later in the chapter.

11.3 Case studies

This section considers four New Zealand councils and one multi-council-owned company. The case studies highlight both the variety of approaches different councils have taken to the choice of structure and governance arrangements, and differences of practice in important areas of corporate governance, including managing conflicts of interest. They also illustrate the growing maturity of the model, with recent practice placing a strong emphasis on good corporate governance and relying significantly on the experience of central government with its SOEs, as well as the guidance of bodies such as the Institute of Directors.

11.3.1 Dunedin City Council

Dunedin City Council became the owner of a substantial council-owned company as the result of the *Energy Companies Act 1992*, which required the corporatisation of its then municipal electricity department. As a consequence of financial advice, the council decided to use a holding company structure, Dunedin City Holdings Ltd. At the same time it established Dunedin City Treasury Ltd to manage the council's borrowing and funding activity. This structure gave the council certain financial advantages, and took its borrowing outside the then regulatory arrangements for local authorities.

The energy company was restructured as two separate businesses:

- Aurora Energy Ltd, which owns the city's electricity distribution network and that of Central Electric Ltd (an adjoining company which it acquired by takeover); and
- Delta Utility Services Ltd, which undertakes network and other maintenance services for Aurora Energy and other service providers in the South Island.

Dunedin City Holdings Ltd also holds three other companies:

- City Forests Ltd, the owner of substantial forestry plantation interests;
- a half share of Dunedin International Airport Ltd, a joint venture with the New Zealand government; and
- Citibus Ltd.

The holding company, at the behest of its shareholder, has placed a strong emphasis on providing cash returns, sometimes to the detriment of its subsidiary companies, as its chairman's report in the annual report for the year ending 30 June 2010 makes clear:

> The strategy of the Dunedin City Holdings Limited board has been to pursue opportunities for growth where we see the potential to develop or extend our existing businesses. However, this year with the need to support the shareholder's capital expenditure programme the group's capital expenditure has been down (Dunedin City Holdings Ltd 2010: 4).

In 2011, the city council commissioned a governance review of the holding company and its subsidiaries. The resulting report (Larsen 2012: 9–12) made a number of critical findings, including:

- Conflicts of interest arising from the appointment of councillors on the board of the holding company, and appointment of holding company directors to the boards of subsidiary companies. In each case the central issue was placing people in a situation in which it was their obligation in one role to monitor their performance in another.
- Conflict between the council's objective of extracting maximum cash from the holding company and its subsidiaries, and the long-term needs of the businesses. A specific issue was the implicit challenge to the statutory obligation of directors to act in 'the best interests of the company'.

Recommendations included:

- No one should be both an elected member and appointed director on either the holding company or any subsidiary board. Council managers should be ineligible for director positions.
- The holding company and the council should adopt a standard dividend policy of paying out 50–70 per cent of tax paid profits.
- A review of all council-owned companies with the objective of determining their fit with council cash flow and 'risk appetite' boundaries. Any entity falling outside the boundary should be considered for sale.
- Provision of in-house governance training for elected council members.

The Dunedin experience is an example of what can happen when a council fails to give informed consideration to the good governance issues associated with being the

owner of companies undertaking significant business activities (or, if it has given such consideration, to apply it). Dunedin was not the only council in which appointment as a director of a council-owned company was seen as an attractive addition to councillor remuneration, or which regarded its companies as a potential cash flow source to the detriment of the investment needs of the businesses. Arguably the concerns raised in Dunedin can be seen as a consequence of the failure to accompany a statutory framework for local authority-owned companies with adequate guidance on good practice in governance.

11.3.2 Christchurch City Council

As with Dunedin, the Christchurch City Council became the owner of significant council-owned companies through restructuring initiatives required as a result of central government legislation. This included the corporatisation of Christchurch's municipal electricity undertaking (which also absorbed the electricity undertakings of two nearby local authorities); the inheritance of a majority shareholding in the port of Lyttelton; corporatisation of the council-owned public transport undertaking; and ownership of 75 per cent of Christchurch International Airport Ltd (with the New Zealand government as the minority shareholder).

These entities are owned through Christchurch City Holdings Ltd (CCHL). Its website states that 'CCHL was set up in 1993 in response to calls for a confidential independent non-political buffer between the Council and the companies it owned. CCHL therefore ensures that a commercial approach is taken to managing the interface with the Council's companies' (CCHL 2012). Another factor in CCHL's establishment was the same financial analysis as led to the establishment of Dunedin City Holdings Ltd: the recognition that the use of a holding company structure would improve access to capital markets and potentially reduce borrowing costs for the council group as a whole.

Today, the principal companies in the CCHL group include:

- Orion New Zealand Limited (89.3 per cent owned), which owns and operates the electricity distribution network within Christchurch City and surrounding areas;
- Lyttelton Port Company Ltd (79.3 per cent owned);
- Christchurch International Airport Ltd (75 per cent owned);
- Red Bus Ltd (100 per cent owned), a major public transport provider within Christchurch; and
- Enable Services Ltd (100 per cent owned), a broadband provider.

CCHL has the strategic objective of 'playing a more proactive role in supporting the council's aim of making Christchurch a "world class boutique city" by investing in, or promoting the establishment of, key infrastructure assets in a commercially viable manner. Areas such as high-speed telecommunications, water, security of energy supply and integrated transport have been identified as key regional infrastructure priorities' (see CCHL website: www.cchl.co.nz/cchl/about-cchl [accessed 17 February 2012]).

CCHL management argues that long-term council ownership gives it an ability to make future-oriented investments in a way that might not be undertaken by a purely commercial owner. As an example, it supported the redevelopment of Christchurch International Airport five years ahead of the time at which conventional cost–benefit analysis would have suggested making the investment. From the CCHL perspective, and that of the parent council, the early investment was an important initiative in building Christchurch's attractiveness as a destination and point of entry to the South Island. Similarly, CCHL has become a significant investor in ultrahigh-speed broadband, having established Enable Services Ltd in 2007 to develop a broadband network. In 2011, the company became the government's partner in the rollout of its ultrafast broadband project in Christchurch.

11.3.3 New Plymouth District Council

New Plymouth provides an example of a council that has taken a deliberative approach to the use of CCOs, including considering the different reasons why a council might wish to use an arm's-length organisation rather than undertake an activity in-house.

The council's major involvement began with the compulsory corporatisation of its municipal electricity department. This was merged with the energy company serving the surrounding rural area, and the merged company then listed on the New Zealand stock exchange. When the company was first listed, the value of the council's shareholding was NZ$90 million. Ten years later the council sold its shareholding for NZ$259 million. During those years, the council had been supportive of a commercial approach to the management of the business, including its growth through acquisitions.

The sale proceeds were used by the council 'to set up a Perpetual Investment Fund to diversify its investment and retain it for all generations to come – many golden eggs in the basket' (Taylor 2010). To assist with the management of the fund, the council established a CCO, Taranaki Investment Management Ltd (TIML), initially in a purely advisory role, but latterly with an investment management capacity. TIML operates within a corporate governance framework designed to make clear the respective responsibilities of the council and the board. The council has adopted a policy on the appointment and remuneration of directors drawn substantially from private sector practice, and, to avoid conflicts of interest, councillors and managers are precluded from becoming directors.[6]

TIML is an example of a CCO with a structure designed to support and enable a fully commercial approach to the management of a significant activity, in this case an investment fund. The council itself recognises that CCOs may be formed for a number of different purposes, and that commercial performance is only one such purpose and not always the most significant. This reflects the fact that the CCO model is an extremely flexible one which allows elected members to determine what objectives they wish to optimise, and what trade-offs they wish to make; for example, between revenue/value enhancement, delivery of service, engaging the community in the governance of specific activities, or bringing in scarce skills not available through normal recruitment and employment means.

Among the council's other CCOs are special-purpose trusts in areas such as sports and event venues, and arts and cultural activities. One objective of these trusts is to recruit board members with particular skills, commitment and knowledge of the sector, who would not otherwise be part of the governance framework. In some of these activities, the use of a CCO can almost be seen as a means of facilitating co-production, bringing in essentially volunteer but expert people to support the facility concerned. The next case study provides a specific example of this approach.

11.3.4 Horowhenua District Council

Horowhenua is a small district council serving one significant township and an otherwise largely rural and coastal area with a number of smaller townships. Some years ago it acknowledged a resourcing issue with its library services, recognising that they were underfunded.

A decision was taken to create a council-controlled trust, with trustees drawn from the community and with the objective of enabling the library to draw on community resources and support in a way that would not be possible for the council itself. Based on the chairman's report in the trust's annual report for 2010/11 (see: http://issuu.com/joransom/docs/annualreport_2010_2011_final [accessed 12 March 2012]) that objective has been achieved. More importantly, the most significant benefit turned out to be the freedom to operate under its own governance structure, being responsible to people who are committed to the library service itself. As the trust website comments:

> In Horowhenua, library users have benefited from more money being spent on new books, libraries open for longer hours and extensions to the premises of one of our libraries. But the biggest advantage is a different attitude. We now have a more empowered approach to library service – if something is worth doing, we find a way to get it done (Horowhenua Library Trust 2012).

Innovations have included developing new open source software, Kete, for the management of small libraries, which is now in wide use internationally. Overall, Horowhenua's experience confirms that one of the real benefits of using arm's-length entities to undertake services that the community itself values is the unleashing of community and staff energy and commitment.

11.3.5 Bay of Plenty Local Authority Shared Services (BOPLASS Ltd)

BOPLASS Ltd is jointly owned by the eight 'territorial' (local) authorities and Regional Council across the Bay of Plenty region, plus two adjoining areas. It was established to promote the development of shared services among the partner councils. Relationships between council shareholders are governed by a shareholders' agreement.

The company structure was chosen quite deliberately in order to set a different incentive framework from more common local authority shared services arrangements, such as a joint committee. Typically, accountability is directly back to participating

councils so that decisions taken around the 'board table' normally require a mandate from each partner. By contrast, BOPLASS operates on the principle that directors are responsible for the management of the company (a statutory provision which courts have held prevents shareholders from intervening in management), and have a duty to act in good faith in the best interests of the company, rather than the best interests of shareholders.[7]

The result is that BOPLASS has real power to act. The board has been developing a culture of decision-making which reinforces the understanding that the directors, who are either the chief executive or his/her nominee from each of the shareholder councils, act in accordance with their directorial responsibilities and not as a shareholder or customer representative. Participants report that this has a major impact on BOPLASS's ability to make decisions, especially in situations where one or more shareholder councils may not have been supportive of a particular course of action. Its ability to develop shared services initiatives has also been helped by other characteristics of the way BOPLASS operates, including:

- Rather than taking service delivery and control away from councils, it has adopted a 'centres of excellence' approach under which individual shared services will be developed by one of the shareholder councils and utilised by all.
- It has conceptualised the essence of shared services as being management of and access to information. Partner councils are linked by high-speed broadband and have real-time access to their own information wherever it is held. This removes the common fear that a shared services approach may result in a loss of control over a council's own information.
- A recognition that, even given the relative strength which directors have in a decision-making capacity, long-term success does depend on taking their council shareholders with them; it is not just a matter of maintaining shareholders' confidence in the board as such, but of retaining their support for utilising the initiatives which result from the company's activities.

11.4 Fast forward: the Auckland Council experience

One of the principal drivers for the recent sweeping reform of local government in the city and region of Auckland was the belief that existing council service delivery arrangements were relatively inefficient, often failed to exploit potential economies of scale and were unduly prone to direct political interference. This was considered by the Royal Commission on Auckland Governance, which without specifying particular services commented that 'the Commission expects that, in future, the Auckland Council's major commercial trading and infrastructure activities will be undertaken through CCOs, to enable the Council to access the best commercial and engineering expertise and resources' (Royal Commission 2009 volume 1: 13).

The government built on this suggestion. In creating a single unitary authority for the whole of the Auckland region, it determined that major commercial activities and major service delivery functions should be placed within council-owned companies.[8] This decision was strongly contested in public submissions on the legislation to

establish the new 'super council', and in public debate through the media. Typical of this was an editorial in the *New Zealand Herald* for 14 March 2010, which observed that 'by their very nature, CCOs are designed to take control away from politicians and the public in the interests of greater speed and efficiency' and 'as matters stand, the CCO model is anathema to the idea of democracy and is not what anyone in the region signed up for'.

This reaction reflected an inherent distrust of corporatisation stemming from state sector reforms in the late 1980s and early 1990s. This made it easy for a public and a media, both predisposed to see corporatisation as a first step to privatisation, to assume that this was indeed the government's agenda. Little consideration was given to the possibility that the regulatory framework for CCOs could actually enable elected members to exercise more effective oversight, or to the likely alternative, namely that the activities involved would become large business units within the Auckland Council bureaucracy, reporting to elected members only through a single chief executive.

The remainder of this chapter will explore the details of the Auckland experience to date, including the extensive measures being taken to ensure that the seven CCOs not only remain accountable to the Auckland Council itself, but are also required to be publicly transparent in their deliberations (except when commercial confidentiality requires otherwise), and to engage closely with Auckland's 21 local boards. Lessons will be drawn for the use of this model within other councils and other jurisdictions.

First, however, it is useful to clarify the role of the Auckland Council itself. Despite the fact that much of its service delivery activity is now the responsibility of CCOs, it is the Auckland Council that remains responsible for policy. CCOs are explicitly required to comply with the terms of relevant Auckland Council plans, including its Long Term Plan, which sets out proposed activities, expected outcomes and budgetary arrangements. The legislation establishing the council includes power for it to require a CCO to prepare and adopt a plan covering a period of at least ten years that describes how the organisation intends to:

- manage, maintain, and invest in its assets;
- maintain or improve service levels;
- respond to population growth and other changing environmental factors; and
- give effect to the council's strategy, plans and priorities.

The seven major CCOs are:

- Auckland Council Investments Ltd, which holds the council's 22 per cent shareholding in Auckland International Airport Ltd, and owns 100 per cent of Ports of Auckland Ltd;
- Auckland City Properties Ltd, which owns and manages the council's general property portfolio;
- Auckland Tourism Events and Economic Development Ltd;

- Auckland Transport, a statutory corporation responsible for transport planning, local and regional roads and the delivery of public transport services;
- Auckland Waterfront Development Agency Limited, which holds the council's property interests in the city's downtown waterfront and is responsible for its ongoing development;
- Regional Facilities Auckland Limited, which owns and manages major arts, cultural and recreational facilities, including museums, art galleries, the city's zoo, stadia, event centres and theatres; and
- Watercare Services Ltd, which is responsible for bulk and retail water and wastewater services for the region (with one or two minor exceptions from legacy arrangements entered into by previous councils).

The *Local Government (Auckland Council) Act 2009* defines the seven entities as 'substantive CCOs'. Under the Act the council is required to adopt an accountability policy for substantive CCOs covering matters such as alignment between their activities and council plans, the council's expectations in terms of their contribution to government policy, and accountability to the wider community. The Act also requires that the board of each Auckland Council CCO must nominate two of its meetings during that year to be open to members of the public.

Arguably all of these requirements could have been imposed under the catch-all provision in the standard legislation for statements of intent for CCOs that covers 'any other matter agreed between the shareholder and the board' (clause 9, schedule 8, Local Government Act 2002). However, the government clearly recognised the need to respond to public concern that the CCOs might not be properly accountable, hence the additional legislative requirements.

The Act also prohibits the appointment of any elected member to the board of a substantive CCO, with the exception that two could be appointed to the board of Auckland Transport. Interestingly, it does not prohibit the appointment of any employee of the council.

The establishment of Auckland's seven CCOs is the first instance in which specific major restructuring of local government service delivery through the use of arm's-length entities has been imposed by central government. To ensure continuity of service delivery, the CCOs needed to be in place, with boards appointed, on the same date as the new Auckland Council came into office (1 November 2010). This meant that both the organisational design and the governance arrangements for the CCOs were put in place under government supervision, rather than being dealt with by the new Auckland Council. As a result, there was a strong public expectation that the new council would act to ensure that concerns about lack of accountability were immediately and effectively addressed.[9] The incoming council was aware that the performance of the CCOs would play a major role in the quality of its relationship with residents and ratepayers, because many of their transactions would be with one or more of the CCOs rather than with the council itself. This strengthened the incentive for elected members to ensure that individual CCOs were both responsive

to the publics they serve and appropriately accountable. Thus the arrangements made for Auckland's CCOs inevitably saw a strong focus on the governance relationship between them and the council.

The council recognised the need for specialist advisory and monitoring services and established its own internal unit, complemented by a position in the mayor's office advising him on CCO-related matters. It has also largely adopted the practice followed by central government in establishing an annual accountability cycle between the council as shareholder and the CCOs. The annual cycle begins with a letter of expectations to the board of each CCO, setting out what the council expects over the next financial year. The letter serves as the basis for developing the statement of intent, which is to be delivered in draft form by 1 March and agreed by 30 June. The council has also followed central government practice by developing a shareholder's expectations manual, which provides the detailed background and rationale for the way in which the council will work with its CCOs, and the expectations which the council has of the relationships.

However, there is one significant difference from central government practice: a requirement that CCOs provide all necessary information in a timely manner to ensure council planning processes can be completed. CCOs need to provide financial information somewhat earlier than would be the case for SOEs in order to feed into council long-term plans and annual plans, first drafts of which are normally completed by December for the financial year beginning the following 1 July.

The organisational structure for Auckland Council also includes 21 elected 'local boards', which are intended to have an input into decision-making on local matters affecting the communities they represent. Those boards have a keen interest in the workings of the CCOs, and both the letters of expectation and the statements of intent for each CCO reflect a council objective that they will also be accountable to local communities. This applies particularly in the case of roads and transport.

The current letter of expectations for Auckland Transport requires it to have regard to transport-related matters identified in local board plans, and its statement of intent requires the development of a Local Board Engagement Plan.[10] The plan is to show how Auckland Transport intends to:

- support each local board to effectively represent the interests of local communities in local transport issues;
- ensure that Auckland Transport is responsive on local issues;
- contribute to the development of Local Board Engagement Plans;
- give effect to any Local Board Agreement to the extent the agreement requires actions by Auckland Transport; and
- gain input from local boards, via the mayor and councillors, on Auckland Transport's priorities and direction.

In practice it is now usual for a representative of Auckland Transport to attend each meeting of every local board in order to deal with transport-related issues.

11.4.1 Working with CCOs

Although it is still relatively early in the evolution of the relationship between the council and its new CCOs, experience suggests that the CCOs are now significantly more accountable to the communities they serve than were their predecessor councils. This is more than a function of the practices outlined above; it flows from the fact that, rather than being individual business units with financial statements and performance data often 'buried' within that for the council as a whole, each CCO now has its own separate financial statements and its own performance requirements against which it reports.

None of these provisions erase the difficulties of dealing with 'wicked issues' – for example, decision-making over a major infrastructure investment that may be beneficial for the region as a whole, but will have significant negative impacts on some localities. The processes in place for resolving those challenges lie outside individual CCOs themselves. They are found within the planning and accountability processes of Auckland Council, including its spatial plan and Long Term Plan. Complex challenges of necessity require a political response: structural change cannot by itself resolve inherent differences within a community.

Enhanced accountability is evidence of Auckland Council's constitution placing a strong emphasis on ensuring good governance. One possibly unanticipated consequence is the way in which this has changed the skills that both councillors and CCO board members need in order to function effectively within the new environment. The recent controversy surrounding Ports of Auckland Ltd (POAL), still unfolding at the time this chapter was written, illustrates this point.

POAL is wholly owned by Auckland Council Investments Ltd (ACIL), the council's investment CCO. As part of its statement of intent with the council, ACIL has agreed to quite aggressive targets for increasing port revenues and productivity. The board of POAL has determined that, in order to do so, it needs to put in place different employment arrangements for a large number of its staff – traditional waterside workers who have carried out the port's stevedoring work for many years. It is unclear whether the council was aware when it agreed to the statement of intent that the port company would see shifting to contracting-out to be an integral part of its strategy for meeting targets.

The immediate result of POAL changing its employment arrangements has been a serious and ongoing industrial dispute with the Maritime Union of New Zealand. The usual response within a council-owned business would be for political pressure to force a settlement protecting the status quo. In this case, however, Auckland Council has made it clear that dealing with the dispute is the responsibility of ACIL, and ACIL in turn has made it clear that managing the port business to achieve the required improvement in profitability and productivity is the responsibility of the POAL board.

Both those responses are consistent with the formal requirements of the CCO model, and both may be creating difficulties for elected members and directors respectively. It seems clear that elected members, including the mayor, had not foreseen the industrial

dispute, or the widespread public support for the view that the council has an ultimate 'good employer' responsibility to the staff of its CCOs. It also seems that elected members may not have fully understood the powers they have to change the mandate for a CCO board, by amending the statement of intent either to rule out particular practices or to require changes in the way in which they are implemented.[11] Equally, it seems clear that the board of POAL has not sufficiently understood the sensitivities associated with public ownership. These include an emerging public value expectation that even commercial businesses owned by a council should act somewhat differently and in a more employee-friendly manner than private companies.

11.5 Reflections on the New Zealand experience

There are four separate elements of the New Zealand experience which merit reflection, both for the ongoing development of the CCO regime within New Zealand and to offer lessons for local government in other Westminster jurisdictions. These relate to corporate governance; monitoring and support; accountability; and flexibility/co-production and capability development.

11.5.1 Corporate governance

The private sector has evolved its understanding of best practice in corporate governance over a number of years, beginning with the UK's Cadbury Report (Cadbury et al. 1992). The result is that expected practice and understanding of the separate roles of shareholders, directors and executive management are now well embedded in the sector. Issues such as conflict of interest, the obligation of directors to act in the best interests of the company and the importance of accountability are all now part of 'this is how we do things around here' for well-performing boards.

In New Zealand, that practice has been largely embedded in the SOE environment. This is in part because of the use of a specialist monitoring and advisory unit, and in part because the shareholder's representatives (government ministers) are common for all major SOEs. In contrast, there is no consistency of practice as yet within local government.

As noted earlier, New Plymouth District Council's *Director Remuneration and Appointment Policy* prohibits the appointment of elected members or staff as directors on the grounds of conflict of interest. In contrast, Dunedin City Council's policy allowed the appointment of elected members or staff, and the appointment of elected members has been a common practice.

New Plymouth has benefited significantly through the high performance of its fund manager, Taranaki Investment Management Ltd, and its recruitment of independent directors. Dunedin City Council encountered something of a crisis in the management of its CCOs as the result of a policy of treating the parent council's cash requirements (including minimising property tax increases) as a priority over and above the need for the CCOs to invest in the continuing development of their businesses. This approach was seen to be facilitated by the presence of elected members on the board of Dunedin City Holdings.

However, local government practice does appear to be evolving towards recognising the importance of good corporate governance. As a result of the Larsen review (Larsen 2012), Dunedin has moved away from appointing elected members. In Auckland, there is a statutory prohibition in respect of substantive CCOs.

Related to the question of good corporate governance is that of how monitoring and advisory services are provided, especially in terms of reconciling the broader objectives councils may have with the demands of running a commercial enterprise. The need for appropriate training for elected members is also now being recognised – it was one of the recommendations to the Dunedin City Council in the Larsen review.

This need is emphasised by the Auckland Council's experience with the POAL dispute. It seems clear that elected members are still on a relatively steep learning curve in terms of the powers they have, and how they should be exercised. It is also clear that at least some CCO directors need to better understand how best to operate in a public ownership environment.

None of this is to suggest that the model itself has any inherent defects. Rather, because the very purpose of the CCO model is to put a much greater emphasis on the nature and quality of performance, it needs to be complemented by ensuring that the people involved, especially elected members, have the necessary understanding and experience.

11.5.2 Monitoring and support

Monitoring of CCOs and support of shareholder councils in managing their relationships with them is a highly skilled and specialist activity. Frequently CCOs are engaged in activities that are at the leading edge in terms of technology, regulatory innovation or business practice. Examples within the local government environment include electricity undertakings, investment management and transport.

The central government recognised early on that monitoring and support of SOEs (including advice on the appointment of directors) required specialist capability and a critical mass of activity, both to attract and retain skilled advisors, and to ensure that they remained aware of developments within their areas of responsibility. It also recognised the merits of applying a consistent approach across a portfolio of SOEs to minimise, for example, the potential for conflicts of understanding about required performance and how that might be measured.

There is no equivalent for local government, in part because the central government simply left it to local authorities to establish whatever arrangements they saw fit. This helps explain why different councils have different approaches on issues such as conflict of interest, the eligibility of elected members to be appointed to boards, and how to measure the performance of entities that may undertake similar activities but have different local government owners.

One lesson from the New Zealand experience is that other jurisdictions contemplating a similar approach should consider establishing a monitoring and support service for councils. This will help provide the critical mass required for effective performance of

the role, which most councils would find difficult to support as a stand-alone activity. It would also ensure a useful measure of independence from any one council.

11.5.3 Accountability

Accountability has been one of the most interesting and in many ways exciting aspects of New Zealand's CCO regime. The conventional wisdom has been that placing public sector activity within a company structure undermines community accountability. In the words of the *New Zealand Herald* editorial, 'by their very nature, CCOs are designed to take control away from politicians and the public in the interests of greater speed and efficiency' (*New Zealand Herald* 14 March 2010). This comment reflects both public understanding of the nature of companies as a means of undertaking activity, and experience from New Zealand's state sector corporatisation and privatisation in the late 1980s and early 1990s.

In contrast, a close examination of the CCO model suggests that it may be the best option for combining production efficiency with a public value approach. The CCO model provides comprehensive provisions for public accountability. It requires that councils have a good understanding of corporate governance, and of the reasonable measures that need to be in place for the monitoring and oversight of arm's-length entities. This should result in greater accountability, including the strengthening of local democracy. Reasons for this improvement include:

- The CCO activity, rather than being a business unit potentially buried within 'whole-of-council' reporting, has its own separate legal identity, balance sheet, financial statements and performance measures, both financial and non-financial. The result is an improvement in transparency.
- The CCO is directly accountable to elected members, rather than being accountable through the council chief executive, along with all the other matters for which the chief executive is responsible. The terms of the statement of intent are negotiated between elected members and the CCO board (typically with the support of advice from officials, as in the case of the Auckland Council with its specialist governance and monitoring unit).
- The statement of intent process provides the means for elected members to look not just at standard financial/commercial performance, but also at other potentially non-commercial outcomes. Additionally, the process ensures that any non-commercial outcomes are transparent and appropriately costed.
- The statement of intent can, as with Auckland's CCOs, include specific requirements for involvement with local communities.
- Finally, the incentives that elected members face are quite different between CCO structures and council business units. With a business unit the incentive for elected members is to resist transparency, because they are likely themselves to be held responsible for any shortcomings in performance. In a CCO structure the incentive is reversed. Elected members become accountable for ensuring that CCOs either achieve expected performance or explain to the council and the public why they have not done so.

11.5.4 Flexibility/co-production and capability development

Not all CCOs are inherently commercial in their purpose, or responsible for the management of large assets on behalf of a council. CCOs also include a number of trusts and other non-commercial entities responsible for managing services, where there is a strong public or merit good element. Often the rationale for using a CCO structure is to engage the community itself, both in terms of governance and other involvement (such as volunteering to help with arts, cultural or recreational facilities), and to strengthen resourcing (as with the Horowhenua Library Trust). CCOs can play an important role in developing capability within the community by providing an opportunity for people to take part in the governance of community-focused entities.

Finally, as the BOPLASS case study shows, CCOs can help bring about much needed change in the culture of engagement within and between local authorities, and thus help break down persistent barriers to new ways of delivering services.

11.6 Conclusion

The New Zealand experiment with the use of CCOs is still in its early stages. There are obvious areas for further development in terms of building common understandings of corporate governance, accountability and what is required for effective monitoring and support. Despite this, it represents the most successful regime among Westminster jurisdictions for post-establishment governance of local authority-owned entities, not just in the commercial sphere but as a means for improving community engagement and facilitating co-production. It is well worth close examination by other jurisdictions considering whether to create, extend or review the power of local authorities to undertake activity through companies or other arm's-length entities.

Understanding the New Zealand process depends on recognising that the focus of the post-establishment regime should be on separating political and performance accountability. It is the elected members who make the political judgements about the operating objectives and framework for the CCO. It is the board of the CCO that has the performance accountability for determining how to deliver within the framework established in agreement with elected members. The model is both flexible and relationship-based. Fully understanding its potential requires setting aside conventional perceptions of the operation of the different corporate forms which an arm's length-entity may take (especially the company form), and focusing instead on the potential of the model to balance political and performance accountability in a way which reinforces both.

Notes

1 A statutory official who has a variety of approval and oversight functions in relation to local government.

2 See: www.communities.gov.uk/localgovernment/decentralisation/localismbill/keymeasures/ (accessed 12 March 2012).

3 The original City of Brisbane Act gave the council a power of general competence, which enabled it to form companies without further authority. The rewritten Act is accordingly more restrictive.

4 Formerly the Crown Companies Monitoring and Advisory Unit; now the Crown Ownership Monitoring Unit.
5 It should be noted that a public value approach has been much more evident, although not necessarily clearly articulated, in the use of council-controlled trusts than in council-controlled companies. For a useful discussion of the shift from new public management to public value see O'Flynn (2007).
6 See the council's policy on Appointment and Remuneration of Directors of Council Organisations, available at: www.newplymouthnz.com/CouncilDocuments/Policies/AppointmentAndRemunerationOfDirectorsOfCouncilOrganisations.htm (accessed 20 February 2012).
7 Interpretation of the duty has been a matter of case law rather than statute. For a recent discussion of the duty as it applies in Australia (and would in New Zealand), see: http://corporatelawandgovernance.blogspot.co.nz/2008/11/australia-directors-duty-to-act-in-best.html (accessed 21 November 2012). In England the law was recently and controversially changed so that a director of a company must act in a way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in so doing, to have regard to a number of other interests, including those of stakeholders (see Keay 2010).
8 This still left the Auckland Council itself with a significant range of functions, including spatial, environmental, transport and land-use planning, local regulation, building control, libraries, local and regional parks and overall corporate and strategic planning for the Auckland Council group, including CCOs.
9 In some respects this was a less daunting task than it may have appeared, because a number of the concerns were relatively ill founded – largely because the public did not understand the full range of tools that the council had available to it for ensuring effective control over its CCOs.
10 These requirements are common to each of the seven CCOs.
11 At the time of writing the advice that elected members had received was still confidential, so these comments are necessarily somewhat speculative.

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