



Options for Future Ownership of the Shares in Unison Networks Limited

**A Report by the Directors of Unison Networks Limited
to the Hawke's Bay Power Consumers' Trust**

8 February 2007

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Unison Networks Limited Ownership Review, 23 January 2007;
PricewaterhouseCoopers

1. Introduction

The Directors of Unison Networks Limited (Unison) have prepared this report as required by Clause 4 of the Hawke's Bay Power Consumers' Trust Deed.

Clause 4 states that the Trustees shall require the Directors to prepare a report considering proposals and available options for the future ownership of the shares of the Company. The Trust currently owns 100% of the shares in Unison.

The Trust Deed requires the Trustees to initiate ownership reviews within five years of making a decision on any previous review, as long as the Trust continues to hold any shares in the Company.

Clause 4 specifies the minimum contents of the report and specifically requires the Directors to set out their conclusions as to the most appropriate form of ownership for the future period.

This is the third review of the ownership of the shares of the Company. The first review was completed in 1996 and the second review was completed in 2001. At a public meeting held on 11 October 2001, the Trustees resolved:

"It was moved by K Gilligan and seconded by B Pattullo that given the views expressed by the public, as consumers, and the Directors, the shares in Hawke's Bay Network Ltd will remain in Trust ownership."

2. Brief Company History

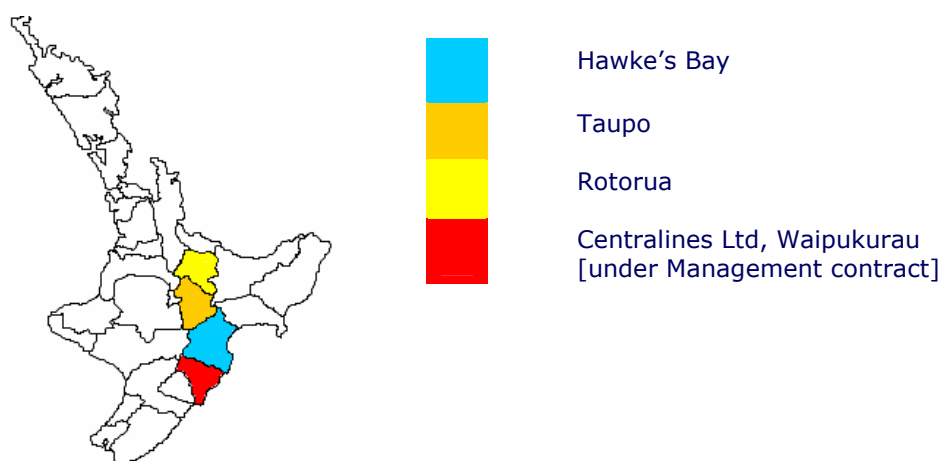
Hawke's Bay Power Distribution Limited was formed on 23 May 1993 in accordance with provisions of the Electricity Companies Act 1992. Hawke's Bay Power Distribution Limited and its subsidiary, Hawke's Bay Power Limited, traded as "Hawke's Bay Power". All the shares in the parent company were vested in the Hawke's Bay Power Consumers' Trust.

Due to requirements of the Electricity Industry Reform Act 1998 the electricity retail business was sold on 30 September 1998. This left the Company with the electricity network and energy related service activities. The name of the Company was subsequently changed to Hawke's Bay Network Limited in January 1999. The Company was further restructured in 1999 with the sale of non-core activities and the contracting out of some activities previously carried out internally.

The Company acquired the distribution network assets servicing consumers in the Rotorua and Taupo areas in November 2002. The Company was renamed Unison Networks Limited in April 2003.

Unison is currently the fourth largest electricity distribution business in New Zealand, supplying consumers in the Hawke's Bay, Taupo and Rotorua regions.

In addition, Unison provides management services on a contractual basis to Centralines, an electricity lines company based in Waipukurau, Central Hawke's Bay.



Unison currently has an annual turnover of \$90 million and total assets of \$480 million. Unison distributes approximately 1,700 GWh of electricity annually across remote rural areas and highly populated urban areas. The network spans 9,317km covering a supply area of some 11,000 square kilometres. The network includes 30 zone substations owned by Unison, 14 connection points to the national grid and generation plants.

Unison outsources approximately 80% of its capital and maintenance work, with the balance being carried out by Unison's own specialised service delivery teams.

3. Requirements of the Trust Deed

The object of the Trust is to:

"hold the shares in the Company on behalf of the consumers and distribute to the consumers, in their capacity as owners, the benefits of ownership of the shares in the Company and to carry out future ownership reviews involving public consultation in accordance with the terms of [the Trust] Deed."

Under the Trust Deed the Trustees are required to undertake a review of the ownership arrangements of the Company. Clause 4 of the Trust Deed sets out the process to be followed for the initial review and each subsequent (five yearly) review. Clause 4.8 requires that, subsequent to the first review after vesting (the first review having been undertaken in 1996) *inter alia*:

"... within five (5) years of the decision of Trustees on the initial review and at five (5) yearly intervals thereafter ... the Trustees shall initiate a review, such review to be completed in accordance with the provisions of Clauses 4.1 to 4.7."

As part of each review, the Trustees are required to request a report from the Directors of the Company considering proposals and available options for the future ownership of the shares. Clause 4.1 specifies *inter alia* that:

"... the Trustees shall require the directors of the Company to prepare a report considering proposals and available options for the future ownership of the shares. If the directors of the Company have failed to produce such a report within six (6) months of being requested to do so by the Trustees, the Trustees shall prepare such report."

The Trustees formally requested a report from the directors of the Company on 14 September 2006.

The detailed requirements of the report, as specified in clause 4.1 of the Trust Deed, are included in section 5 of this report.

4. Directors' Review of PwC Report

In order to fulfil the requirements of Clause 4.1 of the Trust Deed, the Directors have sought a report from PricewaterhouseCoopers ("PwC"). The PwC report was sought to provide advice to Directors on the ownership structure that is preferable, having regard to the Directors' obligations to act in the best interest of the Company. PwC also undertook analysis of the performance of Unison under Trust ownership and relative to other Electricity Lines Businesses ("ELBs").

The Directors believe that it is important for the vitality of the Company and for value creation for the shareholder and beneficial consumer-owners that the business is able to expand and grow. The PwC report identifies that Trust ownership may limit the Company's ability to access capital necessary to achieve the growth objectives of the business. However, it is also recognised that:

- Unison has existing financial flexibility through its ability to increase its level of debt within prudent limits i.e.: Unison will raise additional debt funding to finance some of its growth opportunities.
- A number of options will be available to the Company to access additional capital as and when this is required. Some of these may not impact materially (if at all) on the ownership structure.
- Capital will be needed only when growth opportunities of a certain size arise. Such an opportunity will need to be supported by a compelling business case, including persuasive reasons for additional equity capital (if required). At that point the Trust can reassess the Company's ability to access equity capital and the appropriateness of the ownership structure.

In summary, while the Directors recognise that the Company's intention to grow will bring a requirement for additional funding, there are no identified projects which could not currently be financed under the existing ownership structure. It is possible that further growth opportunities will arise on an opportunistic basis and these can be addressed when they arise. Any material growth opportunities will succeed (including obtaining all necessary approvals and accommodations from the Trust) on the strength of the particular opportunity and will require assessment, at the time, of the various funding and structural implications and options. The Directors, therefore, do not see the Company's growth strategy, per se, as requiring a change to the current ownership structure at this point in time.

Based on the PwC review of Trust ownership and alternative ownership structures, the Directors concur with the PwC conclusion:

"The key advantages of retaining 100% HBPCCT ownership are the ability for the Trust to balance financial and non financial performance, the simplicity of the structure and the role of custodian for existing and future generations of Hawke's Bay consumers. ... It is the most simple option to implement, because it requires no change from the Status Quo."

The business has changed dramatically since the last ownership review and has faced several major challenges.

The acquisition of the network assets serving the Rotorua and Taupo areas significantly increased the size of the business. This has brought benefits in terms of scale and the ability of the business to develop its capabilities in the key areas of asset management, planning, operation and maintenance.

At the time of the last ownership review the Company was operating as a low cost/low price business. At that time it was recognised that, with an ageing network, a low cost approach would not be sustainable. This necessitated an increase in prices. This conscious realignment of costs and revenues is demonstrated in the industry statistics and Unison's rankings against its peers.

The Directors note PwC's conclusion from its review of Unison's performance under Trust ownership:

"In relation to comparable ELBs, Unison displays comparable levels of system reliability once extreme weather events are taken into account. Both revenues and returns have increased in 2005, as have costs, albeit from a low base. Overall the performance of Unison is well within the expected range of its peers."

Trustee Appointment Process

PwC also observe that the Trust model is heavily dependent on the three yearly election cycle and the calibre and interests of local Trustee candidates. The Directors consider that the Company has been, and continues to be, well served by the elected Trustees over recent years but recognises the potential for significant change in the make-up of the Trust following an election and the potential for a sea-change in the direction of the Company as a result. Such dramatic changes are considered to not be in the best interests of the Company.

The Directors recommend that the Trustees undertake a review of the Trust Deed, in particular reviewing the Trustee election process by:

- increasing the number of Trustees from five to six;
- lengthening Trustees' terms to four years;
- staggering the election cycle of Trustees so that no more than half of the Trustee positions are subject to re-election at any one time every (i.e.: three Trustee positions are made available every two years); and
- remove the limitations on the number of consecutive terms as Trustee.

5. Summary of Directors' Responses to Clause 4.1

The Directors specific responses to the matters specified on Clause 4.1, and which are to be contained within the report, are:

- 4.1.1** an analysis of the performance of the Company to the date of the report together with a summary of the benefits or otherwise of such ownership to Consumers

Directors' Comment:

The analysis of Company performance is included in the attached report from PwC, as are the benefits or otherwise of Trust ownership to Consumers. The Directors consider that the Company has performed in line with industry averages and believe that it is on a path to improved performance relative to its peers.

- 4.1.2** an analysis of other ownership options including, without limitation, share distribution to Consumers, sale of shares to the public, sale of shares to institutional investors, compared with retention of ownership by the Trust

Directors' Comment:

The analysis of other ownership options is included in the attached PwC report. The Directors do not believe that other forms of ownership are preferable to Trust ownership at this time.

- 4.1.3** a comparison of the Company's performance with the performance of other companies engaged in energy distribution

Directors' Comment:

The comparison of Company performance with the performance of other companies engaged in energy distribution is included in the attached report from PwC. The Directors acknowledge that Unison's average cost and revenues have moved from being relatively low by comparison with other ELBs to being mid range and consider this is appropriate given the increasing need to maintain and replace the ageing assets in the network. System reliability statistics are also comparable to other ELBs.

- 4.1.4** the conclusion of the Directors as to the most appropriate form of ownership together with an indication whether the conclusions are unanimous and, if the decision is not unanimous, a summary of the conclusions of the dissenting Directors.

Directors' Conclusion:

The Directors are unanimous in concluding that Trust ownership remains the most appropriate form of ownership at this time.

4.1.5 if a distribution of shares is recommended the matters contained in paragraphs (a), (b) and (c) of Clause 4.6

Directors' Comment:

Given the unanimous support by Directors for retention of Trust ownership, a distribution of shares is not recommended.

4.1.6 a statement as to whether or not the Directors have had regard to any views expressed by the public with respect to ownership

Directors' Comment:

The Directors are generally aware that in the period since the last ownership review there has been overwhelming support for continued Trust ownership, however, the Directors have not specifically consulted with the public with respect to ownership options. The Directors recognise that the Trust will undertake a consultation process, in accordance with the Trust Deed, to allow interested parties to express their views prior to the Trustees making a decision on the appropriate ownership option for the shares in Unison over the coming period.

4.1.7 a summary of the professional advice (if any) obtained in respect of the preparation of this report.

Directors' Comment:

The Directors sought advice from PwC and the full PwC report is attached to this report.