Auckland Energy Consumer Trust

## Review from the Chairman

I am pleased to give the following report on behalf of the Trustees of the Auckland Energy Consumer Trust (AECT) for the year ended 30 June 2006.

The major event of the year was the change from the Trust holding 100% of the shares in Vector to a majority shareholding with 75.1% of Vector's shares. The remaining 24.9% of Vector shares were made available through the process of an Initial Pubic Offering (IPO) in August 2005. The purpose of the IPO was to raise funds for Vector to acquire the energy company NGC. Vector shares are now listed on the New Zealand Stock exchange.

As part of the IPO, Trust beneficiaries were given the opportunity to purchase shares in Vector through the AECT priority offer. I am pleased to report that 34,000 beneficiaries took up that opportunity.

## About Vector

Since acquiring NGC, Vector has become a more diversified business, with a portfolio of electricity, gas and telecommunication assets which are worth $5.7 billion.

That compares to the $3 billion asset value prior to the acquisition.

This is a significant increase in scale, not only for Vector but also for the Trust which owns 75.1% of this much enlarged business.

This increase in the size and scope of Vector has been reflected in the increased dividend payments which the Trust receives and distributes to beneficiaries.

## Dividend

As the majority shareholder of Vector Limited, the AECT receives dividends from Vector. The payment to the AECT is then distributed to all AECT income beneficiaries as a dividend.

AECT income beneficiaries are defined as Vector customers residing in the former Auckland Electric Power Board area on the date a roll of beneficiaries is struck for dividend distribution purposes. That area covers Auckland City, Manukau City and parts of Papakura.

In September 2005 the Trust paid each beneficiary a dividend of $180.

This amounted to a total distribution by the Trust of $53.5 million.

The $180 dividend was an increase on the previous year's dividend of $170.

Higher again is the 2006 dividend of $310 which is noted here although it is outside the dates of this report. The increased dividend is due largely to the increased earnings of Vector following the NGC purchase, the related IPO and the debt restructure.

This most recent dividend was significantly higher than in previous years, and almost twice the average monthly power bill for a family of four, and for this and other reasons, it was paid by cheque rather than as a credit on beneficiaries' power account as has been the practice in the last few years. I am pleased to note that, despite an incident where 166 cheques were stolen with mail from letterboxes in the Parnell area, the payment has proceeded smoothly.

## Financial Review

The audited financial statements of the Trust for the year ended 30 June 2006 are attached.

As noted in the accounts, interest received by the Trust this year has increased from $643,000 to $1.639 million.

The reason for the higher interest is that we received two dividends from Vector this year. An interim dividend was received in April and placed on term deposit. Consideration was given to paying an interim dividend to beneficiaries but there were several tax issues to clarify which weren't answered until nearer the time of the full year dividend, and we were also mindful of the additional administration costs in paying the dividend twice in one year. However this option may be considered in future.

Another key figure in the accounts is the Trust's operating expenditure of $2.397 million which is slightly down on last year's expenditure of $2.460 million.

In terms of expenditure, operating costs have increased relative to past levels.

| | |
|---|---|
| 2003 | $1.839million (annualised) |
| 2004 | $2.037million |
| 2005 | $2.460million |
| 2006 | $2.397million |

The higher costs reflect the increased scale and complexity of the Trust's operations. We do not have a large staff, just our two employees, so the Trust regularly requires outside, specialised assistance to deal with complex legal, financial and industry related issues. This is necessary because it is the duty of the Trustees, acting in the best interests of beneficiaries, to seek independent, professional advice and assistance as and where it is needed.

## Committees and Meetings

During the year there were 16 full Trust meetings, and 18 meetings of subcommittees.

Attendances at the Trust meetings from 1 July 2005 to 30 June 2006 were as shown here.

**Trustees Meeting Attendances : 1 July 2005 – 30 June 2006**

| | Full Trust | Business Planning Subcommittee | Strategy Subcommittee | Nominations Subcommittee |
|---|---|---|---|---|
| Warren Kyd | 15 | 2 | 10 | 3 |
| Shale Chambers | 16 | 2 | 13 | 3 |
| Michael Buczkowski | 10 | 1 | | |
| John Collinge | 12 | | | |
| Karen Sherry | 16 | 1 | 13 | 1 |

In addition, Trustees attended a number of Vector briefings and other events on behalf of the AECT.

**Trust structure**

During the year, the Trustees became aware that talks were taking place at very high levels between government officials and local authorities, including the Auckland City Council and the Auckland Regional Council, regarding the future of the Trust.

The Trust was set up in 1993 as part of the electricity reforms and, under the terms of the trust deed, will not be wound up until 2073. At that time the Trust's assets will revert to its capital beneficiaries which are the three local authorities in the original Auckland Electric Power Board area: Auckland City, Manukau City and Papakura District.

The Trust understands that one proposal put to government was that the termination date be brought forward significantly. This would require a change of legislation.

In order to have an objective view of the best options for the future of the Trust, an independent report was commissioned from The New Zealand Institute of Economic Research (NZIER). This was published in September this year.

The report evaluated the current trust arrangements against four alternative ownership structures that had been suggested. The alternatives were:

- local council ownership of the Trust's current shareholding in Vector;
- appointment of a professional trust company to manage the trust instead of the current arrangement of five trustees directly elected by the income beneficiaries of the Trust;
- the distribution of the shares in Vector owned by the Trust to the income beneficiaries, the local authorities that are capital beneficiaries and the Auckland Regional Council; and
- the transfer of the shares owned by the Trust to a special purpose body, so it can use the income and capital of Vector to fund other infrastructure investments in Auckland, like roads, urban rail and other public transport.

The report stated that none of the alternative arrangements or options is completely free from all, or even most, of the potential criticisms and allegations that might be levelled against the current arrangements. The conclusion NZIER drew from the evaluation is that, on almost every measure and against any reasonable weighting of the various criteria, the current arrangements are superior.

The full report is available on the Trust website and has been made available to government ministers, members of parliament, local bodies and government officials.

I recommend you view the report because this is an issue that continues to be a threat to the Trust's beneficiaries.. Indeed, earlier this month the Auckland City finance committee chairman Vern Walsh confirmed that the Auckland City Council is pressing for local government ownership of the Trust assets.

**Trust role and rights**

As mentioned earlier, the major activity of the year related to the change in the Trust's shareholding in Vector and the associated public offering of shares and listing of Vector on the New Zealand Stock Exchange.

The decision to authorise Vector to proceed with a public offering of shares was made by the Trust after careful consideration of the proposal and how it would affect the Trust and its beneficiaries.

One of the critical considerations was that the Trust should retain its important and traditional rights including:

- The right to be consulted on any network price increases to Trust beneficiaries, and
- The right to require the company to continue its undergrounding programme.

During the year, the Trust also addressed one further important right.

**Direct representation on Board**

Prior to the IPO, when Vector was wholly owned by the Trust, we were able to exercise our fiduciary duties through an arm's length relationship under which Vector consulted us on strategic direction, significant investment decisions and the company's annual business plan.

However since Vector listed on the stock exchange in August last year this has become more difficult due to the continuous disclosure requirements of the Securities Markets Act and the Listing Rules.

As a result, the Trust took the decision to appoint two Trustees to the Vector Board of Directors, as allowed for in the Trust Deed. This ensures that the Trust, as majority shareholder, has direct representation on the board and is at all times fully abreast of the company's plans. As the holder of a 75.1 per cent stake in Vector, the Trust has a direct and immediate interest in ensuring the company's success on behalf of our almost 300,000 beneficiaries, and so the decision was made to exercise our rights under the Trust Deed. Subsequently, two Trustees, Karen Sherry and Shale Chambers, were appointed to the Board.

The Trust was mindful of an earlier commitment given to the Government that whilst the Trust remained 100% owner of Vector there would be no Trustee directors. We consulted with the Minister of Energy about the changed circumstances and the Trust's view that direct representation on the Vector Board was appropriate, and the Minister, David Parker, said he had no objections.

I consider that Trustees would be failing in their legal duties were they not to appoint Trustee directors to the Vector Board.

**Appointment of Directors**

The Vector Board of Directors has 5 other directors appointed by the Trust. These are: are Michael Stiassny (Chairman), Tony Gibbs, John Goulter, Greg Muir,  and Bob Thomson.

In April this year,  Don McLaren retired as a director of Vector Limited, as he had advised prior to the IPO.

Earlier this week, Brian Plimmer also announced his retirement from the Board.

We thank Don and Brian for the significant contribution they have made to the Board during a period of significant growth for the company, involving major acquisitions and Vector's public listing.

We also thank all the Directors, and Chairman Michael Stiassny, for the immense contribution they make to the company's achievements, especially in view of the regulatory challenges that the company faces.

**Company achievements**

One of the major achievements reported by Vector this year has been the successful integration of NGC and Vector. The company is now a more diversified business and is in the unique position of being able to offer a 'triple play' of electricity, gas and telecommunications capabilities.

The company's financial results for the year were very satisfying, with net earnings ahead of the forecasts provided in the IPO prospectus.

Key financial results reported by Vector include:

- Net profit after tax (NPAT) of $45.1 million which was above the prospectus forecast of $36.5 million.

- Net profit after tax and before intangible asset amortisation of $143.7 million, above the forecast of $134.7 million.

- Earnings of $578.8 million before interest, tax, depreciation and amortisation (EBITDA) which is in line with the prospectus forecast.

- A total dividend for the year of 12 cents per share, which is ahead of the 11.5 cents forecast in the prospectus.

The Trustees, on behalf of AECT beneficiaries, thank the management and staff of Vector for their dedication and hard work during what was a particularly challenging year.

**Regulatory Intervention**

Although it is outside the period for this report, it is appropriate that I comment here on the situation regarding the Commerce Commission.

In August this year, the Commerce Commission announced its intention to declare control of Vector's electricity distribution charges. The Commission cited a number of reasons for such an intention and commenced a public consultation process for those interested to outline their perspective.

I am pleased to advise that earlier this month, the Commission accepted in principle Vector's offer for an administrative settlement, and to put it out for public consultation. It was the recommendation of the Trust's industry and legal advisors that the Trust support the settlement in the awareness that rebalancing is inevitable as the Commission is requiring other lines businesses also to rebalance their prices. We will now participate in the consultative procedure and do all in our power to secure a successful outcome.

Entering into an administrative settlement also will result in the removal of the prospect that the Commission will declare control of Vector.

The proposed settlement will formalise the staged rebalancing which Vector embarked on two years ago, and which is due for completion in 2009. Regrettably, domestic customers in the Trust district are experiencing increased electricity prices as a result of the rebalancing programme.

However, for the great majority of our beneficiaries, the increase in price is presently more than offset by the increased dividends received by beneficiaries. The most recent dividend of $310 is almost double what the average annual impact per household will be from the rebalancing.

**Undergrounding**

The Trust is pleased to report on the progress of the Overhead Improvement Programme, more commonly known as undergrounding.

The undergrounding of overhead lines is a continuing benefit for Trust beneficiaries that is carefully protected by the Trustees.

The Trust has an agreement with the company that at least $10.5 million a year - with further increases in line with the Department of Statistics Producers Price Index – is invested in undergrounding lines in the AECT district. That is, in Auckland City, Manukau City and the northern parts of Papakura.

In the year to 30 June 2006, the actual expenditure was $10.517 million.

Key achievements of the undergrouding programme this past year were:

- The large scale projects in Glen Innes and Weymouth were both completed.

- The large scale project in Howick was started and is due to be completed in April 2007.

- Smaller projects were completed in:
  Ormiston Road, Otara
  The Parade, Taranaki Road, and Devore Street, St Heliers
  Jervois Road and Hamilton Road, Herne Bay
  McVilly Road, Manurewa
  Russell Street, Freemans Bay
  St Stephens Avenue, Parnell
  The Strand, Onetangi
  Kiwi Esplanade, Mangere
  and
  Ron Keat Road and Railway West Street, Papakura

- Work is underway in the Motions Road, Western Springs, project.

The Trust is pleased to see the progress of undergrounding around our region and we are especially pleased that we have a formal agreement with the company for this to continue.

The budget for the coming year will increase slightly to $10.9 million and specific projects have been identified for this budget.

**Trust staff**

In February this year the Trust appointed Mark Bogle as executive officer, succeeding Gary Sturgess in the role. Mark is an experienced business consultant and was previously founding CEO of publicly listed Evergreen Forests and a director of the New Zealand Forest Industries. His qualifications include a Master of Public Policy and he is a member of the Institute of Chartered Accountants. We welcome Mark's business skills and investment management experience.

We also acknowledge the continuing dedication and hard work of our office administrator, Joy Stevens. We thank Joy for all the support she gives the Trustees and the Trust.

**Election of Trustees**

The triennial election of Trustees for the Auckland Energy Consumer Trust takes place in October 2006. Voting documents have been sent to beneficiaries and must be returned by the closing date of **5pm Friday 27 October 2006.**

This year, 20 candidates are standing for the 5 positions of Trustee. Information about all candidates has been sent with the voting papers or is available on the election pages at the Trust website, www.aect.co.nz.

**Energy Trusts of New Zealand (ETNZ)**

We are pleased to continue to support this organisation and to act as an information centre for the sharing of industry issues with the ETNZ membership. ETNZ recompenses AECT financially for providing this service.

**Annual Meeting of Beneficiaries**

The fifth annual meeting of beneficiaries will be held on Thursday 19 October at the Great Northern Room, Auckland Racing Club and Ellerslie Convention Centre, 80-100 Ascot Avenue, commencing at 7pm.

**Appointment of Auditors**

Grant Thornton are the current auditors of the AECT. Trustees will be recommending to beneficiaries that Grant Thornton be appointed auditors of the AECT for the year ending 30 June 2007.

## Acknowledgements

This has been a most significant year for the Trust, which now manages an investment where the shares alone are worth almost $2 billion. By all measures, the Trust has a most valuable role to play on behalf of its nearly 300,000 beneficiaries.

The issues facing the Trust continue to be complex and challenging. By necessity, the Trustees take – and will continue to take – the best possible independent, professional advice as we seek to do what's right for the Trust's beneficiaries. But, even with the benefit of that advice, the responsibility of our task places considerable demands on the Trustees, and I thank them all for their effort and contributions throughout the year and for their support to me as Chairman.

Warren Kyd
**Chairman**
October 2006