Making a capital repayment to ratepayers

There has been recent publicity regarding capital repayments to consumers made by some electricity trusts, and hence this is a topical issue.

On a political or philosophical basis, there will always be a divide between those who believe that individual ratepayers should be able to decide how best to spend the money, and those who believe that greater public benefit can be obtained by combining the resources of individuals to enhance the City as a whole.

On balance, and having taking independent economic advice, the Council has concluded that there would be greater public good from retaining the capital in a separate investment fund to provide a continuing benefit to the City. The Council views the availability of this capital as a unique opportunity to further enhance the long-term wealth of the City for the benefit of current and future generations.

Quite distinct from the philosophical or economic viewpoint discussed above, there would be some very significant legal, equitable and practical issues to be addressed (discussed below) before a return of capital to ratepayers could be contemplated.

No Legal Power to Return Capital

From a legal perspective, local government legislation is restrictive as to what councils can do. The legislation is expressed in terms of what councils are legally permitted to do, with the corollary that any action outside the specified activities is illegal. There is no power in the legislation to return funds directly to ratepayers.

Distinction between councils and electricity trusts

The Council's situation must be distinguished from that of local electricity trusts. The Energy Companies Act 1992 established energy companies out of two previous structures, with the resulting ownership of the newly-corporatised bodies depending on that structure.

The first of these structures – Municipal Electricity Departments ('MEDs') – evolved from departments of urban councils. Generally when the MEDs were corporatised under the 1992 Act, the shares were vested in the local authorities that had owned them.

The other types of structure – power boards – had no obvious owners, as they were established by Act of Parliament in the 1930s to reticulate rural areas. When the 1992 Act required the power boards to be corporatised, statutory provision was made for ownership of the shares to be vested in a local trust to represent the local consumers as there were no other obvious owners. These trusts do not operate under the same statutory restrictions as Councils.

Any capital repayment by an energy company will be made to its owner – the local council in the case of most urban electricity companies and the trust in the case of the rural companies. Often the trust will in turn return the capital to the consumers, since it has no alternative use for the money. Councils, on the other hand, have a multitude of community uses for the capital, and it is quite proper that they use the funds for community purposes, given that the MEDs and the earlier electricity departments were originally established and developed using Council funds.

Allocation of repayments – inter-generational and other equity issues

If, for the sake of argument, it was legally possible for the Council to return capital to the ratepayers, there would be significant issues regarding the allocation of the payments. For example, ratepayers are not the same body of people as Orion's electricity consumers. In particular, non-ratepaying consumers such as tenants would not benefit from such a repayment, even though they may have been long term Southpower/Orion customers. There are also some significant inter-generational and equity issues.

- Should people who have only just moved to Christchurch benefit equally to long-standing residents?
- Should the present generation of ratepayers receive a windfall payment at the expense of future generations?

A one-off Increase in Capital Expenditure

There is no proposal to use the capital returned for additional capital projects. All of the capital is proposed to be invested in either the long-term investment fund or the debt repayment reserve.

Applying Funds to Reduce Rates

If the capital sum is applied directly to reduce the rates requirement of the Council it will have an impact on the year it happens and a significantly adverse impact on the rate increase in the following year. The following table illustrates this point by showing how a reduction of $5 million in year 2 will create a rate decrease of 3.1% in year 2 and a rate increase of 7.4% in year 3 (this would have normally been 2%).

	Year 1	Year 2	Year 3
Normal Rates Required million (assumes 2% increase on previous year)	$98 million	$100 million	$102
Temporary Rate reduction	Nil	$5 million	Nil
Reduced rates required million	$98 million	$95 million	$102
Rates increase	N/A	-3.1%	7.4%

Application of the interest reduction from debt repayment or the interest income from the proposed Capital Endowment Fund can have an ongoing impact in terms of the level of total rates provided it is applied consistently in successive years. It would mean however, that the income once applied in this way could not be used in later years for other things without causing a spike in the level of rate increases. Use of the funds on a single year basis to reduce a rates increase will have an adverse affect on the following year in terms of the percentage rate increase. By way of example, the Council is concerned about the spike in forecast rates in year 2004/05 when there is a forecast rates increase of 8.60%. If the Council was to apply the income from the Capital Endowment Reserve to reduce this spike it would merely defer the impact for one year. The following table illustrates this issue.