The Treasury

Mixed Ownership Model for Crown Commercial Entities:
Treasury Advice Information Release

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Release Document

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

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[3] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[4] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.
Date: 27 February 2012

To: Minister for State Owned Enterprises

**Aide Memoire: funding sources for SOES**

This note responds to your request for some information on the funding options available to SOEs. We understand you wanted this material urgently so we have kept our response brief. Please let us know if you require more in-depth information.

SOEs have access to most, if not all, of the funding options available to other companies, except that they are unable to issue ordinary shares to anyone other than the Crown. Publicly listed MOM companies will be able to issue ordinary shares to entities other than the Crown only where this does not conflict with the 51% Crown minimum shareholding or 10% maximum non-Crown shareholding requirements.

We describe the main funding options below.

**Ordinary shares:** An ordinary share represents equity ownership in a company and entitles the owner to a vote in matters put before shareholders in proportion to their percentage ownership in the company. Ordinary shareholders are entitled to receive dividends and their share of the residual economic value of the company should the business unwind. A low cost source of finance for expansion is retained earnings where the company pays out less than its full earnings in dividends. SOEs have typically funded their growth through retained earnings.

**Bank Borrowings:** senior ranking debt from banks ranging from short term lending in the form of an overdraft through to medium-term loans for a period from three to ten years. The rate of interest charged on medium-term bank lending to large companies will be a set margin, with the size of the margin depending on the credit standing and riskiness of the borrower.

**Corporate Bonds:** debt securities that are generally subordinated to senior debt such as bank borrowings. Bonds typically have a set maturity date and a coupon rate indicating the level of interest paid annually on the security. Corporate bonds would generally be tradable on debt markets and would generally require a higher interest rate than bank borrowing due to their lower ranking in the event of liquidation.

**Hybrid Securities:** these are securities that have a mixture of debt and equity characteristics. SOEs have the ability to use a number of different types of hybrid securities as long as they do not require the issuing of shares to non-Crown shareholders. Under s.12 of the State Owned Enterprises Act 1986, if authorised by a resolution of the House of Representatives, SOEs may issue equity bonds, effectively non-voting shares. Equity bonds would be entitled to a dividend in a fixed proportion to the shares held by the Crown, and would be tradable on the stock exchange. They
could also have other features, such as a fixed term, a dividend tied to a benchmark interest rate or convertibility to voting shares sometime in the future.

In accordance with s.11(2) of the SOE Act redeemable preference shares can also be issued by SOEs as long as they cannot convert into ordinary shares and do not provide voting rights. Preference shares have a fixed percentage dividend before any dividend is paid to the ordinary shareholders. As with ordinary shares a preference dividend can only be paid if sufficient distributable profits are available, although with 'cumulative' preference shares the right to an unpaid dividend is carried forward to later years. The arrears of dividends on cumulative preference shares must be paid before any dividend is paid to the ordinary shareholders.

One example of a hybrid security would be the $275 million issue of capital bonds by Genesis Energy in April 2011 at an interest rate of 8.5%. These bonds feature an early redemption option for the issuer after 5 years and at every interest payment date thereafter and allow Genesis to defer interest payments for up to five years if the company’s credit rating falls below BB+.

**Joint Ventures:** SOEs have the ability to enter into joint ventures with external parties in order to access third party funding, for example, by forming subsidiaries and issuing equity in those subsidiaries to non-Crown shareholders. An example of this is Mighty River Power’s approximate 75% interests in the Rotokawa steam field and the Nga Awa Purua geothermal station. The remaining interests in those assets are owned by Maori trusts.

**Project Finance:** SOEs have the ability to use project finance for given investment proposals. Project finance involves financing a given project with a non-recourse or limited recourse financial structure where project debt and equity used to finance the project are paid back from the cashflow generated by the project.

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