

Treasury Report: South Canterbury Finance: Managed Receivership

| | | | |
|--------------|------------------|-------------------|------------|
| Date: | 1 September 2010 | Report No: | T2010/1625 |
|--------------|------------------|-------------------|------------|

Action Sought

| | Action Sought | Deadline |
|---|---|------------------|
| Minister of Finance (Hon Bill English) | Note the process and operation of a managed receivership assuming that a receivership is not quickly resolved on the basis of SCF assets being sold early as a going concern. | 3 September 2010 |

Contact for Telephone Discussion (if required)

| Name | Position | Telephone | 1st Contact |
|---------------|-----------------------------------|------------------|--------------------|
| John Park | Manager, Deposit Guarantee Scheme | | ✓ |
| Joanna Gordon | Manager, Financial Markets | | |

Minister of Finance's Office Actions (if required)

| |
|------|
| None |
|------|

Enclosure: No

Treasury Report: South Canterbury Finance: Managed Receivership

Executive Summary

This report contains an outline of the process of a managed receivership for South Canterbury Finance (SCF). At 10.00am on 31 August 2010, Trustee Executors Limited (TEL) appointed Receivers to SCF.

Treasury has been considering the prospect of an SCF receivership and how the Crown would interact with that process. The Annex to this report describes these processes. This report does not cover specifics of any post-receivership deals that may be presented to the Receivers.

The Crown has positioned itself to effectively become the only stockholder and the sole party with rights to the assets under receivership by:

- Arranging to repay prior charge holders;
- Purchasing \$100 of SCF stock (which will not be repaid); and
- Paying out all eligible and ineligible depositors under the Retail Deposit Guarantee.

With the exception of the stock purchase (which had already taken place, giving the Crown voting rights should any matters require a stockholder resolution), these arrangements were put into effect shortly after receivers Kerry Downey and William Black (from McGrathNicol) were appointed.

In terms of the structure for the Crown engaging during the receivership, provision has been made for an Advisory Committee to be established. The Committee would comprise the Receivers, two Crown appointees and one TEL representative. The Advisory Committee would offer advice to the Receivers on the process of selling SCF's assets. The SCF receivership could take some time (e.g. it could be up to four years). The Advisory Committee would be the main way in which the Crown is kept informed of progress during the receivership and for the Receivers to be informed of the Crown's views. A delegation has been made to the Secretary of the Treasury and the two Deputy Chief Executives that enables the two Crown representatives to be appointed to the Advisory Committee.

Unless a transaction was agreed involving the purchase of SCF's assets out of receivership as a going concern (which, if this was an option, would take place relatively shortly into the receivership), an orderly realisation of SCF assets would proceed consistent with the Crown minimising its losses and maximising its gains..

A receiver will generally face a tension between the need for creditors to be repaid as soon as possible and the desire to maximise the return to those creditors. Receivers will need to determine whether to quick sales, possibly at a lower price are better or worse for creditors compared to a more measured approach over a longer time scale that may result in higher prices. The Crown has, through its pre-positioning, removed this tension. The Crown is also able to shape the Receivers' strategy to maximise the Crown's returns via the Advisory Committee and the Crown's stockholder voting rights.

Treasury has been investigating how the potential returns from a receivership may take place. SCF's assets comprise mainly loans. As has been widely discussed, there are both good (well performing) loans and bad (impaired) loans within SCF. To this extent, Treasury would expect there to be plenty of interest in the good book. Similarly, SCF's investment assets (consisting of Helicopters (NZ) Limited, which is New Zealand's largest helicopter

business; Scales Corporation Limited, which is a large apple grower and exporter; and Dairy Holdings Limited, which is New Zealand's largest corporate dairy farmer) are expected to be attractive to a range of investors and that on sale or more of book value is realistic.
[Withheld under s.9(2)(b)(i)]

The Receivers could receive a number of bids in a number of possible configurations including for example: for all the assets as a "going" concern, for the good and bad loan assets excluding investment assets; for specific or all parts of the good book; and for specific or all parts of the bad book.

Once the Receivers have formed an understanding of the assets under their control (which could take some weeks), the Advisory Committee would expect to be involved in key decisions on potential sales. As a first step, the Advisory Committee could be expected to be advised and to inform a strategy for the sale of SCF's assets. In any case, the Crown representatives will be seeking to maximise the Crown's returns and will be advising both the Government and the Receivers on the options that best achieve this.

The Crown representatives on the Advisory Committee would also be expected to ensure that the processes through which assets sold or realised are consistent with good practice from a Crown perspective. For example, that the process is transparent and competitive.

As the receivership progresses, we expect the Advisory Committee to be engaged in monitoring that progress to ensure the outcomes achieved remain consistent with the Crown's objectives, including maximising the return to the Crown.

Recommended Action

We recommend that you:

- a **note** the general approach to a managed receivership outlined in this report including the structure and process that would be put in place;
- b **note** that the objectives of the Crown representatives on the Advisory Committee would be to maximise the Crown's returns from the receivership and that the representatives would advise the Crown, as well as the receivership, on the options put forward as part of an overall strategy and on specific assets to achieve this objective; and
- c **note** that the Crown representatives on the Advisory Committee would also be expected to act in ways consistent with the Crown's expectations of good practice in relation to these matters.

John Park
Manager, Guarantee Schemes
for Secretary to the Treasury

Hon Bill English
Minister of Finance

Annex 1: Description of Receivership: South Canterbury Finance

1. This annex describes the details of a South Canterbury Finance Receivership.

Personnel involved

2. Trustees Executive Limited (the '**Trustee**') holds a general charge over South Canterbury Finance's (SCF) assets (the '**security**') on behalf of SCF's investors and, with it, the right to place SCF in receivership. The Trustee appointed a receiver to SCF on 31 August 2010.
3. The Trustee appointed Kerry Downey and William Black as the joint receivers of SCF (the '**Receivers**'). Kerry Downey and William Black are both partners of financial consultants McGrathNicol. As such, they will draw on the resources of their firm to manage SCF in receivership. The Receivers are supported by their legal adviser, Chapman Tripp, who is represented by partner, ^[Withheld under s.9(2)(a)]

Receivers' objectives

4. Once appointed, the Receivers' paramount duty is to exercise their powers in good faith and for a proper purpose. In this regard, their principal purpose is to manage an orderly sale of SCF's assets in order to recover as much cash as possible, thereby realising the Trustee's security (and, by extension, repaying the investors who claim through the Trustee). Although the Receivers' principal duty is to investors, the Receiverships Act also requires the Receivers to have regard to both the interests of unsecured creditors (who cannot rely on the Trustee's security) and to the interests of the Crown as guarantor.
5. When SCF was placed in receivership, the Crown paid \$1.8 billion to the Trustee to discharge in full the Crown's obligations to deposit holders under the Crown guarantee (The Crown does not expect that the full \$1.8 billion will be used and any excess is repayable to the Crown.) In addition, the Crown will provide a loan to the Receivers which they will use to repay the investors who hold charges over SCF's assets that rank ahead of the Trustee's security. Once the prior charges are discharged, the Crown will hold the sole beneficial interest in the security held by the Trustee. Although other creditors (such as trade suppliers and shareholders) will still have a claim against SCF, the Crown's beneficial interest will be by far the largest and will rank ahead of all other creditors bar those protected by statute (see below).

Advisory Committee

6. Under these arrangements, the Crown will have two means for communicating its interests to the Receivers. First, under the terms of the loan the Crown is providing to repay the prior charge holders, the Crown will participate in a committee (the '**Advisory Committee**') that offers advice to the Receivers on the process of selling SCF's assets. The members of the Advisory Committee will be the Receivers, two Crown representatives and one Trustee representative, together with any advisers that may be appropriate. The Advisory Committee will meet every fortnight and be the primary means through which the Crown is kept informed of the Receivers' progress and the Receivers are kept informed of the Crown's views on the options the Receivers face at each stage of the receivership.
7. A delegation has been made to the Secretary of the Treasury and the two Deputy Chief Executives that will enable the two Crown representatives to be appointed to the Advisory Committee.

Crown's stockholder rights

8. The second means the Crown will have to communicate its interests to the Receivers will be through the \$100 investment the Crown has made in SCF as a secured debenture holder and which will not be repaid under the arrangements noted in paragraph five. Because the Receivers' principal purpose is to realise the Trustee's security and because the Receivers' main duty is to act in the Trustee's best interests, the Receivers may consult the Trustee for directions when considering any options for the sale of particular SCF assets. In turn, because the Trustee acts on behalf of investors, the Trustee may call meetings of the deposit holders in order to seek their approval for any directions the Trustee wishes to give to the Receivers.
9. In this case, because the Crown will have repaid all other deposit holders on the first day of the receivership, the sole remaining deposit holder will be the Crown. Consequently, whenever the Receivers seek a direction from the Trustee and the Trustee seeks approval from the deposit holders, the Crown will be the sole remaining party with any voting rights, obtained through the \$100 secured debenture the Crown holds (and which it will continue to hold until the receivership is complete).
10. The Treasury made the \$100 investment under the authority provided by section 65I of the Public Finance Act. Under subsection 2 of that section, the Treasury has the power to invest the money on any terms and conditions that it thinks fit. Hence, Treasury officials have the authority to exercise the Crown's voting rights if and when the Trustee seeks the views of the sole remaining deposit holder.

Ranking of claims

11. Treasury does not expect that the sale of SCF's assets will recover enough cash to fully repay all of the secured creditors, including the Crown. In these circumstances, the Receiverships Act ranks claims in order of priority. The Receivers have the first claim on any cash they recover, to pay their fees and expenses. Certain claimants protected by the Personal Property Securities Act have the next claim. Payments of outstanding wages, PAYE and tax deductions rank third. The Trustee's security and, through it, the Crown's claim, ranks fourth.
12. Treasury expects the first three claims are likely to deduct approximately^[*] million from the amounts recovered from the sale of SCF's assets. The balance will be paid to the Crown under the Trustee's security, causing a loss to the remaining unsecured creditors who are not protected by statute.

Strategy for managing the receivership

13. While the Receivers' objective is to sell all of SCF's assets, the size and complexity of SCF's business mean that not all assets can be sold immediately. In addition, even if all the assets could be sold immediately, certain assets will fetch a better price at a later date if the Receivers can wait for a better offer, or if actions the Receivers can take in the interim mean a particular asset can be offer to potential purchasers in better condition.
14. For this reason, receivers usually face a tension between, on the one hand, the desire to maximise the return for creditors by delaying any asset sales until the best price can be obtained and, on the other hand, the urgent need many creditors have to be repaid as soon as possible. Thus, the key benefits to the Crown of removing all but the unsecured creditors are the patience the Crown can show in how the Receivers conduct the sale of SCF's assets and the Crown's ability to shape the Receivers' strategy to maximise its returns via the Advisory Committee and the Crown's stockholder voting rights.

Projections for the receivership

15. As such, Treasury anticipates that the receivership as a whole could take up to four years to complete, with the majority of assets being sold only in the second year of the receivership.
16. SCF's business is comprised of loans it has made to third parties, some of which are still performing well (the '**good loan book**') and some of which are impaired (the '**bad loan book**'). In addition, SCF either owns or is the major shareholder in three New Zealand companies with significant business value:
 - a Helicopters (NZ) Limited, which is New Zealand's largest helicopter business;
 - b Scales Corporation Limited, which is a large apple grower and exporter; and
 - c Dairy Holdings Limited, which is New Zealand's largest corporate dairy farmer.
17. The good loan book is likely to prove attractive to potential purchasers as a single sale of all the relevant loans. Alternatively, it may be sold in a small number of large blocks. Similarly, SCF's investments in the three companies noted above will also be attractive to potential purchasers, whether grouped together or sold separately. In all of these cases, Treasury has estimated that it should be able to recover at least [redacted] of the value of these assets.
18. Treasury estimates that the bad loan book could recover [Withheld under s.9(2)(b)(ii)] For this reason, it will be more difficult to sell in one block, although it may still attract offers. The risk for purchasers is [Withheld under s.9(2)(b)(ii)]