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Report to the Policy and Finance Committee
from Greg Schollum, Chief Financial Officer

WRC Holdings – Capital Restructuring

1. Purpose

To seek approval of a number of proposals in relation to rationalising the capital structure of WRC Holdings Limited ("the Company").

2. Background

In the past the Directors of the Company have expressed concern at the capital structure of the Company and have instructed officers to put forward proposals to rationalise the capital structure accordingly.

At their meeting on 29 February 2000 the Directors of the Company approved in principle the proposals included within this report and resolved to seek the agreement of the Wellington Regional Council ("the Council") as shareholder (refer to **Attachment 1** for the form of the consent required).

The proposals included within this report take into account the interests of both the Company and the Council.

3. What is being proposed through the Capital Restructuring?

3.1 Summary

In summary the proposals which, in principle, have been approved by the Directors are:

- to replace the bulk of the redeemable preference capital in the Company with ordinary share capital (which will make it easier in future for the Company to satisfy the solvency test when paying dividends to the Council);
- for the Council to repay its current account with the Company and for the Company to apply the proceeds from that repayment to return the share capital to the Council (the current account creates problems for Council's Treasury and the capital is not required by the Company at this time); and
- for the Council to subscribe for $5 million of new ordinary shares in the Company and for the Company to apply the proceeds from that issue of shares to acquire and cancel $5 million of existing ordinary shares in the Company (which will re-establish the nexus for tax purposes between Council borrowings and shares held by the Council in the Company which was removed in 1997).

Attachment 2 outlines the current capital structure of the Company compared with the capital structure post the rationalisation measures outlined in this report. Councillors will note the change in the mix of capital (i.e. it will be primarily ordinary share capital) and the overall reduction in capital as a result of the planned repayment of the current account.

3.2 Preference Share Capital

It is proposed that the bulk of the preference share capital in the Company be replaced with ordinary share capital. The current level of preference share capital in the Company creates problems when the Company wants to pay dividends to the Council. This is not a satisfactory situation for the Company or the Council to be in and the reasons for having redeemable preference share capital are largely historical.

The problems arise with the need for the directors of the Company to be satisfied that the Company will, immediately after the payment of a dividend, satisfy what is known as the solvency test. Satisfying the solvency test is a requirement of the Companies Act 1993. For the purposes of applying the solvency test when authorising a dividend, preference share capital must be treated as a liability (rather than equity), which makes it harder for the solvency test to be satisfied.

It is, therefore, proposed that the bulk of the redeemable preference shares be redeemed and replaced with ordinary shares to remove any impediment which may arise in connection with the Company authorising and paying dividends in the future. The Company currently has on issue the following redeemable preference shares:

Number of shares	*Date of issue*	*Amount paid up in respect of shares*	*Amount uncalled in respect of shares*
25,000	27 June 1991	$250	$24,999,750
1,200,000	16 August 1991	$13,500,000	Nil
1,466,600	20 May 1997	$1,466,600	Nil

The uncalled capital in respect of the 25,000 redeemable preference shares issued on 27 June 1991 is subject to a charge pursuant to the debenture executed by the Company in favour of the Company's Bank. No action is proposed in respect of those shares.

However, it is proposed that the 1,200,000 redeemable preference shares issued on 16 August 1991 and the 1,466,600 redeemable preference shares issued on 20 May 1997 be redeemed out of the proceeds of an issue of 15,000,000 ordinary shares issued for $1.00 per share.

The benefit to the Council of what is proposed will be to facilitate the future payment of dividends from the Company.

3.3 **Repayment of Current Account and Return of Capital**

Over the years the Council has cumulatively borrowed approximately $4.5 million from the Company on current account. That current account borrowing creates an unnecessary internal cost for Council's Treasury. Officers are proposing that the Council repay its current account with the Company and have the Company return share capital to the Council. From the Council's perspective the return of capital will mean that the intercompany liability can be extinguished. From the Company's perspective the current level of capital can be reduced without compromising the viability of the Company (on the basis that the transactions outlined in Section 3.2 above are completed first). In addition the Company has approximately $22 million of uncalled capital which is unencumbered (the remaining $53 million is effectively tagged as security for the Bank) should further capital be required in future.

It is proposed that the return of capital in the Company be by way of the Company acquiring a number of its ordinary shares for a price equal to the amount of the current account.

The benefit to the Council of what is proposed will be to remove a cost from Treasury and to remove an arrangement that is currently tax inefficient. (Interest paid by Council is currently non deductible for tax purposes but interest received by the Company is currently assessable for tax purposes).

3.4 **Re-establishment of Nexus Between Borrowing and Share Purchase**

In 1997, the Council's Treasury retired some $5 million of debt that had been raised to acquire shares in the Company. Officers now suggest that the Council should re-establish that debt to fund its shareholding in the Company.

To achieve the necessary nexus, for tax purposes, between the borrowings of the Council and its acquisition of shares in the Company, it is proposed that the Council subscribe for a fresh issue of 5 million ordinary shares in the Company for $1.00 per share with the Company applying the proceeds of that issue to acquire (from the Council) 5 million of its ordinary shares previously issued for $1.00 per share.

The shares which were originally acquired by the Council with the debt that was retired were 5 million of the ordinary shares issued by the Company on 28 March 1994. It is therefore proposed that 5 million of these shares be acquired by the Company.

The benefit to the Council of what is proposed will be to increase the amount of interest deductible for tax purposes which will flow through to increased tax losses within the Council.

4. How will the restructuring be effected?

The Companies Act 1993 provides a company with a number of mechanisms to issue and redeem shares and to acquire its own shares. In the case of a closely held company, the simplest procedure is by way of an entitled persons' agreement under section 107 of that Act. The only entitled person of the Company is the Council. Attached to this report as **Attachment 1** is a copy of the letter from the Company to the Council seeking its agreement to the proposed restructuring for the purposes of section 107 of the Companies Act 1993, the constitution of the Company and the terms of issue of the redeemable preference shares.

5. Other Considerations

5.1 Bank Consent

The restructuring of capital in the Company will require the consent of the Bank under the Debenture entered into in October 1998. Discussions already held with the Bank indicate that such consent should be forthcoming.

5.2 Funding Implications

Council's Treasury will ensure that the borrowings and other cashflows detailed in this report are put into effect within the normal treasury parameters and limits contained within the Treasury Management Policy.

6. Communications

The items included within this report are technical in nature and not expected to be of any interest to ratepayers.

7. Recommendations

(1) That the report be received and the contents noted.

(2) That the Committee recommend to Council that:

(a) it grant its consent to the capital restructuring proposals included within this report and, subject to the receipt of the necessary consent from the Company's Bank, authorise the Chief Financial Officer to put into effect the transactions necessary on behalf of the Council.

(b) it authorise the Council Secretary to affix the Council's common seal to the necessary documentation as evidence of the Council's consent to the restructuring proposals.

GREG SCHOLLUM
Chief Financial Officer

Attachment 1: **Capital Restructuring – Shareholder's Agreement to Proposals**

Attachment 2: **Issued Capital in WRC Holdings Ltd**
- current structure
- structure after proposed restructuring