

#### 4. CHRISTCHURCH CITY HOLDINGS REPORT - SALE OF ORION GAS NETWORK ASSETS

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Corporate Plan Output: Trading Activities Monitoring	

The purpose of this report is to inform the Council of the recent sale of Orion's gas networks and outline a process for considering the re-deployment of the sale proceeds.

##### **BACKGROUND**

In November 1999, after consultation with shareholders (including the Council), Orion commenced a process for the sale of its North Island gas networks. The sale process was a competitive one which culminated in the acceptance of an offer from United Networks on 22 March 2000.

The sale price was \$550 million and after the payment of taxes and expenses the net cash proceeds are expected to realise \$525 million. In addition, Orion have recently sold their interest in the Southdown co-generation plant in South Auckland and are seeking bids for the sale of their remaining 40 commercial gas retail customers. Once these proceeds are added to the network sale the expected net proceeds are likely to be approximately \$560 million.

In the mid 1990s, Orion (formerly Southpower) progressively acquired a gas network and retail company which serviced various centres in the North Island and was known as Enerco. This was a strategic purchase to provide counter climatic balance to the revenue streams of Orion. Following the introduction of government regulation in 1999, Orion opted to quit its electricity and gas retailing businesses and retain its network businesses. As Orion was no longer in the electricity retailing business there were no longer any synergies with the local electricity networking business and the market value for these assets was perceived to be well in excess of the value in Orion's books. A decision was therefore made to dispose of the North Island gas networks.

The acquisition cost for those assets was approximately \$330 million so there has been a capital gain from this transaction of approximately \$220 million.

Settlement of the sale is expected in early May but it will be sometime before decisions can be made on the distribution of the bulk of the proceeds.

##### **ISSUES TO CONSIDER**

Over the next few months the Council and Christchurch City Holdings need to work carefully through a wide range of issues before decisions can be made on specific application of the funds. A lot of background information needs to be gathered and analysed to provide CCHL and CCC with a sound framework on which to base its decision-making. Some of the issues which need careful study first are:

- The amount of funds which can realistically be extracted from Orion.
- An appropriate level of debt for Orion to match its reduced asset base.
- The level of debt which is appropriate for the CCC group as a whole.
- Assessment of the most efficient mechanisms for extraction of surplus capital from Orion.
- Ways of maintaining the revenue streams for the Council which will at least match those derived from the assets sold.
- Identification of possible replacement investments or debt reduction mechanisms.
- Ways of protecting these capital funds for the long term benefit of Christchurch residents
- Obtaining IRD binding rulings to support any capital repayments to the Council.

Standard and Poors have recently reviewed the credit rating of CCHL and CCC in light of the sale. While they have confirmed the existing credit rating in the meantime they have posted an outlook of ‘developing’. They will clearly be watching what is done with the proceeds of this sale and there is a clear expectation that at least in part there will be an application to reduce earlier group debt projections.

#### **DEPLOYMENT OF AVAILABLE FUNDS**

Broadly there are four main uses to which funds can be applied:

- New Investment in Orion
- New Investments by other Council owned companies
- New investments or debt repayment by CCHL which would yield a financial return
- Application of funds to other community investments by the Council.

The amounts available in each area will depend on:

- Firstly the projects which are available and which stand the scrutiny of analysis and feasibility studies where appropriate; and
- Secondly, on the financial structure of the group and its ability to transfer funds between Orion, CCHL, CCC and other subsidiaries in a tax efficient manner.

#### **PROCESS**

CCHL has had an initial strategy discussion on this process and has identified the importance of working closely with the Council on these complex issues. It will clearly be necessary to build a framework for evaluating options and this will be best achieved through an ongoing and developing dialogue with the Council as the issues are explored in a methodical way. This could take several months.

Clearly it is for the Council to agree on the overall framework and to determine priorities for the use of the funds which can be utilised for community purposes. However, CCHL considers that it is best suited to advise the Council on the overall strategy and consult with Orion on these matters. CCHL therefore seeks the approval of the Council to do the necessary work and consult with and advise the Council on the basis of its research.

If this process is agreed then CCHL would commence the dialogue with the Council by a series of seminars to inform the Council and obtain feedback on all the issues and aspirations on a regular basis until a formulated plan was agreed.

The Council will want to consult the public on the utilisation of the funds which are available. The timing for this consultation will depend on how complex the issues are and the time needed to fully investigate them. There is no urgency on the consultation as the bulk of the funds are unlikely to be available this calendar year. There could either be a round of public consultation (separate from the Annual Plan) later this calendar year or it could be part of the 2001 Annual Plan process. No decision is necessary on this detail at this time.

Once a plan for the deployment of funds is developed and agreed with the Council, it will be necessary to obtain IRD binding rulings on some aspects of the financial structuring to ensure that the decisions made are not open to later review for tax purposes. The time needed for this process can be quite lengthy.

#### **SUMMARY**

Significant funds are likely to be available from this process and the utilisation of these funds needs to be carefully planned so that the application is for the long term benefit of the community. An opportunity of such magnitude is unlikely to be available on a regular basis in the future. In light of the time needed to obtain access to the funds and assess options there is therefore no urgency for the final decision making although it is sensible to commence planning immediately so that the task is completed thoroughly and provides lasting benefit to the ratepayers of the city.

- Recommendation:**
1. That CCHL be asked to advise the Council on the issues outlined in this report with particular reference to:
    - (a) The proportion of available funds which should be used to repay debt within the Orion Group.

- (b) The proportion of funds which should be reinvested to maintain an income stream to the Council.
  - (c) The options for reinvestment of those funds.
  - (d) The funds that might be available for other purposes and investments.
2. That the Director of Finance be asked to advise the Council on appropriate levels of debt within the Council and the CCHL group.