Education Report: Approval to continue holding equity securities

To: Hon Chris Hipkins, Minister of Education

Date: 5 December 2018

Security Level: In Confidence

Drafter: Nash Anand

Key Contact: Emma Dorrian

Messaging seen by Communications team: No

Priority: High

METIS No: 1164414

DDI: S 9(2)(a)

Purpose of Report

This report seeks your approval (along with the Minister of Finance) to allow the Feilding High School Board of Trustees (the board) to continue holding all existing equity securities (shares) issued by three farming co-operative companies (co-operatives), and any bonus/rebate shares issued by each co-operative commencing from the date of this decision.

Summary

1 Clause 28 of Schedule 6 to the Education Act 1989 provides that sections 160 and 161 of the Crown Entities Act 2004 (which place restrictions on the acquisition of financial products, including shares, by Crown Entities) apply to school boards of trustees. Section 160(1)(b) of the Crown Entities Act 2004\(^1\) requires school boards of trustees to obtain approval from the Ministers to acquire securities that are not otherwise provided for under Section 161 of the Crown Entities Act 2004.

Process for Assessment

2 Ministers have approved guidelines\(^2\) for school boards of trustees considering applying to acquire securities not otherwise provided for under Section 161 of the Crown Entities Act 2004. These guidelines are attached as Annex A.

3 The main considerations are the school board of trustees’ reason(s) for the acquisition, the benefits to the board and an assessment of default risk by the issuer. Shares have additional considerations. School boards of trustees must show the connection between the purchase of the shares and the school’s objectives.

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\(^1\) Replicated in clause 28(2)(b)(ii) of Schedule 6 to the Education Act 1989

\(^2\) S/88105
5 Ministers have delegated\(^3\) their powers under Section 160(1)(b) of the Crown Entities Act 2004 to the Secretary for Education and Secretary to the Treasury with respect to approval of the acquisition of securities by school boards of trustees up to a maximum value of $10,000.

6 The Feilding High School board of trustees has applied to continue holding shares exceeding $10,000.

**Recommended Actions**

The Ministry of Education recommends you:

a. **note** that the following conditions apply to all approvals for securities given to school boards of trustees under the Crown Entities Act 2004:
   - approval is from the date of the decision and is not retrospective, and
   - any approval will be given on a case-by-case basis and typically subject to conditions specific to the transactions for which approval was sought;

   **Noted**

b. **note** that section 160(1)(b) of the Crown Entities Act 2004, requires school boards of trustees to obtain approval from the Ministers of Education and Finance to acquire securities that are not otherwise provided for under Section 161 of the Crown Entities Act 2004;

   **Noted**

c. **approve** the application from Feilding High School Board of Trustees to renew the holding of shares in each of the following co-operative companies under Section 160(1)(b) of the Crown Entities Act 2004:
   i. Ravensdown Fertiliser Co-operative Ltd;
   ii. Farmlands Trading Society Ltd; and
   iii. Livestock Improvement Corporation Ltd (LIC);

   **Approve/Not approve**

d. **approve** Feilding High School Board of Trustees to acquire future bonus/rebate shares issued by each co-operative listed in recommendation 6(c), but not to purchase additional shares, from the date of this decision under Section 160(1)(b) of the Crown Entities Act 2004;

   **Approve/Not approve**

e. **note** that in preparing this report, the Ministry of Education has consulted with The Treasury, and The Treasury concurs with the actions recommended above;

   **Noted**

\(^3\) T2005/1017 and S/88105
f. note that following Ministers’ approval of recommendations (c) and (d), the Secretary to The Treasury will notify this approval in the Gazette as required by section 160(3) of the Crown Entities Act 2004, pursuant to the delegation given by the Minister of Finance on 21 June 2006;

Noted

g. sign and date the attached letter informing Leon Dale, Business Manager of Feilding High School, of your decision; and

Agree/Disagree

h. agree that this Education Report is proactively released as part of the Ministry's next publication.

Agree/Disagree

Katrina Casey
Deputy Secretary
Secto of Enablement and Support
5/12/2018

Hon Chris Hipkins
Minister of Education
11/12/12

Hon Grant Robertson
Minister of Finance
16/12/18
Background


2. Ministers have delegated their powers under Section 160(1)(b) of the Crown Entities Act 2004 to the Secretary for Education and Secretary to the Treasury with respect to approval of the acquisition of securities by school boards of trustees up to a maximum value of $10,000. The value of these shares exceeds $10,000.

3. Ministers have approved guidelines to consider applications made by school boards of trustees to acquire securities under Section 161 of the Crown Entities Act 2004.

Application from Feilding High School

4. Feilding High School (formerly known as Feilding Agricultural High School) operates both a dairy and sheep/beef farm on the school property. This provides some senior students with the option to study agriculture as an integral component of their curriculum.

5. Over a number of years the Feilding High School board of trustees has acquired shares in several farming co-operatives. Shares in some co-operatives were acquired to obtain discounts on products and services, as well as rebates on expenditure. Shares in other co-operatives have been acquired due to restructuring in the dairy industry.

6. Current share holdings are listed below. The acquisition of these shares was approved in line with the appropriate delegation, and the board was required to re-apply after a five year period to continue holding the shares. The date of last approval was 7 July 2011. It has recently been brought to the board’s attention that shares in the three co-operatives require an approval for renewal to continue holding these shares.

<table>
<thead>
<tr>
<th>Co-operative</th>
<th>Number of Shares</th>
<th>Total Value ($)</th>
<th>Reason for Owning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ravensdown</td>
<td>6,942</td>
<td>$6,942</td>
<td>Discounts/rebates</td>
</tr>
<tr>
<td>Farmlands</td>
<td>550 ord / 2124 bonus</td>
<td>$2,674</td>
<td>Discounts/rebates</td>
</tr>
<tr>
<td>Livestock Improvement</td>
<td>142 co-op / 850 investment shares</td>
<td>$2,097</td>
<td>Rebates/restructuring</td>
</tr>
</tbody>
</table>

4 replicated in schedule 6 section 28(2)(b)(ii) of the Education Act 1989
5 T2005/1017 and S/88105
6 S/88105
7 See paragraph 10
8 See paragraph 11
7. The board is aware that it will be in breach of Section 161(1)(c) of the Crown Entities Act 2004\(^9\) from 1 January 2019 unless you agree to approve this application. The board of trustees of Feilding High School has therefore applied for consideration of approval for renewal to continue holding these shares.

Guidelines for assessing applications

8. Ministers have approved guidelines\(^10\) for school board of trustees applying to acquire securities not otherwise provided for under Section 161 of the Crown Entities Act 2004. These guidelines are attached as Annex A.

9. The main considerations in the guidelines are the school board of trustees' reason(s) for the acquisition, the benefits to the board and an assessment of default risk by the issuer.

10. Shares have additional considerations. School boards of trustees must show the connection between the purchase of the shares and the school's objectives. Applications based purely on speculative financial gain would not be approved, as this would be inconsistent with the legislation's rationale of limiting potential fiscal risk to the Crown and Crown entities.

Discussion

Reason for acquiring shares

*Ravensdown Fertiliser Ltd and Farmlands Trading Society Ltd*

11. The board acquired a small number of shares in Ravensdown Fertiliser Ltd and Farmlands Trading Society Ltd (1980s) to join each co-operative and thereby purchase products and services. While the board has not purchased additional shares, the size of the board's portfolio has increased as a result of bonus/rebate share offers\(^11\).

12. Shares in each co-operative cannot be traded or sold unless the board ceases farming operations\(^12\). The board, therefore, has no practical option but to accept bonus/rebate shares.

*Livestock Improvement Corporation Ltd (LIC)*

13. The board acquired shares in LIC following restructuring in the dairy industry.

14. The board was given shares in LIC (previously a subsidiary of the New Zealand Dairy Board) at no cost under Section 46(1)(a)(ii) of the Dairy Industry Restructuring Act 2001. Shares were granted to all persons that purchased qualifying products or services from LIC to the value of $500 or more (exclusive of GST) during the year ending 31 May 2001. The Board received shares equal to 4% of its expenditure on qualifying products during the previous financial year\(^13\).

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\(^9\) Replicated in clause 28 of Schedule 6 to the Education Act 1989

\(^10\) S/88105

\(^11\) Co-operative companies may offer bonus shares to shareholders in lieu of rebates under Section 31 of the Co-operative Companies Act 1996.

\(^12\) As stated in each co-operatives respective constitution.

\(^13\) Example: shareholder spending $5,000 on qualifying products and services – 4% of $5,000 is 200 shares.
15. This system of allocation continues to operate, thus the number of shares the board owns fluctuates on an annual basis.

16. On 16 April 2004, LIC’s shareholders voted to adopt a dual share structure, where shares were subdivided into co-operative control shares (voting shares) and investment shares (profit earning/tradable shares). Previously, a single class of share existed with a fixed nominal value of $1 per share\(^{14}\).

17. The new share structure allocated the board ten investment shares for every one nominal share based on 2002/2003 expenditure. Investment shares are tradable on the Alternative Market of the New Zealand Stock Exchange.

18. Investment shares may only be owned by owners of co-operative control shares, and all owners of co-operative control shares must own some investment shares. The minimum ratio (to co-operative control shares) is 2:1, and the maximum 30:1.

19. The co-operative control shares cannot be traded, and the board must hold these shares while it continues to purchase qualifying products and services to the value of $500 per annum.

20. The board of trustees currently holds 142 co-operative control shares (voting shares) and 850 investment shares.

**Benefits of owning shares**

21. The board must own shares to transact with each co-operative. The board can access technical support and advice, discounted goods and services, as well as rebates on annual expenditure, as a result of owning shares in each co-operative. It is, therefore, important that the board owns shares to access products and services needed to run a farm.

22. The specific benefits of owning shares in each co-operative are listed below:

<table>
<thead>
<tr>
<th>Co-operative</th>
<th>Primary Benefit</th>
<th>Secondary Benefit(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ravensdown</td>
<td>Purchase discounted fertiliser</td>
<td>Soil analysis at Ravensdown’s testing laboratory</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Advice from field staff</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Rebates/bonus shares on expenditure</td>
</tr>
<tr>
<td>Farmlands</td>
<td>Discounted general farming supplies</td>
<td>Rebates/bonus shares on expenditure</td>
</tr>
<tr>
<td>LIC</td>
<td>Access to artificial breeding services and genetic database management</td>
<td>Rebates/dividends on shares</td>
</tr>
</tbody>
</table>

\(^{14}\) Co-operatives may issue shares with a nominal value under Section 15 of the Co-operative Companies Act 1996.
Financial risk – Feilding High School

23. The table below lists the board’s key financial indicators. The board is currently in a sound financial position and has positive working capital.

<table>
<thead>
<tr>
<th>Key Financial Indicators for Feilding High School (2017)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Surplus (Deficit)</td>
</tr>
<tr>
<td>Working Capital</td>
</tr>
<tr>
<td>Total Net Assets</td>
</tr>
</tbody>
</table>

24. The board’s liability in each co-operative is limited to the extent of their shareholding. If all three co-operatives went into liquidation without any equity to return to shareholders, the total loss for the board would be approximately $120,209 or 4.55% of current working capital. This level of loss would not present a material risk to the financial health of the board.

25. The board is able to sell/redeem shares in each co-operative if it decides to cease farming.

Financial risk – farming co-operatives

26. Each co-operative must have their annual financial accounts audited. This limits the risk to shareholders of financial imprudence by the management of each co-operative.

27. The table below shows a series of key financial indicators taken from each co-operative’s 2017 audited financial accounts. Each co-operative is in a strong financial position, and none appear to be at immediate risk of insolvency.

<table>
<thead>
<tr>
<th>Financial Indicator</th>
<th>Ravensdown $'000</th>
<th>Farmlands $'000</th>
<th>LIC $'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>$553,711</td>
<td>$413,622</td>
<td>$341,484</td>
</tr>
<tr>
<td>Equity</td>
<td>$405,981</td>
<td>$121,138</td>
<td>$233,413</td>
</tr>
<tr>
<td>Gearing</td>
<td>73.32%</td>
<td>29.29%</td>
<td>68.35%</td>
</tr>
<tr>
<td>Net Profit</td>
<td>$713</td>
<td>$3,184</td>
<td>$22,454</td>
</tr>
</tbody>
</table>

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16 Section 2(4) of the Co-operative Companies Act 1996 makes co-operatives subject to Section 97(2) of the Companies Act 1993 with reference to shareholders liability.
17 Section 4 of the Financial Reporting Act 1993 defines co-operatives as issuers, and issuers must have their annual accounts audited as required under Section 16(1) of the Financial Reporting Act 1993.
18 Equity = capital or net tangible assets, as reported in each co-operative’s audited financial statements.
19 Gearing = net assets (assets less liabilities) divided by total assets. It is a measure of the level of losses that could be absorbed and still be able to return some equity to shareholders (higher % generally better for shareholders).
Approval to accept bonus/rebate share offers

28. Co-operatives are entitled to issue bonus/rebate shares in lieu of rebates. With the exception of some LIC investment shares, these bonus/rebate shares cannot be sold or surrendered and the board therefore has no practical option but to accept. In the case of LIC co-operative control shares, the number of shares the board owns fluctuates on an annual basis. It would, therefore, place a large administrative burden on the board and officials if the board needed to seek approval on an annual and ongoing basis in either case.

29. The following conditions apply to all approvals for securities given to school boards of trustees under the Crown Entities Act 2004:

- approval is from the date of the decision and is not retroactive, and

- any approval will be given on a case-by-case basis and typically subject to conditions specific to the transactions for which approval was sought.

Recommendation

30. In conclusion, the board receives a number of benefits by owning shares in each co-operative with very few associated risks. The board is able to access discounted products and services, as well as receive end of year rebates on expenditure. Therefore, we recommend that you approve this application.

31. In preparing this report, Ministry of Education officials have consulted with The Treasury, and The Treasury concurs with the actions recommended.

32. Officials from the Ministry and the Treasury also recommend that you grant the board ongoing approval to accept additional co-operative control shares issued by LIC, and annual bonus/rebate shares issued by each co-operative. This approval would not allow the board to purchase additional shares without reapplying for consideration of approval from the date of this decision.

33. The approval must be notified in the Gazette under Section 160(3) of the Crown Entities Act 2004. The Minister of Finance delegated the power to publish Gazette notices to the Secretary to the Treasury on 21 June 2006. Draft Gazette notices are attached to this report for signature by the Secretary to the Treasury.

Proactive Release

34. This Education Report will be proactively released as per your expectation that information be released as soon as possible. Any information which may need to be withheld will be redacted in line with the provisions of the Official Information Act 1982.

Annexes

Annex A – approved guidelines for the acquisition of securities

Annex B – Draft Gazette notice

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20 Section 31 of the Co-operative Companies Act 1996.
21 T2006/1004
Annex A – approved guidelines for the acquisition of securities

Boards seeking approval for the acquisition of a security must send the Ministry of Education (the Ministry) a written application. Applications need to include:

1. the reasons (business, educational, or otherwise) why your board wants to acquire securities that are not permitted in clause 28 of schedule 6 of the Education Act 1989
2. information on the benefits to the board if it acquires the security
3. a copy of the board’s latest audited financial statements (if they haven’t already been sent to the Ministry) and current year-to-date financial information for the school
4. a full description of the security, its value, and the term over which the board wishes to hold the security
5. details of any interest a board trustee may have in the security, and the extent and financial value of that interest
6. any credit rating or other financial risk information about the security or its issuer
7. any security offered by the issuer, including any guarantee they provide
8. an assessment of the potential effect on the school if the issuer defaults
9. information on the board’s actions, or planned action, to minimise the financial risk associated with this investment, and
10. anything else you think the Ministry should know about this application.

Additional conditions for equity securities

If your board wishes to acquire equity securities (e.g. shares), it must show that the business reasons reflect the strategic direction and objectives set out in your charter.

Ministers are unlikely to approve applications from boards wanting to invest in equity securities for financial return rather than for a business reason. This is because of the higher level of risk generally associated with those investments.

Approvals

If approval is granted the following conditions will apply:

1. the approval is from the date of the decision and is not retrospective
2. the Crown does not guarantee securities acquired by school boards, and
3. any approvals will be given on a case-by-case basis and typically subject to conditions specific to the transactions for which approval was sought.
CROWN ENTITIES ACT 2004

Notice of Approval Given Pursuant to Section 160(1)(b) of the Crown Entities Act 2004

Pursuant to section 160(3) of the Crown Entities Act 2004, and acting under delegated authority I hereby give notice that on November 2018 Honourable Chris Hipkins, Minister of Education, and Honourable Grant Robertson, Minister of Finance gave approval under section 160(1)(b) of the Crown Entities Act 2004, in relation to section 161 of that Act, for Feilding High School Board of Trustees to continue holding:

1. the following number of equity securities issued by:
   a. Ravensdown Fertiliser Co-operative Ltd (6,942 shares);
   b. Farmlands Trading Society Ltd (2,674 shares);
   c. Livestock Improvement Corporation Ltd (142 co-operative/850 investment shares)

2. future bonus/rebate shares issued by each co-operative listed above, but not to acquire additional shares, from the date of the approval.

Dated at Wellington this day of 2018.

Treasury Solicitor
Leon Dale  
Business Manager  
Feilding High School  
1 Churcher Street  
Feilding 4702

Dear Leon

Approval for Feilding High School Board of Trustees to continue holding equity securities issued by four farming co-operative companies and accept bonus/rebate shares

This letter advises that approval has been given under Section 160(1) (b) of the Crown Entities Act 2004 to allow Feilding High School Board of Trustees to continue holding:

3. The following number of equity securities issued by:
   a. Ravensdown Fertiliser Co-operative Ltd (6,277 shares);
   b. Farmlands Trading Society Ltd (550 shares);
   c. Livestock Improvement Corporation Ltd (123 ordinary/850 investment shares).

4. Future bonus/rebate shares issued by each co-operative listed above from the date of this letter.

Both approvals will take effect from the date of this letter and will be published in the Gazette as required under Section 160(3) of the Crown Entities Act 2004.

Please note that this approval does not allow Feilding High School Board of Trustees to purchase additional shares in any of these co-operatives.

Yours sincerely

Chris Hipkins  
Minister of Education

Hon Grant Robertson  
Minister of Finance