

## Written evidence from an anonymous submitter (LS0001)

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***The Committee asked:***

- What role did audit, corporate governance, supply chain finance and other financing methods such as circular invoicing play in the difficulties facing Greensill Capital, GFG Alliance and Liberty Steel? What reforms might be warranted?
- What financial support have governments provided to GFG? What due diligence was undertaken prior to this support being given, and what checks and balances were put in place in return for this support?

***Introduction***

This document specifically considers matters arising from the £330m supply-chain finance enabled acquisition of Alcan Aluminium UK Limited by the GFG Alliance in December 2016. These issues are summarised on page 2.

The participants (the GFG Alliance, Scottish Ministers and Greensill Capital (UK) Ltd) created an investment-grade financial asset based on a guaranteed 25-year power-purchase agreement between two related-parties to enable GFG Alliance to fund the acquisition. The structure is summarised in Figure 1 on page 3. The background that forms the basis of the key issues is presented on pages 4 and 5.

***Relevance to the Committee:***

High-value and long-term supply chain finance structures remain appropriate for sophisticated market operators. Participants enter the market at their own risk with a level of corporate failure a natural hazard in any open economy.

Before proposing reform, the initial focus of the UK Parliament's inquiries should be on probing (1) the quality of the statutory audits of key supply-chain finance participants, such as GFG Alliance and Greensill Capital, including the power-size dynamic between client and audit firm; and (2) the role played by related-party transactions in supply-chain structures. There is an above-average risk that the valuation of balance sheet assets based on related-party transactions are not at market value. The Committee should be cognisant of the possibility of related-party transactions within supply chain finance structures being used to inflate balance sheet values.

While not considered in this paper, the committee should also probe the level of financial interdependence between the GFG Alliance and Greensill Capital (UK) Ltd.

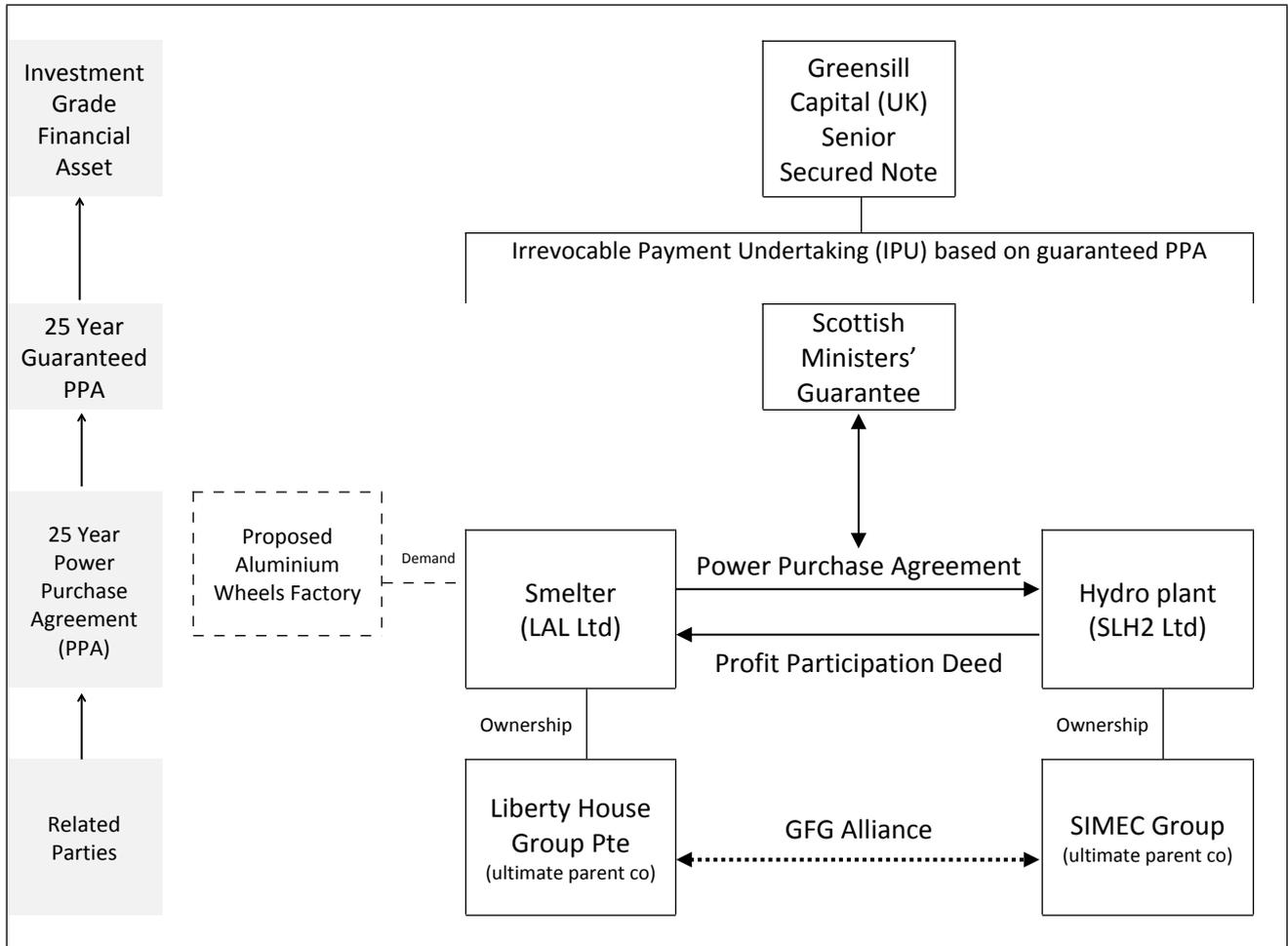
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## Summary

Para Ref.

- A The primary purpose of Scottish Ministers' financial guarantee is to **create an investment-grade financial asset** than can be marketed to investors by Greensill Capital (UK) Ltd with funds used by the GFG Alliance to purchase Alcan Aluminium UK Ltd. Other benefits, such as the protection of jobs or to prevent the potential loss of captive power produced by the hydro plant are incidental to the primary purpose. The value of the guarantee is not in the public domain. Some commentators have estimated it at up to £575m although an alternative valuation proposed here is £365m.
- B The financial guarantee provided by Scottish Ministers to the GFG Alliance is unusual. It is guaranteeing payments between two related parties (group companies of the GFG Alliance). Trading between related-parties is less subject to the natural market tensions that exist between companies operating at an arm's length. As a result, **there is an above average risk that the guaranteed amount does not reflect market conditions**. The value of the guarantee informs the value of the financial asset used to finance the acquisition.
- C There is a **noticeable circular financing arrangement** between the smelter (LAL Ltd) and the hydro plant (SHL2 Ltd). This arrangement warrants close scrutiny. Sales are generated by the hydro plant under a 25-year Power-Purchase Agreement (PPA) with the smelter. Significant profits are subsequently returned by the hydro plant to the smelter under a Profit Participation Deed (PPD). There is a risk that the value of the PPA has been overstated to the extent of the value of the PPD. It is unclear whether Scottish Ministers were aware of the PPD at the time they entered into the financial guarantee.
- D The **substantial increase in book value of the hydroelectric stations immediately following the acquisition** by the GFG Alliance is noticeable and warrants close scrutiny. The value of the hydro plants has been increased by a total of £495m. The revaluation exceeds by £235m the sum paid by the GFG Alliance to Rio Tinto for Alcan Aluminium UK Ltd. It would be reasonable to assume that Rio Tinto were astute market operators with realistic knowledge of their business unit's value at the time of sale. It is probable that the increase in book value is based on future earnings from the guaranteed PPA.
- E The annual accounts of the GFG Alliance's UK businesses are audited by King and King a two-partner two office firm located in London. The relative size-power dynamic between the client and audit firm should be a matter for the Committee's consideration.
- F As a result of the financial guarantee, Scottish Ministers are financially exposed through the guaranteed Power-Purchase Agreement to the 25-year business performance of LAL Ltd and the GFG Alliance as a whole. LAL Ltd performance is, in part, dependent upon the proposed but now cancelled Aluminium Wheels Factory and the newly proposed substitute of the recycling and casting facility.
- G While Scottish Ministers hold an extensive range of security over assets of various member companies of the GFG Alliance, the value of the security is likely to be low-to-negligible due the financial status of the GFG Alliance. The GFG Alliance attracts an unrated position from credit reference agencies.
- H Prior to Alcan Aluminium UK Ltd's acquisition by the GFG Alliance, Scottish Ministers stated that they offered the financial guarantee to all short-listed bidders on an even-handed basis. However, **the guarantee favours bidders using supply-chain finance as the method of acquisition**. Questions should be raised as to who initiated the guarantee concept.

**Figure 1: The Supply Chain Finance Structure**  
in the acquisition of Alcan Aluminium UK Ltd



Source: See pages 4 & 5

**Notes:**

Greensill Capital (UK) Limited entered administration on 8 March 2021.

GFG Alliance: During 2020, the proposal for £70m aluminium wheels factory was replaced with a proposal for a £94m recycling & casting facility.

## Background

Para Ref.

- 1 On the 16 December 2016, the GFG Alliance through a group company, SIMEC Lochaber Hydropower Ltd (“SLH Ltd”), purchased Alcan Aluminium UK Ltd for £330m from Rio Tinto plc. £180m was payable on completion and £150m by 28 February 2017.

The principal assets of Alcan Aluminium UK Ltd were the Lochaber aluminium smelter and two hydroelectric power stations – at Lochaber and at Kinlochleven. The Lochaber hydroelectric power station is not connected to the national grid and exclusively supplies the smelter. The Kinlochleven hydroelectric power station is connected to the national grid and is not connected to the Lochaber smelter. The smelter has annual sales of c£80m.

- 2 On the 16 December 2016, the assets of the Lochaber smelter were transferred from Alcan Aluminium UK Ltd into a newly incorporated company within the GFG Alliance – Liberty Aluminium Lochaber Ltd (“LAL Ltd”). Alcan Aluminium Ltd was then renamed SIMEC Lochaber Hydropower 2 Ltd (“SLH2 Ltd”). LAL Ltd then entered into a 25 year Power-Purchase Agreement (“PPA”) with SLH2 Ltd to purchase electricity for the smelter at a combination of fixed quantities at fixed prices and variable quantities at other fixed prices.

- 3 Simultaneously, Scottish Ministers entered into a 25-year Guarantee and Reimbursement Agreement (“GRA”) to guarantee a proportion of the payments due by LAL Ltd to SLH2 Ltd under the PPA. In return for the guarantee, Scottish Ministers receive an annual fee. The annual value of the guarantee varies between £14m and £32m. The total value of the guarantee over the 25-year life is not in the public domain also some commentators have estimated it at up to £575m. Ernst & Young conducted due diligence on the GRA on behalf of Scottish Ministers although the nature, extent and limitations of the due diligence is not in the public domain.

As part of the GRA, the GFG Alliance agreed to invest £70m in an Automotive Wheels Factory (AWF) on the Lochaber site. It is not in the public domain whether the PPA included the additional power demand on the Lochaber hydroelectric power station as a result of increased demand from the smelter servicing the proposed AWF.

Prior to Alcan Aluminium UK Limited’s acquisition by the GFG Alliance, Scottish Minister have stated that they offered the guarantee ultimately provided to the GFG Alliance to all short-listed bidders on an even-handed basis.

- 4 SLH2 Ltd assigned the government-guaranteed 25-year lifetime trade receivables due from LAL Ltd under the PPA to Greensill Capital (UK) Ltd. Greensill Capital (UK) Ltd issued a limited recourse zero coupon senior secured note via a special purpose securitisation vehicle – Lagoon Park Capital SA, Luxembourg. The secured note had an investment grade rating due the financial guarantee provided by the Scottish Ministers (which in turn is underwritten by the UK Government). The funds raised by the note issue were used by GFG Alliance to purchase Alcan Aluminium UK Ltd.

- 5 On 16 December 2016, Grant Thornton LLP revalued the Lochaber and Kinlochleven power stations based on a discounted cash flow of the stations future earnings capacity. The asset values were increased by £495m to £565m. SLH2 Ltd assets are now valued at £235m more than the GFG Alliance paid Rio Tinto for the purchase of the company (£565m - £330m).

- 6 As part of the GRA, Scottish Ministers hold a floating charge over all the property and assets of SLH2 Ltd other than the (1) PPA obligations assigned to Greensill Capital (UK) Ltd and (2) Kinlochleven hydroelectric power station. Scottish Ministers hold a range of fixed and

floating charges against other assets of certain companies within the GFG Alliance.

7 LAL Ltd and SLH2 Ltd entered into a Profit Participation Deed (“PPD”) whereby certain profits, subject to an annual maximum of £10m, arising in SLH2 from the PPA are transferred back to LAL Ltd. The PPD lasted four years and expired on 31 March 2021. It is not in the public domain whether the PPD has been renewed. In the period up to 30 November 2019, for which records are available, £22.6m was transferred from SLH2 Ltd back to LAL Ltd under the PPD.

8 On 28 April 2017, the Kinlochleven hydroelectric power station was transferred to a newly incorporated entity (SIMEC Kinlochleven Ltd) within the GFG Alliance at book value of £151.5m. On 12 October 2020, the operation of the Kinlochleven power station was long-leased to a company external to the GFG Alliance. The GFG Alliance remains the landlord.

9 On 13 June 2017, a meeting was held between Scottish Ministers, GFG Alliance, Greensill Capital (UK) Ltd and GAM Investments. There were limited notes produced to record the meeting. These notes were put into the public domain following a FOI request.

The Lobbying Act (Scotland) Act came into force on 12 April 2018. There was no requirement to formally record lobbying activity prior to this date.

10 Scottish Ministers initially recognised the financial guarantee as a financial asset in the Scottish Government’s consolidated accounts with a value of £21.4m based upon the discounted value of premiums due under the GRA. However, the asset value has subsequently been revised to zero and a provision created for expected losses under the GRA. At 31 March 2020, an amount of £36.7m was included as a provision.

11 During 2020, the GFG Alliance changed its business plan discontinuing the planned AWF replacing it with a proposal for a £94m recycling and casting facility and doubling aluminium production at the Lochaber site.

12 On 3 March 2021, the German financial regulator (BaFin) stated that Greensill Bank AG was unable to provide evidence of the existence of receivable balances purchased from the GFG Alliance (unrelated to this case) and suspended its operating licence.

On 8 March 2021, Greensill Capital (UK) Ltd entered administration.

13 The annual accounts of GFG Alliance’s UK companies are audited by King and King. Newspaper reports indicate that this is a two-partner two-office firm based in London.

There are a number of balance sheet misclassification errors in the publicly filed accounts that are amended in subsequent years. This included a significant misclassification of borrowings between a related party and external company within the accounts of SHL Ltd.

The 2019 balance sheet of SLH Ltd includes a 25 year long-term loan of £361.7m (estimated at £365m at inception) which has similar characteristics to the financing arrangement with Greensill Capital (UK) Ltd although the name of the lender is not disclosed.

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