Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information, or who is the subject of the information

[3] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[4] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[5] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[6] 9(2)(j) - to protect the commercial position of the person who supplied the information, or who is the subject of the information; to enable the Crown to carry out commercial activities without disadvantage or prejudice; and to enable the Crown to negotiate without disadvantage or prejudice

[7] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied

[8] Information is out of scope or not relevant.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [3] appearing where information has been withheld in a release document refers to section 9(2)(f)(iv).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.
Solid Energy: Shareholder consultation on proposed Stockton Coal Washery Plant

To: Minister for State Owned Enterprises
cc: Minister of Finance
Date: 22 December 2008
Priority: Urgent
Deadline: 23 December 2008

Purpose
Solid Energy has sought shareholding Ministers’ feedback on its proposed Coal Handling and Processing Plant (CHPP) at Stockton, with an estimated cost of $130 million.

This report provides a review of the proposal and recommends sending the attached letter to the Chair, supporting the Board and management’s effort with the proposal.

Background
For several years, Solid Energy has been investigating the feasibility of constructing a CHPP at Stockton. The CHPP is more commonly referred to as ‘the Washery’ as it essentially screens and washes coal which is not suitable for sale in the condition in which it was extracted due to various forms of contamination.

The plant is currently forecast to cost approximately $130 million, and over the next 10 years is expected to process 15 million tonnes of coal from current waste stockpiles (~2 million tonnes), and future coal from Stockton and the proposed nearby Millerton Mine (due to begin production in 2010) that would otherwise not be saleable.

Timing of investment
As a result of the current global economic situation, Solid Energy has had several coal shipments cancelled or delayed. Solid Energy is therefore prioritising all operations and investments to reduce cash expenditure and delay investment over the next 18 months.

Proceeding with the CHPP is perversely part of this strategy, as it will redeploy up to 100 Stockton staff to its construction for up to a year, during a period in which extraction from Stockton is being reduced until international demand and prices rise again.

The Board has, subject to shareholder consultation as per Solid Energy’s Statement of Corporate Intent, approved the project with construction contracts expected to be signed by 30 January 2009, with commissioning in February 2010.

Strategic Justification
In principle, we support the construction of the CHPP. It will convert what is currently waste, or at best low-grade coal, into some of the world’s best hard coking coal at a low cost per tonne. The technology is straightforward and proven, and similar to (but scaled
up from) the same plant already running at Spring Creek and Pike River mines, and to processing plants at many Australian mines.

**Operational Risks**

Several risks exist around the yield of coal from the plant, the quality of the output product, available feedstock, development of the Millerton mine, and maintaining suitable staff. Solid Energy has had several external reviews undertaken which support its own assessment of the viability of the project and have helped to develop a response strategy should these risks eventuate.

The most significant risk we see is the yield ratio of converting waste coal to saleable coal. The expected ratio has varied significantly over recent years from 45% to the current 64%. Although the current estimate is supported by plant design changes, it remains a key operational variable that will affect the return on investment.

Staff turnover has become an operational risk at all of Solid Energy’s mines, and is often a factor on large civil projects such as this. Solid Energy will look to employ specialist staff early and provide good training programmes as part of its retention policy.

**Financial Risks**

The CHPP has several financial risks associated to it, though these are common throughout Solid Energy’s business (and the company is therefore experienced at managing). These risks include cost over-runs on the project, operational cost increases, international coal price movements and foreign exchange risk.

Officials’ primary concern is around the forecast coal prices that Solid Energy has used to calculate the expected returns. The assessment that the Board has approved is based on the 2008/09 Business Plan coal price projections which were made at the height of coal prices in mid-2008.

Since that time, spot prices have fallen significantly, from ~$US300/tonne to ~US$150/tonne. Should prices continue to fall toward 2007 levels, and remain at that level for several years, and there are delays to the development of Millerton, the return on this project may be very low. Solid Energy believes these risks are low, and is confident that any delays to Millerton would be at its discretion.

The CHPP has been allowed for in its current business plan and is not expected to impact the company’s ability to pay the planned dividend. However, the current economic conditions are likely to impact dividends.

We consider Solid Energy has put sufficient measures in place to minimise the financial and contractual risks that exist.

**Shareholder consultation process**

The Owners Expectation Manual conveys to the board of each SOE the expectation that shareholding Ministers will be consulted before certain transactions or strategic initiatives are entered into. The consultation process, as distinct from the higher level of
shareholder approval, is expected to be conducted in good faith, and that the board will seek and consider Ministers’ comments, with an open mind, before it proceeds with the final decision for which it is responsible.

In response to Solid Energy’s draft 2008/09 Statement of Corporate Intent, shareholding Ministers wrote to the Solid Energy Chair in October 2008, specifically commenting on these expectations, as they had not been met in the past.

Although the information supplied for the proposed CHPP is adequate, we do not consider that it is reasonable to request a response from shareholding Ministers within one business day for a project which has been under consideration by the company for over three years. We recommend advising the company that a more reasonable expectation would be two weeks, as other state-owned enterprises have done in the past.

Conclusion
As with any project of this scale, numerous operation and financial risks exist. Of most concern to officials is feedstock volume for the plant and yields achieved and international coal prices. However, we see no reason why Solid Energy should not be able to manage these risks adequately.

The feasibility study has been externally peer reviewed, confirming the business case is credible and viable with a less than four year payback under all project scenarios analysed. The breakeven point for coal price and production output are low by current international price benchmarks and in comparison to the amount of feed that is already stockpiled to be processed.

Recommendations
We recommend that you agree to sign the attached letter to the Chair of Solid Energy.

Chris Jones                               Hon Simon Power
Manager – Energy, Land & Environment     Minister for State Owned Enterprises
CCMAU [1]

Hon Bill English
Minister of Finance
Dear Mr Palmer

Shareholder consultation on Coal Handling and Processing Plant (CHPP)

Thank you for consulting with shareholding Ministers in regard to the proposed CHPP at the Stockton mine on the West Coast.

Further to our discussion on Wednesday 10 December 2008, it is pleasing to see Solid Energy has taken such a proactive approach to initiating its economic downturn strategy and managing its exposure to world markets and coal prices, with the investment in the proposed CHPP a vital part of that strategy.

As outlined in our discussion, and in the information supplied to officials, numerous risks exist for the project, most notably around the operational performance of the plant and the financial returns achieved. However, I have confidence that the Board and management team will continue to assess and manage these, and adapt the Company’s strategy where appropriate.

Therefore, we support the Board’s efforts to progress the CHPP capital investment as you have outlined. As outlined in shareholding Ministers’ letter of 14 October 2008, I look forward to being consulted, and updated, on investments such as this. I would however re-confirm the expectation that such consultation be made so as to allow an appropriate amount of time to fully consider such a proposal, which would normally be at least two weeks.

Ministers wish the Board and management all the best with the proposed developments at Stockton, and look forward to it fulfilling its investment potential.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of shareholding Ministers

cc: Dr Don Elder, Chief Executive, Solid Energy New Zealand Ltd