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.
Treasury Report: Expectations Letters for the Mixed Ownership Companies

Date: 19 December 2011  Report No: T2011/2561

Action Sought

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<td>Note contents</td>
<td>Thursday 22 December 2011</td>
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Contact for Telephone Discussion (if required)

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<th>Name</th>
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<tr>
<td>Justin Anderson</td>
<td>Senior Analyst, Commercial Transactions Group</td>
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<td>Andrew Blazey</td>
<td>Manager, Commercial Transactions Group</td>
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Minister for State Owned Enterprises' Office Actions (if required)

Sign the attached letters to MRP, Meridian, Genesis and Solid Energy

Enclosure: Yes – draft expectations letters to the mixed ownership companies

2012/13 Expectations Letters for Mixed Ownership SOEs (Treasury:2230619v1)
Treasury Report: Expectations Letters for the Mixed Ownership Companies

1. Attached are draft expectations letters to Mighty River Power, Meridian, Genesis and Solid Energy. The letters are based on the expectations letters for other SOEs (T2011/2407 refers), but have been customised to reflect the fact that these companies are part of the Mixed Ownership Model and therefore require slightly different expectations.

Solid Energy

7. The letter to Solid Energy refers to the company preparing "a revised strategy and business plan to prepare the company for an IPO", which "will be provided to shareholding Ministers by 31 January 2012. This plan will reflect the Board's response to the analysis in the scoping study prepared by UBS. The board will provide quarterly reports to shareholding Ministers and COMU on the plan's implementation."

8. There is no specific reference to capital structure or dividend policy in the letter to Solid Energy. These issues will be covered in the revised strategy.
12. The commercial valuation sections of the Meridian, Genesis and Solid Energy letters are the same as for the non-MOM SOEs. We believe that publishing a commercial valuation in the SCI remains appropriate for these SOEs, although careful communication may be required to avoid establishing unhelpful expectations around potential IPO pricing. For example, commercial valuations are typically done on the basis of a 100% shareholding, and therefore incorporate a "control premium". So all else equal, the commercial valuations will overstate the price that minority shareholders will pay in an IPO. We do not believe this is a major issue, as long as the commercial valuations make this point explicit.

Recommended Action

We recommend that the Minister for SOEs sign the attached expectations letters to Mighty River Power, Meridian, Genesis and Solid Energy.

Andrew Blazey
Manager, Commercial Transactions Group

Hon Bill English
Minister of Finance

Hon Tony Ryall
Minister for State Owned Enterprises
Mr J Palmer  
Chair  
Solid Energy New Zealand Limited  
PO Box 1303  
CHRISTCHURCH 8024

Dear Mr Palmer

2012/13 SHAREHOLDER EXPECTATIONS FOR STATE OWNED ENTERPRISES

I am writing on behalf of shareholding Ministers to set out the shareholder's expectations for 2012/13. These build on the expectations set out in similar communications for 2011/12.

As you are aware, the government is seeking to release capital for reallocation to higher priority areas by extending a Mixed Ownership Model (MOM) to certain SOEs, including yours. On 15 December the government announced that it had:

- agreed in principle to proceed with the mixed ownership model
- agreed that Mighty River Power (MRP) should be the first company prepared for an IPO, most likely in the third quarter of 2012, subject to market conditions
- agreed that decisions about share allocations will be made early next year during the design phase of the IPO
- agreed to consult with Maori in early 2012, and
- agreed that legislation will be required to support the mixed ownership programme – including removing the four mixed ownership energy companies – MRP, Genesis, Meridian and Solid Energy – from the State Owned Enterprises Act (the SOE Act).

These decisions will kick off the MOM process. The Government will make final decisions on timing and other details regarding the MRP offer early next year.

Until Solid Energy is removed from the SOE Act, the provisions of that Act will continue to apply. Additional expectations (such as those set out in the Owners'
Expectations Manual) will be assessed for mixed ownership companies on a case-by-case basis, depending on the likely timing of any partial sale. In general however, we would expect MOM companies to meet the same expectations as other SOEs unless there is a good case for an exception.

Our expectations in this letter are divided into three categories – company specific, priority and general. Priority and general expectations apply across all SOEs. These expectations, which are largely a continuation of those set out in previous expectations letters, are outlined below.

Specific Expectations for Solid Energy

Continuing to prepare Solid Energy for an IPO will obviously be an important focus for the coming year and will involve Solid Energy continuing to work closely with the Commercial Transactions Group (CTG) in Treasury and its advisors. As discussed with you, a revised strategy and business plan to prepare the company for an IPO is expected to be provided to shareholding Ministers by 31 January 2012. This plan will reflect the Board’s response to the analysis in the scoping study prepared by UBS. The board will provide quarterly reports to shareholding Ministers and COMU on the plan’s implementation.

Solid Energy has shown leadership with respect to the transparency of the reporting of the Chief Executive’s salary and performance arrangements. There are, however, other areas where Solid Energy could be more transparent in its public reporting. In particular, Solid Energy could separately identify the financial performance of different business activities in its annual report.

This expectation is the same as last year but I consider its importance has increased with Solid Energy entering the MOM process. In particular, unless Solid Energy provides sufficient detail of the profitability of its business units, investors will have to make their own assumptions. It is my view that if Solid Energy were currently listed the level of disclosure that we are requesting would be provided to the market.

Priority Expectations

- **Shareholder Returns:** A prime focus for shareholding Ministers is that commercial entities should, over time, deliver returns that meet or exceed the company’s cost of capital. Over the past year, we have been progressing towards better ways to monitor and measure shareholder returns. The Crown has a long term perspective on returns, and acknowledges that returns will vary from year to year, sometimes due to temporary or non-controllable factors. Emphasis will therefore be placed on total shareholder returns (TSR) over periods of up to the past 5 years. In circumstances where the TSR is persistently below the cost of capital, or is not expected to achieve it over the forecast period, we expect the company will develop a plan to take corrective action.

- **Valuation:** As per prior years’ expectations we would expect that a comprehensive, up to date, and robust commercial valuation be produced annually. This should be publicly disclosed in the Statement of Corporate Intent (SCI), with any major changes in assumptions from previous valuations
being made transparent and justified. We have attached the model disclosure statement to this letter, which we expect you to adopt in your SCI.

- **Investment Review:** We expect SOE Boards to review major past investment decisions to assure themselves that the benefits claimed when such decisions were made are in fact being realised. Our expectation is that such reviews are made available to the shareholders.

- **Dividends and Capital Structure:** Shareholders expect SOEs to operate a dividend policy that is commensurate with listed peers. This would include dividends showing a degree of consistency across years, and that an appropriate balance between dividends and re-investment in the business is maintained.

**General Expectations**

Since 2009, shareholding Ministers and the Crown Ownership and Monitoring Unit (COMU) have been implementing a programme of increased transparency and disclosure of performance information.

Improved transparency and public disclosure of companies has been achieved via a number of new mechanisms:

- a continuous disclosure regime for key SOEs that mirrors the sort of disclosure expected of publicly-listed companies

- an expectation that SOEs will each year hold an Annual General Meeting at which shareholding Ministers can engage with the Board about the results the SOE has achieved

- an expectation that, at least once a year, SOEs will hold a public meeting to give the wider community an opportunity to hear and be heard, and

- Publication of a wider range of data and analysis produced or commissioned by COMU.

The Owners' Expectation Manual is currently being updated, now that a new government is in place. This will be finalised and distributed early in 2012. In the meantime, the expectations of the existing Owner's Expectations Manual and the previous two Outlook Letters continue to apply in 2012/13 and the forecast period. Particular regard should be given to the following:

- **Strategic issues letters:** All SOEs are expected to provide Ministers with a letter, by 28 February 2012, setting out the key strategic issues facing the company. Should your company wish to engage with shareholders to seek direction or clarification (e.g. around equity provision), we would ask that you advise COMU as early as possible of such intentions.

- **Draft SCI/Business Plan:** All SOEs are expected to provide Ministers with a draft SCI and Business Plan by 1 May 2012, at the latest. Shareholding Ministers should be alerted as soon as possible if this deadline cannot be met.
• **Annual General Meetings (AGMs):** All SOEs are expected to hold an AGM.

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**Engagement**

Our expectation is that you will engage with officials from COMU shortly after receiving this letter to discuss shareholding Ministers’ expectations in more detail. Please make arrangements with your usual contact in COMU, [email]. Alternatively, please contact Andrew Blazey (Manager, Commercial Transactions Group) on [contact details].

Yours sincerely

Hon Tony Ryall  
Minister for State Owned Enterprises  
*On behalf of shareholding Ministers*

cc: Don Elder, Chief Executive
Attachment: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board’s estimate of the current commercial value of the Crown’s investment in the SOECorp Group is [$1.650 billion].

Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [30 June 2012]

- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis

- The DCF / NPV was based on the nominal (i.e. not inflation-adjusted) future cash flows set out in the SOECorp Group’s 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]

- A discount rate of [X%] was assumed

- The valuation was prepared [internally by the SOECorp Group’s finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board

- The current commercial value of the Crown’s investment of [$1.650 billion] (often referred to as the equity value) was calculated by taking the enterprise value of [$1.950 billion] and deducting net debt of [$300 million].

- Other material factors that are relevant to the determination of this valuation are [....................]

The valuation compares with a commercial value as at [30 June 2011 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x]

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- A reduction in the terminal value assumed of $X million due to..........................

- A change in the discount rate assumed from XX% to XX% because.......................]

These changes could be represented graphically in a waterfall (or similar type of) diagram.
21 DEC 2011

Mr J Palmer
Chair
Solid Energy New Zealand Limited
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CHRISTCHURCH 8024

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