The Treasury

Solid Energy Information Release

March 2013

Release Document

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[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

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.
**Treasury Report:** Solid Energy: Shareholder Approval for Major Transaction – Spring Creek Mine

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**Action Sought**

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<th>Minister of Finance (Hon Dr Michael Cullen)</th>
<th>Note that Solid Energy has requested formal shareholder approval for an Operating Agreement between Solid Energy and a joint venture between Solid Energy and Cargill International;</th>
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<td></td>
<td>Sign the attached Cabinet paper and submit to Cabinet office; Pending the outcome of the Cabinet process, sign the attached shareholder special resolution and letter; and Refer to media staff</td>
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<th>Name</th>
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<tr>
<td>Chris Jones</td>
<td>Senior Advisor, CCMAU</td>
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<td>Mike Moore</td>
<td>Manager - Energy, Land and Environment, CCMAU</td>
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<tr>
<td>Matthew Morrison</td>
<td>Senior Analyst, Commercial Investments</td>
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<td>✓</td>
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<tr>
<td>Jean-Pierre Andre</td>
<td>Senior Analyst, Commercial Investments</td>
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Enclosure: Yes
Executive Summary

The purpose of this report is to:

• recommend that shareholding Ministers approve Solid Energy entering into an operating agreement with the Spring Creek Mining Company (a joint venture between Solid Energy (51%) and Cargill International SA (Cargill)(49%));

• provide a Cabinet paper, noting the proposed deal to Cabinet; and

• provide a letter and special resolution for shareholders’ signatures.

Spring Creek underground mine, while having valuable coal deposits, has difficult geology, which has meant that production has been lower than expected. In 2006 Solid Energy planned to cease production at Spring Creek, but in an effort to maintain operations at the mine, the company searched for an investor to at least partially underwrite the development of the mine through a long-term off-take contract.

As proposed in the attached letter of 8 February 2007, Solid Energy now intends to sell 49% of the Spring Creek underground mine (land, equipment, coal, and permits) on the West Coast to Cargill (a large US company) for [2],[5] Under the proposed sale, Solid Energy will retain all employees (approximately 130), and will be paid through a long-term contract for the provision of operating services to the new joint venture mining company. Solid Energy (51%) and Cargill (49%) will jointly acquire the output from the mine at an agreed price. Solid Energy’s Board recommends that shareholders approve the Operating Agreement.

Shareholders have been asked to approve the Operating Agreement by way of a special shareholder resolution (attached). This is required because the length and scope of the Operating Agreement is such that it would constitute a major transaction under the Companies Act.

The proposed deal with Cargill brings a more secure future to the mine by providing new international marketing opportunities for Spring Creek coal and a source of capital (up to [2],[5] to develop the mine. Solid Energy has assessed the net present value (NPV) of retaining the Spring Creek mine in 100% Solid Energy ownership as being between [2],[5] Assuming the mine meets minimum production targets over the next 5 years, the NPV of the proposed deal (including the payment from Cargill) is approximately [2],[5]

Other benefits of the deal include:

• Cargill provides expertise on international thermal coal trading/marketing;
• Ongoing employment for 130 Solid Energy employees;
• Maintain underground mining expertise within Solid Energy;
• Development costs and risks shared with Cargill;
• Increase likelihood of securing international customers for this particular coal; and
• Risk limitation to Solid Energy through no-recourse structure.
Shareholders should be aware of the following issues raised by this deal:

**Unlimited Company Structure**

The Spring Creek Mining Company will be formed on an unlimited liability basis because this provides some United States taxation benefit to Cargill. Solid Energy has assured us it has put appropriate safe guards in place to ensure there is no-recourse to Solid Energy in the event of default.

**Asset Sale**

There is some potential for this to be interpreted as a breach of the Government’s policy not to have a state asset sales programme. However the proposal does not involve the Crown selling any of its shares in Solid Energy, issuing equity in Solid Energy, or Solid Energy selling down a significant proportion of its overall business. The sale is motivated by Solid Energy seeking to secure a future for its staff and investment in Spring Creek, and is consistent with a successful business changing its asset mix to meet its business environment. Spring Creek has only been in full Crown ownership since 2002. Prior to 2002 the mine was a joint venture between the Crown and Todd Coal Limited.
Recommended Action

We recommend that you:

a  note that Solid Energy has requested formal shareholder approval for an Operating Agreement between Solid Energy and a joint venture between Solid Energy and Cargill, called Spring Creek Mining Company;

b  note that officials support Solid Energy’s Operating Agreement which forms part of a partial sale of Spring Creek mine to Cargill;

c  sign the attached Cabinet paper and submit to Cabinet office by 10am Thursday 22 February;

d  Pending the outcome of the Cabinet process, sign the attached shareholder special resolution and letter; and

e  refer to media staff

Jean-Pierre Andre               Michael Moore
Senior Analyst, Commercial Investments       Manager - Energy, Land and
for Secretary to the Treasury               Environment, CCMAU

Media Staff

Referred: Yes/No

Hon Dr Michael Cullen       Hon Trevor Mallard
Minister of Finance           Minister of State-Owned Enterprises
Treasury Report: Solid Energy: Shareholder Approval for Major Transaction – Spring Creek Mine

Purpose of Report

1. The purpose of this report is to:
   - recommend shareholding Ministers approve Solid Energy entering into an operating agreement with the Spring Creek Mining Company (a joint venture between Solid Energy (51%) and Cargill (49%));
   - provide a Cabinet paper, noting the proposed deal to Cabinet; and
   - provide a letter and special resolution for shareholders’ signatures.

Analysis

Summary of the proposed transaction

2. Solid Energy intends to sell 49% of the Spring Creek underground mine (land, equipment, coal, and permits) on the West Coast to Cargill for [2],[5]. Under the proposed sale, Solid Energy will retain all employees (approximately 130), and will be paid through a long-term contract for the provision of operating services to the new joint venture mining company. Solid Energy (51%) and Cargill (49%) will jointly acquire the output from the mine at an agreed price. Other key elements of the transaction include:
   - Cargill provides a [2] to support mine’s development;
   - Solid Energy retains the right to supply [2] of coal to South Island domestic industrial companies; and
   - Solid Energy provides rail and port facilities for the coal produced.

3. Solid Energy’s Board recommends shareholders approve the deal.

The reason shareholder approval is required

4. Shareholders have been asked to formally approve the Operating Agreement by way of a special shareholder resolution (attached). The special shareholder resolution is required because the length and scope of the Operating Agreement is such that it would constitute a major transaction under the Companies Act. The Operating Agreement is just one of five agreements that form the overall deal. Assessment of the Operating Agreement is only practical in the context of the deal as a whole, therefore Solid Energy have provided information on the whole deal and we have formed our recommendations based on an assessment of the whole deal.

5. The Operating Agreement is between Solid Energy and the Spring Creek Mining Company. Under this agreement Solid Energy agrees to undertake all mining and business activities of the mine in return for a service fee, calculated on a cost recovery basis. The agreement has no termination date.
Strategic Justification

6. Spring Creek underground mine, while having valuable coal deposits, has difficult geology, which has meant that production has been lower than expected. This led to a $43 million write down in the value of the mine in 2005. In 2005 Solid Energy reviewed the economics of the mine. In 2006 Solid Energy planned to cease production at Spring Creek and the mine was to be held on a care and maintenance basis for 5 years in the expectation that future market prices may support its reopening. During business planning in 2006, Solid Energy indicated that it was searching for an investor to at least partially underwrite the development costs and risks of the mine.

7. The proposed deal with Cargill brings a more secure future to the mine by providing new international marketing opportunities for Spring Creek coal and a source of capital to develop the mine. It is anticipated that for at least the next year the bulk of the time will be spent on mine development work and that it will not be until 2008 that coal will start to be removed.

8. Cargill’s key interest is securing access to export coal for thermal markets.

Financial Gain

9. Solid Energy has assessed the net present value (NPV) of retaining the Spring Creek mine in 100% Solid Energy ownership as being between 2 assuming the mine meets minimum production targets over the next 5 years, the NPV of the proposed deal (including the payment from Cargill) is approximately 2 assuming successful development of the mine beyond 5 years, out to 20 years, the NPV rises to as much as 2.

10. The deal is very likely to have a positive effect on dividends to the Crown. The amount of the 2 that is returned to the Crown as a dividend will be determined after the company’s other capital needs and its financial gearing are considered.

11. These values do not take into account the considerable risk reduction achieved through the access to non-recourse debt funding 2 from Cargill. Underground mining in general and at Spring Creek in particular, is more risky than other forms of coal mining.

Issues / Risks

Unlimited Company

12. The Spring Creek Mining Company will be formed on an unlimited liability basis because this provides some United States taxation benefit to Cargill. It is therefore important that Solid Energy, as 51% shareholder, ensures it has put appropriate safe guards in place to ensure there is no-recourse to Solid Energy in the event of default. Solid Energy has assured us that this is the case and that the documentation explicitly includes that there is no recourse to Solid Energy.

Employment

13. The proposal provides a more secure future for the Spring Creek miners than the current ownership arrangements. Without a partner to develop the mine up to 130 jobs are at risk. This is Solid Energy’s main underground mine, underground mining trades are specialised and not directly transferable to other mining, therefore closure of the mine will put at risk Solid Energy’s ability to operate underground mines in the future.
Cargill

14. Cargill is a large US multinational involved in a range of industries (mainly food related) with 149,000 employees in 63 countries and profits of US$1.73 billion in 2006. Cargill has been criticised for poor social responsibility in some of its operations in Brazil and Africa. However, Cargill takes its corporate social responsibilities seriously because of the world wide repercussions to its reputation of poor social/environmental outcomes in the countries in which it operates.

Consistency with Government Policy

Asset Sale Policy

15. The Government has a clear policy to not run a state asset sales programme. The proposal does not involve the Crown selling any of its shares in Solid Energy, issuing equity in Solid Energy, or Solid Energy selling down a significant proportion of its overall business. The sale is motivated by Solid Energy seeking to secure a future for its staff and investment in Spring Creek. Government policy is not intended to interfere with the normal activities of SOEs to shape and develop their businesses in response to changing circumstances, which may require changes in asset mixes and business models.

16. Spring Creek has only been in full Crown ownership since 2002. Prior to 2002 the mine was a joint venture between the Crown and Todd Coal Limited.

17. Agreement will be conditional on approval of the Overseas Investment Office and approval by Crown Minerals to transfer the mining license to the new entity.

Climate Change/Sustainability

18. The majority of Spring Creeks’ output is exported and it is tiny relative to international volumes of coal (less than 0.1% of internationally traded coal).

Media Interest

19. Solid Energy will be handling all media enquiries in New Zealand and intend to publish a media release within a couple days of shareholder approval of the transaction. Due to the issues noted above we recommend that you refer this report to your respective media staff.

Conclusion

20. The benefits of the deal include:

- Cargill provide expertise on international thermal coal trading/marketing;
- Access for up to [2] in finance for mine development from Cargill;
- Payment of [2],[5] for purchase of 49% of the mine’s assets;
- Ongoing employment for 130 Solid Energy employees;
- Maintain underground mining expertise within Solid Energy;
- Development costs and risks shared with Cargill;
• Solid Energy continues to operate and manage the mine, transport the coal, and employ all the mines employees;

• Increase likelihood of securing international customers for this particular coal; and

• Risk limitation through no-recourse structure (underground mining is high risk).

21. The key risk is that Spring Creek Mining Company will be formed on an unlimited liability basis. However, Solid Energy has informed us it has put the necessary safeguards in place to ensure there is no recourse to Solid Energy, in the event of default.

22. We do not consider this proposal breaches the Government’s policy to not hold a state asset sales programme as no shares in Solid Energy will be sold, it does not involve the issuing of any Solid Energy equity, the mine is of a small scale relative to the company’s overall business, and it is consistent with a normal business modifying its asset mix to respond to its changing business environment.
22 February 2007

The Chair
CABINET

SOLID ENERGY AND CARGILL JOINT VENTURE – SPRING CREEK MINE

Introduction

1. The purpose of this paper is to inform Cabinet:
   • about a Solid Energy proposal to divest a 49% share in the Spring Creek underground mine for the purpose of creating a joint venture (Spring Creek Mining Company) to continue development and operation of the Spring Creek underground coal mine; and
   • that shareholding Ministers consider the proposed deal is consistent with Government policy.

Executive Summary

2. Solid Energy intends to sell 49% of the Spring Creek underground mine (land, equipment, coal, and permits) on the West Coast to Cargill International SA (Cargill) (a large US multi-national company) for $[Amount]. Under the proposed sale, Solid Energy will retain all employees (approximately 130), and will be paid through a long-term contract for the provision of operating services to the new joint venture mining company. Solid Energy (51%) and Cargill (49%) will jointly acquire the output from the mine at an agreed price. Solid Energy’s Board recommends shareholders approve the deal.

3. The proposed deal with Cargill brings a more secure future to the mine by providing new international marketing opportunities for Spring Creek coal and a source of capital (up to $[Amount] from Cargill) to develop the mine. Solid Energy has assessed the net present value of the deal is approximately $[Amount].

4. Other benefits of the deal include:
   • Cargill will provide expertise on international thermal coal trading/marketing;
   • Ongoing employment for 130 Solid Energy employees;
   • Maintain underground mining expertise within Solid Energy;
   • Development costs and risks shared with Cargill;
   • Payment of $[Amount] for purchase of 49% share in mine;
• Increase likelihood of securing international customers for this particular coal; and
• Risk limitation to Solid Energy through no-recourse structure.

5. There is some potential for this to be interpreted as a breach of the Government’s policy to not hold a state asset sales programme. However, the proposal does not involve the Crown selling any of its shares in Solid Energy, the issuing of equity in Solid Energy, or Solid Energy selling down a significant proportion of its overall business. Government policy is not intended to interfere with the normal activities of SOEs to shape and develop their businesses in response to changing circumstances, which may require changes in asset mixes. The sale is motivated by Solid Energy seeking to secure a future for its staff and investment in Spring Creek, and is consistent with a successful business changing its asset mix to meet its business environment.

6. Ministers do not consider that the proposed transaction breaches the Government’s asset sale policy because it enhances Solid Energy’s long-term commercial prospects and supports the further development of the Spring Creek mine consistent with its statutory objective of being a successful business.

Background

7. Spring Creek is an underground mine located near Greymouth which produces low ash and low sulphur thermal and semi-soft coking coal for the domestic and export markets. Over recent years a number of write-downs have occurred with the mine, the most significant being $43 million in 2005. While excellent coal resources of 136 million tonnes have been identified the geology is very difficult and production levels have been significantly below forecast. In 2005 Solid Energy reviewed the economics of the mine. In 2006 Solid Energy planned to cease production at Spring Creek and the mine was to be held on a care and maintenance basis for 5 years in the expectation that future market prices may support its reopening. In 2006 Solid Energy indicated that it was searching for an investor to at least partially underwrite the development costs and risks of the mine.

Proposal

Summary of the proposed transaction

8. Solid Energy intends to sell 49% of the Spring Creek underground mine (land, equipment, coal, and permits) on the West Coast to Cargill for $________. Under the proposed sale, Solid Energy will retain all employees (approximately 130), and will be paid through a long-term contract for the provision of operating services to the new joint venture mining company. Solid Energy (51%) and Cargill (49%) will jointly acquire the output from the mine at an agreed price. Solid Energy’s Board recommends shareholders approve the deal. Other key elements of the transaction include:

• Cargill provide $________ to support mine’s development;

• Solid Energy retains the right to supply minimum of $________ of coal to South Island domestic industrial companies; and

• Solid Energy provides rail and port facilities for the coal produced.
What shareholders have been asked to approve

9. Shareholders have been asked to formally approve the Operating Agreement by way of a special shareholder resolution. The special shareholder resolution is required because the length and scope of the Operating Agreement is such that it would constitute a major transaction under the Companies Act. The Operating Agreement is just one of five agreements that form the overall deal. Assessment of the Operating Agreement is only practical in the context of the deal as a whole, therefore Solid Energy have provided information on the whole deal and we have formed our recommendations based on an assessment of the whole deal.

Strategic Justification

10. The proposed deal with Cargill brings a more secure future to the mine by providing new international marketing opportunities for Spring Creek coal and a source of capital (up to \_

from Cargill) to develop the mine. It is anticipated that during the next year the bulk of the time will be spent on mine development work and that it will not be until 2008 that coal will start to be produced.

11. Cargill’s key interest is securing access to export coal for thermal markets.

Assessment

Consistency with Government Policy

12. The Government has a clear policy not to conduct a state asset sales programme. The proposal does not involve the Crown selling any of its shares in Solid Energy, issuing equity in Solid Energy, or Solid Energy selling down a significant proportion of its overall business. The sale is motivated by Solid Energy seeking to secure a future for its staff and investment in Spring Creek. Government policy is not intended to interfere with the normal activities of SOEs to shape and develop their businesses in response to changing circumstances, which may require changes in asset mixes.

13. The deal enables Solid Energy to establish a long-term strategic alliance with a large company with access to coal markets and expertise in trading thermal coal while mitigating much of the commercial risk inherent to the Spring Creek mine. Responsible Ministers consider that, in the circumstances faced by Solid Energy, the proposed deal is a better long-term strategy than the alternatives of maintaining 100% ownership with Solid Energy.

14. The proposal also needs to be considered in the context of the alternative which is the probable shut-down of operations at Spring Creek.

15. Spring Creek has only been in full Crown ownership since 2002. Prior to 2002 the mine was a joint venture between the Crown and Todd Coal Limited.

16. The agreement will be conditional on approval of the Overseas Investment Office and approval by Crown Minerals to transfer the mining license to the new entity.

Climate Change/Sustainability

17. The majority of Spring Creeks’ output is exported and the volume is tiny relative to international volumes of coal (less than 0.1% of internationally traded coal).

Conclusion

18. The benefits of the deal include:
• Cargill provide expertise on international thermal coal trading/marketing;
• Access for up to [redacted] in finance for mine development from Cargill;
• Payment of [redacted] for purchase of 49% of the mine’s assets;
• Ongoing employment for 130 Solid Energy employees;
• Maintain underground mining expertise within Solid Energy;
• Development costs and risks shared with Cargill;
• Solid Energy continues to operate and manage the mine, transport the coal, and employ all the mine’s employees;
• Increase likelihood of securing international customers for this particular coal; and
• Risk limitation through no-recourse structure (underground mining is high risk).

19. The key risk is that Spring Creek Mining Company will be formed on an unlimited liability basis because this provides some United States taxation benefit to Cargill. However Solid Energy has informed shareholders it has put the necessary safeguards in place to ensure there is no recourse to Solid Energy, in the event of default.

20. We do not consider this proposal breaches the Government’s policy to not hold a state asset sales programme as no shares in Solid Energy will be sold, no equity in Solid Energy will be issued, the mine is of a small scale relative to the company’s overall business, and it is consistent with a normal business modifying its asset mix to respond to its changing business environment.

Consultation

21. The Treasury and CCMAU have contributed to the preparation of this paper.

Financial Implications

22. The financial implications for the Crown in any one year are relatively small, but add up over time. The deal is very likely to have a positive effect on dividends to the Crown. The amount of the [redacted] that is returned to the Crown as a dividend will be determined after the company’s other capital needs and its gearing are considered.

23. Solid Energy has assessed the net present value (NPV) of retaining the Spring Creek mine in 100% Solid Energy ownership as being between [redacted]. Assuming the mine meets minimum production targets over the next 5 years the NPV of the proposed deal (including the payment from Cargill) is approximately [redacted]. Assuming successful development of the mine beyond 5 years, out to 20 years, the NPV rises to as much as [redacted]. These values do not take into account the considerable risk reduction achieved through the access to [redacted] from Cargill.

Human Rights

24. There are no human rights implications.
Legislative Implications

25. There are no legislative implications.

Regulatory Impact and Compliance Cost Statement

26. There is no requirement for a Regulatory Impact and Compliance Cost Statement.

Publicity

27. There is no need for any media communication on this subject. Solid Energy will make all necessary announcements.

Recommendations

28. It is recommended that the Cabinet:

1 note that shareholding Ministers intend to support the sale of a 49% interest in Solid Energy’s Spring Creek mine for the purpose of creating a joint venture to continue development and operation of the Spring Creek underground coal mine; and

2 note that the divestment of 49% of the Spring Creek mine is consistent with Government policy.

Hon Dr Michael Cullen
Minister of Finance

Hon Trevor Mallard
Minister for State Owned Enterprises
Dear John

SOLID ENERGY NEW ZEALAND LTD: SHAREHOLDER APPROVAL FOR SALE OF INTEREST IN SPRING CREEK MINE

Please find attached a signed copy of the Special Resolution of Shareholders approving the Operating Agreement between Solid Energy New Zealand Limited and Spring Creek Mining Company Unlimited relating to the operation of the Spring Creek Mine.

This resolution is approved by shareholding Ministers based on the favourable assessment of the agreement by the Solid Energy Board and management, the information provided in the Chief Executive’s letter dated 8 February 2007 and on Solid Energy’s responses to officials’ questions on the agreement. In particular, we understand that the Board of Solid Energy has approved the terms of the agreement on the basis that it will help to add substantial value to the business and provide significant support to the continued development of the Spring Creek mine.

In signing this resolution, shareholding Ministers understand that the Solid Energy Board has taken all reasonable steps to manage adverse risks from the Operating Agreement and the other agreements that make up the sale of a 49% interest in Spring Creek mine to Cargill International. In particular, we expect that the Board has satisfied itself that:

- The sale of the interest in the Spring Creek mine represents a good deal for Solid Energy and is better than any alternative.
- That there is no recourse to Solid Energy New Zealand Limited for the liabilities of the Spring Creek Mining Company Unlimited, either directly or indirectly.
Thank you for your efforts to ensure Spring Creek’s ongoing viability and in finalising this operating agreement with Cargill International.

Yours sincerely

Hon Dr Michael Cullen
Minister of Finance

Hon Trevor Mallard
Minister for State Owned Enterprises

cc: Associate Minister of Finance (Hon Clayton Cosgrove)

Encls: Special Resolution of Shareholders
IT IS HEREBY RESOLVED this    day of   2007 that the following resolution be passed as a special resolution under section 129 of the Companies Act 1993 for the purposes of approving the Company entering into a major transaction by means of a memorandum signed for the purposes of becoming an entry in the Minute Book of the Company as provided by section 122 of the Companies Act 1993 as follows:

“THAT the shareholders of the Company approve the entering into by the Company of the Operating Agreement which is an ancillary agreement to the sale of a 49% interest in Spring Creek Mine by Spring Creek Mine Holdings Limited (a wholly owned subsidiary of Solid Energy New Zealand Limited) to Cargill International SA dated February 2007. The Operating Agreement will constitute a major transaction under section 129 of the Companies Act 1993 as the income derived by the Company under the Operating Agreement will exceed 50% of the Company’s gross assets when measured over the term of that Agreement.”

Signed by all the shareholders:

Honourable Dr Michael Cullen,
Minister of Finance

Honourable Trevor Colin Mallard,
Minister for State Owned Enterprises