

The Treasury

Solid Energy Information Release

March 2013

Release Document

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

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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: Information on Spring Creek

Date:	30 May 2012	Report No:	T2012/1054
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Note contents	None
Associate Minister of Finance (Hon Steven Joyce)	Note contents	None
Minister for State Owned Enterprises (Hon Tony Ryall)	Note contents	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Juston Anderson	Senior Analyst, Commercial Transactions	[1]	✓
Andrew Blazey	Manager, Commercial Transactions Group	[1]	

Minister's Office Actions (if required)

None.

Enclosure: **Yes (attached)**

[Solid Energy: Shareholder approval for major transaction - Spring Creek Mine \(Treasury:942478v1\)](#)

[Solid Energy Cabinet POL paper \(Treasury:945217v1\)](#)

Treasury Report: Information on Spring Creek

1. Your office has requested information on Solid Energy's partial sale of the Spring Creek mine. Specifically, your office requested answers to a number of questions, which we have answered in brief in the table below:

How significant is the Spring Creek mine in the overall portion of Solid Energy's business?	In the last 5 years Spring Creek's production has been between 7% and 14% of Solid Energy's total coal production
When was 49% of the Spring Creek mine sold by Solid Energy?	March 2007, subject to Overseas Investment Office approval (which was subsequently granted)
Who was it sold to?	Cargill, a large privately held multinational corporation based in the United States
Was the sale considered at any stage by Cabinet?	Yes, Cabinet noted shareholding Ministers intention to approve the sale
Was the decision approved by shareholding Ministers, if so when?	Yes. One part of the sale was a major transaction under the Companies Act, which required formal shareholder approval. This approval was granted in March 2007
Were any restrictions put on the on-sale of the shares?	Both Solid Energy and Cargill had a first right of refusal to purchase the other party's shares in Spring Creek. Other than this, there were no restrictions. Solid Energy purchased Cargill's shares (by mutual agreement with Cargill) in February 2012

2. Your office also requested that we provide relevant papers from 2007 relating to the transaction. The two most relevant papers are attached.

Further Detail on Spring Creek and the 2007 Transaction

- The Spring Creek mine was originally developed by Greymouth Coal, a joint venture between Solid Energy and Todd Coal, and opened in March 2000. Two years later, Solid Energy bought out Todd's share of the joint venture. The mine is located approximately 15km north of Greymouth on the West Coast of the South Island.
- In early 2007, 49% of Spring Creek was sold by Solid Energy to Cargill, a large, privately held (family-owned) multinational corporation based in the United States, Cargill is involved in a range of industries in around 66 countries, mainly in the agricultural sector. Cargill had total revenue of around \$US 120 billion in 2011.
- Under the sale, Solid Energy retained all employees (approximately 130 at the time – recent media comment from Solid Energy has indicated there are now 230 workers at the mine), and was 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%) jointly acquired the output from the mine at an agreed price.
- Shareholding Ministers at the time were not asked to approve the sale itself, but were asked to approve an Operating Agreement between Solid Energy and the joint venture company. The length and scope of the Operating Agreement were such that the Board of Solid Energy advised that it would constitute a major transaction under the Companies Act, and therefore required formal approval by shareholders.

7. Under the Operating Agreement, Solid Energy agreed to undertake all mining and business activities of the mine in return for a service fee which was calculated on a cost recovery basis. The Operating Agreement was one of five agreements that formed the overall deal with Cargill. The other four agreements were not major transactions under the Companies Act.
8. The Operating Agreement could only be assessed in the context of the deal as a whole, and so Solid Energy provided shareholding Ministers with information on the full set of proposed agreements with Cargill relating to Spring Creek. If shareholding Ministers had not approved the Operating Agreement, then the sale to Cargill would not have gone ahead (at least, not without significant changes to the terms of the sale).
9. Shareholding Ministers also informed Cabinet of the proposed deal, and advised Cabinet of their intention "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". Cabinet was not formally asked to approve the sale, only to note it. Following Cabinet's consideration, shareholding Ministers approved Solid Energy entering into the Operating Agreement.
10. We have attached a joint Treasury/CCMAU report from the time, which sets out in more detail the transaction and Treasury and CCMAU's advice on it. The Treasury/CCMAU report also attached a draft Cabinet paper for shareholding Ministers to inform Cabinet of the proposed transaction, and a draft special resolution for shareholding Ministers to approve.

Significance of the Mine for Solid Energy

11. The table below shows Spring Creek's output since production commenced in 2003, relative to Solid Energy's total coal production

	Spring Creek output (tonnes)	Total Solid Energy output (tonnes)	Spring Creek as a % of total
2003	18	3,196	0.6%
2004	92	3,631	2.5%
2005	175	4,288	4.1%
2006	433	4,502	9.6%
2007	297	4,402	6.8%
2008	339	4,439	7.6%
2009	349	3,936	8.9%
2010	533	3,781	14.1%
2011	403	4,022	10.0%
Total 2003-2011	2,640	36,196	7.3%

Recent Repurchase by Solid Energy

12. In February 2012 Solid Energy publicly announced that it had purchased 49% of the Spring Creek Mining Company from Cargill. Therefore Solid Energy now owns 100% of the mine. The repurchase was not a major transaction and did not require shareholder approval. We understand Solid Energy is attempting to replace Cargill with another joint venture partner.

Commercial Sensitivity

13. The basic facts behind the 2007 transaction are public knowledge: i.e. that it involved Solid Energy selling 49% of the Spring Creek mine to Cargill. Solid Energy's media release from the time¹ makes no mention of the transaction requiring shareholder approval. However, a recent public comment from the Chair of Solid Energy stated that the transaction was approved by shareholding Ministers.
14. The full details of the transaction, as contained in the attached Treasury/CCMAU report from 2007 and the Cabinet papers, are not public, and many of these details are still commercially sensitive for Solid Energy.
15. The Cabinet papers are also covered by the Cabinet Office Manual "Convention on access to Cabinet records of a previous administration"². The relevant provisions of the Cabinet Office Manual state that:
 - incumbent Ministers are entitled to consult the Cabinet records of a previous administration on the basis that the confidentiality of the papers is respected. These Cabinet records may be accessed through the Minister's department or through the Cabinet Office
 - Ministers are required to keep the Cabinet documents of a previous administration confidential.

Recommended Action

We recommend that you **note** the contents of this report.

Andrew Blazey
Manager, Commercial Transactions

Hon Tony Ryall
Minister for State Owned Enterprises

¹ <http://www.coalnz.com/index.cfm/1.214.391.0/Spring-Creek-Mine-secures-international-commitment.html>
² <http://www.cabinetmanual.cabinetoffice.govt.nz/8.75>

Office of the Minister of Finance
Office of the Minister For State-Owned Enterprises

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 [REDACTED]. 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 [REDACTED] from Cargill) to develop the mine. Solid Energy has assessed the net present value of the deal is approximately [REDACTED].

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 [REDACTED] 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 [REDACTED]. 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 [REDACTED] to support mine's development;
- Solid Energy retains the right to supply minimum of [REDACTED] 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 [REDACTED] 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

Mr John Palmer
Chairman
Solid Energy NZ Ltd
PO Box 1303
CHRISTCHURCH

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

RELEASED UNDER THE
OFFICIAL INFORMATION ACT

SOLID ENERGY NEW ZEALAND LIMITED
(the "Company")

SPECIAL RESOLUTION OF SHAREHOLDERS

(Pursuant to section 129(1) of the Companies Act 1993)

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

Treasury Report: Solid Energy: Shareholder Approval for Major Transaction – Spring Creek Mine

Date:	21 February 2007	Treasury Priority:	High
Security Level:	COMMERCIAL-IN-CONFIDENCE	Treasury Report No:	T2007/187
		CCMAU Report No:	SEL-035/A61550

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Dr Michael Cullen)	<p>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;</p> <p>Sign the attached Cabinet paper and submit to Cabinet office;</p> <p>Pending the outcome of the Cabinet process, sign the attached shareholder special resolution and letter; and</p> <p>Refer to media staff</p>	<p>10am 22 February 2007</p> <p>26 February 2007</p>
Associate Minister of Finance (Hon Phil Goff)	Note	None
Associate Minister of Finance & Minister for State-Owned Enterprises (Hon Trevor Mallard)	<p>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;</p> <p>Sign the attached Cabinet paper and submit to Cabinet office;</p> <p>Pending the outcome of the Cabinet process, sign the attached shareholder special resolution and letter; and</p> <p>Refer to media staff</p>	<p>10am 22 February 2007</p> <p>26 February 2007</p>
Associate Minister of Finance (Hon Clayton Cosgrove)	Note	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Chris Jones	Senior Advisor, CCMAU	[1]		
Mike Moore	Manager - Energy, Land and Environment, CCMAU	[1]		
Matthew Morrison	Senior Analyst, Commercial Investments			✓
Jean-Pierre Andre	Senior Analyst, Commercial Investments	[1]		

Enclosure: **Yes**

21 February 2007

SE-2-14-0

Treasury Report: Solid Energy: Shareholder Approval for Major Transaction – Spring Creek Mine

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
Senior Analyst, Commercial Investments
for Secretary to the Treasury

Michael Moore
Manager - Energy, Land and
Environment, CCMAU

Media Staff

Referred: Yes/No

Hon Dr Michael Cullen
Minister of Finance

Hon Trevor Mallard
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 [2] 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.