

SOLID ENERGY NEW ZEALAND LIMITED

MEMORANDUM

NATIONAL RESOURCES COMPANY – PRINCIPLES AND ISSUES

Fundamental principles

In order to maximise the opportunity and minimise the execution timetable Solid Energy believes strongly that the following principals and execution strategies need to be followed:

- **Clarity of decision** – Need a clear commitment to the objectives, the process to be followed and the end outcome to ensure the change required can be implemented effectively.
- **Speed of implementation** – Once a commitment is made need to work to remove impediments to ensure fast and efficient implementation.
- **Solid Energy will lead and manage the implementation programme** - however we will partner and work closely with Government and all stakeholders ensure principles one and two above are achieved
- **Communication needs to be well planned and coordinated** – SE will take a strong role using our standard approach to ensure Economic and Public Good, Legislative, Political, Trade and Treaty and Commercial Imperatives and expectations are well managed in the minds of all stakeholders.

Key Issues

Outlined below is a summary of key implementation issues and a high level execution plan to be considered in a decision in principle to proceed.

The issues have been grouped into five categories and include an assessment and discussion of the issues and possible management strategies.

The four categories are:

- Legislative
- Political
- Trade and Treaty
- Commercial

1. Legislative Issues

Potential Issues	Issue Assessment and Interrelationship	Management Strategies
The scope of direct legislative reform (enabling legislation) required to support a National Resources Company is not currently defined	<ul style="list-style-type: none"> - Key elements of enabling legislation are likely include: <ul style="list-style-type: none"> • Priority permit allocation • Land access or acquisition powers 	<ul style="list-style-type: none"> - A detailed scope of required enabling legislation and legislative reform must be prepared.
The scope of <u>associated</u> legislative variations is not currently defined.	<ul style="list-style-type: none"> - The process has potential to require modifications to following associated legislation: <ul style="list-style-type: none"> • Crown Minerals Act • Commerce Act • Resource Management Act • CO₂ reduction and emissions trading 	<ul style="list-style-type: none"> - A detailed review and scope of associated legislative reform must be prepared.
Broad legislative reform strategy still to be determined i.e. the 'big bang' single reform process Vs. a staged legislative process.	<ul style="list-style-type: none"> - The 'big bang' approach risks additional public criticism and delays by including controversial reform for example compulsory acquisition powers - A measured or staged approach potentially limits the effectiveness of the National Resources Company to meet its overall goals 	<ul style="list-style-type: none"> - Based on the scope of direct and associated reform required (above) an agreement on overall approach and strategy to legislative reform is required. - Communication strategy and plan support this decision is critical.
Management of legislative reform process	<ul style="list-style-type: none"> - Legislative reform process has the ability to cause significant delays, frustration and suboptimal output if not managed closely. 	<ul style="list-style-type: none"> - Need to define the legislative reform process and specific ministerial involvement. - Recommend that DPMC lead the process supported by a small committee/taskforce of senior officials from <ul style="list-style-type: none"> • MED • Treasury • Environment • Conservation
Real or perceived conflict and confusion over Government roles as both resource owner/developer (through the National Resources Company) and industry regulator.	<ul style="list-style-type: none"> - This was a common criticism of Petrocorp and likely to be raised again. - Will be used to challenge the priority permit allocation and stronger enforcement of work programme requirements. 	<ul style="list-style-type: none"> - Require a clear definition and clarification of Crown Minerals role as regulator subsequent to implementing this strategy - Consider moving Crown Minerals from MED and the establishment of a separate Crown Entity as regulator only

	Potential Issues	Issue Assessment and Interrelationship	Management Strategies
	Potential for significant legal action from existing industry participants seeking compensation for loss due to restrictions on current or future permit access.	<ul style="list-style-type: none"> - Significant issue given the historic behaviour in the petroleum and minerals sector. - Has potential to cause significant delays and costs during and subsequent to implementing a National Resources Company. - May significantly reduce the effectiveness of a National Resources Company 	<ul style="list-style-type: none"> - Tight drafting of new legislation is critical. Must limit 'grey areas' where common law interpretations are required. - External drafting experts required.

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2. Political Issues

Potential Issues	Issue Assessment and Interrelationship	Management Strategies
Potential implications or inconsistencies between National Resources Strategy and existing commitments to minor coalition parties (ACT, Greens and Maori party);	<ul style="list-style-type: none"> - Inconsistencies with existing commitments which result in a 'watered down' National Resources Strategy will be in conflict with our fundamental principles 	<ul style="list-style-type: none"> - To be managed directly by the National Government - Communication strategies required for each individual parties.
Misalignment between the National Resources Strategy and the public election mandate or other policy initiatives	<ul style="list-style-type: none"> - Public and political challenge identifying this as strategy for "<i>preparing for a Government asset sell down</i>" - Misalignment with other policy initiatives which result in a 'watered down' National Resources Strategy will be in conflict with our fundamental principles 	<ul style="list-style-type: none"> - Detailed communication strategy and plan to address this and other likely challenges. - To be managed directly by the National Government.
Implications for future election positioning and strategy	<ul style="list-style-type: none"> - 	<ul style="list-style-type: none"> - To be managed directly by the National Government
Loss of political mandate through public outcry during the implementation process	<ul style="list-style-type: none"> - There are many potential detractors who will be strongly against this change. <ul style="list-style-type: none"> • Industry (offshore and NZ based companies) • Financial markets • Government opposition (political and bureaucracy) • Environmental groups • General Public - May result in a 'watered down' National Resources Strategy which is in conflict with our fundamental principles 	<ul style="list-style-type: none"> - Management of public perception is critical. - Detailed communication plan and strategy to be prepared. - Timing and content of announcements absolutely critical - Specific strategies required for key organisations interest groups and stakeholders.
Challenges to Government regarding direct investment through forgoing dividends from SENZ and Kupe.	<ul style="list-style-type: none"> - Investment cashflow from SENZ and Kupe to support initial development is fundamental - Strategy unable to progress without this cashflow 	<ul style="list-style-type: none"> - Risk to be specifically addressed in the communications strategy and plan.

3. Trade and Treaty Issues

	Potential Issues	Issue Assessment and Interrelationship	Management Strategies
	Misalignment between National Resources Strategy and international trade treaties and obligations; e.g. APEC to which both NZ and China belong	<ul style="list-style-type: none"> - Potential to impact on NZ's wider trade initiatives with key countries and industry partners. 	<ul style="list-style-type: none"> - Review all international trade treaty's and obligations to identify areas of misalignment and prepare a plan to manage potential conflicts
	Legal or reputational challenges from existing international permit holders regarding Government obligations and commitments through permit conditions	<ul style="list-style-type: none"> - Financial (litigation) risk – cost of being sued for breach of contractual commitments under existing permits. - Raises concerns regarding reputation and sovereign risk with potential to impact future overseas investment and partnering opportunities within the resource sector 	<p>The current proposal does not include repossession of permits which are allocated and remain in compliance with work programmes.</p> <ul style="list-style-type: none"> - Allocated permits which are out of compliance will be cancelled and reissued through the pre-emptive right. - Identify specific areas of potential conflict to be managed.
	Implications/threats to accessing overseas investment in other sectors of the economy	<ul style="list-style-type: none"> - Wider concerns regarding NZ's overall reputation and sovereign risk impacting direct overseas investment across broad NZ industry sectors. 	<ul style="list-style-type: none"> - Identify key areas or stakeholders with potential (or perceived) conflict. - Specifically address key stakeholder management in a detailed Communications plan. - Provide precedents and authoritative evidence of how this issue is managed from countries with national resource and/or oil companies.

4. Commercial Issues

	Potential Issues	Issue Assessment and Interrelationship	Management Strategies
	Optimal commercial structure not yet defined.	<ul style="list-style-type: none"> - Immediate need to determine structure based on long term goals. - Need to consider future governance, funding and partnership arrangements to ensure there are no limitations on future development plans. 	<ul style="list-style-type: none"> - Establish clear long term organisational goals and objectives - Assess commercial structure options to best deliver on organisational objectives. - Establish the commercial entity and implement the agreed framework.
	Inability to secure initial permit allocation and establish of priority rights to permits.	<ul style="list-style-type: none"> - This is the key commercial enabler for this entity. - Creates significant and immediate value for NRL. - Provides security for long term investment and partnering programme. 	<ul style="list-style-type: none"> - See legislative process above
	<p>Inability to secure free cash flow through the set-up and implementation phase.</p> <ul style="list-style-type: none"> - Retention of SENZ cashflows - Transfer of ownership in Kupe from Genesis <ul style="list-style-type: none"> o Management of equity partner commitments (pre-emptive rights etc) o Commercial compensation to Genesis o Relationship management with Genesis 	<ul style="list-style-type: none"> - Immediate cashflows from SENZ and Kupe are critical to funding NRL setup and initial development. - Significant value created from investment of initial cashflow (risk capital) into prospective permits prior to seeking external funding. 	<ul style="list-style-type: none"> - Secure commitment from SENZ shareholding Ministers to allow retention of SENZ profit for reinvestment into NRL. - Assess commercial impediments to transferring Kupe to NRL <ul style="list-style-type: none"> o pre-emptive rights for existing partners o Impacts on Genesis business plan, funding and capital structure o Genesis commercial compensation o taxation implications - Develop and implement a strategy to resolve impediments and affect the transfer.
	<p>Building world class capability. The specific issues relate to</p> <ul style="list-style-type: none"> - Talent attraction - Lead time to secure (and likely relocate key resources) 	<p>Attracting world class capability quickly is a critical success driver to ensure speed of development while prudently managing of investment risk.</p> <ul style="list-style-type: none"> - Talent and capability required across all levels of the business <ul style="list-style-type: none"> o Governance o Management/Leadership o Operational capability 	<ul style="list-style-type: none"> - Initial capability building strategy to be developed and implemented utilising a combination of direct employment, world class consulting and service providers and strategic partnerships. - Opportunity to bring New Zealanders with demonstrated capability home from abroad - Utilise organisations and networks such as Kiwi Expats Abroad (KEA) to connect with highly skilled New Zealanders working offshore in relevant fields.

	Potential Issues	Issue Assessment and Interrelationship	Management Strategies
	<p>Inability to secure external funding (capital risk), impacted by:</p> <ul style="list-style-type: none"> - Negative perception from capital market investors and analysts - Negative industry partner attitude due to perception of resource nationalisation 	<ul style="list-style-type: none"> - The ability to secure external funding is highly correlated with the success of the items above i.e. commercial structure, investment opportunities, development cashflows, and team capability. - Assuming SENZ and Kupe free cashflows are secured, there is no immediate need for external funding. - The proposed business plan requires external capital/funding from 2012 to support development plans - External capital raising is an essential component of the plan as it integrates a number of key elements: <ul style="list-style-type: none"> o It is required to meet the investment profile proposed (alternatively Government equity injection is required) o Provides comfort to the market regarding commercial disciplines and transparency – which will be a criticism of 100% SOE o Important talent retention tool through shareholding options to key staff o Provides an ability for key NZ stakeholders to consider equity investment (Iwi, NZ superfund) o Reduces the risk (and perception) of future political interference. 	<ul style="list-style-type: none"> - Successfully implement all strategies (above) <ul style="list-style-type: none"> o robust commercial structure o secure investment opportunities through permit rights o develop the opportunities using secure development cashflows - Management of potential industry partners perceptions to be specifically addressed in the communications plan. - Provide reference to the many offshore partnership arrangements under similar Government owned resource and oil companies.
	<p>Other major potential impediments (or 'show-stoppers') to accelerating resource development projects include:</p> <ul style="list-style-type: none"> - Land access - Regulatory uncertainty regarding CO₂ - Consenting under RMA 	<p>Under the current minerals regime there is no provision to force access to land to exploit the mineral beneath – therefore land access can 'block' development indefinitely.</p> <ul style="list-style-type: none"> - Uncertainty regarding CO2 regulations and open ended nature of this cost create difficulties in funding emission intensive industry - The consenting process, even with recent call in provisions for projects of national significance, is still an impediment to development timeframes and cost. 	<ul style="list-style-type: none"> - A strategy and plan is required to address these key impediments particularly as they relate to projects of National Significance. - The strategy needs to address the timing of proposed changes i.e. a 'big bang' all changes introduced at one time vs. a staged approach based on priority. - As a minimum, the land access for minerals requires an alignment with the petroleum land access arrangements which provides right of access to the permit holder.

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