

COMMERCIAL SENSITIVE

9 August 2004

CABINET: ORAL ITEM FOR TABLING

GENESIS POWER: UPDATE ON GOVERNMENT SUPPORT FOR E3P

Introduction

1. On 18 July 2004 Cabinet authorised shareholding Ministers, in consultation with the Minister of Energy, to negotiate a risk sharing agreement that would enable Genesis Power (Genesis) to commission **e3p**, a 385MW Combined Cycle Gas Turbine at Huntly, by December 2006 [CAB Min (04) 23/12 refers].
2. Delegated authority was granted on the basis that a risk sharing agreement would only be entered into if the risks associated with it can be managed and shared between the Company and the Crown in an appropriate manner.
3. Cabinet also noted that **e3p** would be a nationally significant power station, with significant national benefits from the perspective of medium term security of electricity supply.
4. Cabinet invited shareholding Ministers to report back to the Cabinet Policy Committee on the outcome of the negotiations as soon as they had been completed. This paper constitutes that report back, and also seeks an alteration to the delegation under which Ministers operate.

Risk Sharing Agreement

5. Since receiving instruction from Cabinet, officials have been in negotiations with Genesis to achieve a risk sharing agreement that provides Genesis with the minimum level of support to enable it to commit to **e3p**. Ministers consider that this outcome will shortly be achieved and will this week, subject to Cabinet authorisation, execute a deed committing the Crown to a formal risk sharing agreement that results in the Crown assuming a portion of the gas risk associated with building **e3p**.
6. The Crown's negotiating position has been informed by a set of principles and Ministers consider that these core principles will be addressed in the agreement by:

- *transferring the minimum level of risk to the Crown such that the Board has sufficient comfort to be able to recommend that proceeding with e3p is in Genesis' commercial interest* – Genesis has conceded on a number of points which substantially increase its exposure to potential gas shortfalls in the medium-to-longer-term. Despite these concessions, the Genesis Board has reconfirmed to Ministers that the risk sharing agreement is sufficient for it to commit to building e3p.
 - *avoiding risk transference with respect to non-delivery for existing contracts*– Genesis has agreed to reviews that will allow both parties to revisit the status of Genesis' gas supply contracts, and to assess the risks inherent in the contracts to determine whether the contracts are sufficiently certain to have the status of being proven. There is provision in the risk sharing agreement for the Genesis to bear all non-delivery risk from those sources that are considered proven by both parties.
 - *avoiding risk transference with respect to the gas supply for existing requirements* – the agreement recognises Genesis' core existing commitments to its gas retail and gas fuelled energy customers as well as providing for a minimum level of gas throughput at Huntly to enable coal fired generation to operate more effectively through a mix of fuels. However the Agreement allows only a minimum level of existing demand to be recognised, which has the effect of ensuring that maximum incentive remains with Genesis to secure additional gas supplies.
7. Ministers consider that the agreement, when concluded, will satisfy these broad criteria and provides 'just enough' for Genesis to commit to building e3p. In that respect, Ministers are satisfied that the overall risk transfer to the Crown will be minimised.

Delegation amendment

8. Although Genesis originally approached shareholding Ministers to enter into this risk sharing agreement, the government's interest in the proposition is from a wider energy perspective. On strict commercial grounds, officials have advised Ministers that they would not support e3p because of the commercial risks involved. From a shareholding perspective, Ministers agree with this perspective. However, officials have also advised that e3p proceeding is desirable from an energy perspective. On this basis, we consider that it more appropriate that the Minister of Finance and the Minister of Energy enter into the risk sharing agreement on behalf of the government. The Minister of State Owned Enterprises concurs with this decision. Approval is therefore sought to amend the delegation.

Industry comment

9. Despite the commercially sensitive nature of the agreement other industry participants are aware of the proposal and have expressed some concern that the government is entering into such an arrangement with Genesis. Some of the concerns raised by industry are premised on inaccurate information regarding the financing arrangements for **e3p**. Ministers are constrained in what they can say on points of detail given the commercially sensitive nature of the information.
10. In undertaking discussions with Genesis, the government has been mindful that any agreement does not deter investment in generation by other market participants. The agreement with Genesis represents a "one-off" and is a response to the uncertainty created by the earlier than expected depletion of Maui gas and the fact that alternative sources have yet to be confirmed. Entering into the agreement recognises the need for decisions around investment before full commercial certainty of gas supply can be achieved.

Communication

11. The Minister of Finance and Minister of Energy will make an announcement regarding government support for **e3p** following finalisation of necessary documentation and Genesis Energy's announcement of a decision to proceed.

Recommendations

12. Ministers recommend that Cabinet:

- a) **note** that negotiations with Genesis Energy are progressing well and the risk sharing agreement that provides Genesis with the minimum level of support will enable it to commit to **e3p**.
- b) **note** that the government's interest in the proposition is from a wider energy perspective.
- c) **rescind** the delegation provided in CAB Min (04) 23/12 that authorised shareholding Ministers to enter into the risk sharing agreement with Genesis Energy;
- d) **authorise** the Minister of Finance and the Minister of Energy to:
 - conclude negotiations with Genesis Energy;
 - provided the risks associated with the agreement are managed and shared between Genesis and the Crown in an appropriate manner, enter into the risk sharing agreement before 15 August 2004, which will allow **e3P** to be built on time.