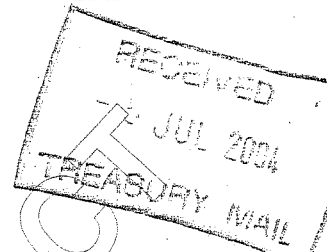




2 July 2004

Hon Mark Burton
Minister for State Owned Enterprises
Parliament Buildings
WELLINGTON

Hon Dr Michael Cullen
Minister of Finance
Parliament Buildings
WELLINGTON



The Genesis Building

602 Great South Road

Ground Floor

PO Box 17-188

Greenlane

Auckland

New Zealand

Telephone 09 580 2094

Facsimile 09 580 4894
Main Number, Corporate
Services, Finance & IS

Facsimile 09 580 4891
Retail

Facsimile 09 580 4869
Sales & Marketing / Natl
Sales

Facsimile 09 580 4813
GM Retail

Facsimile 09 580 4884
Trading

Facsimile 09 580 4896
Human Resources

Dear Ministers

In our letter of 26 April 2004, Genesis Energy updated Ministers on the status of Genesis Energy's project to commission a new 385MW combined cycle gas turbine at the Huntly Power Station Site ("Huntly e3p") and advised Ministers of Genesis Energy's efforts to secure sufficient gas supplies for the operation of Huntly e3p to meet a planned commissioning date of 15 December 2006.

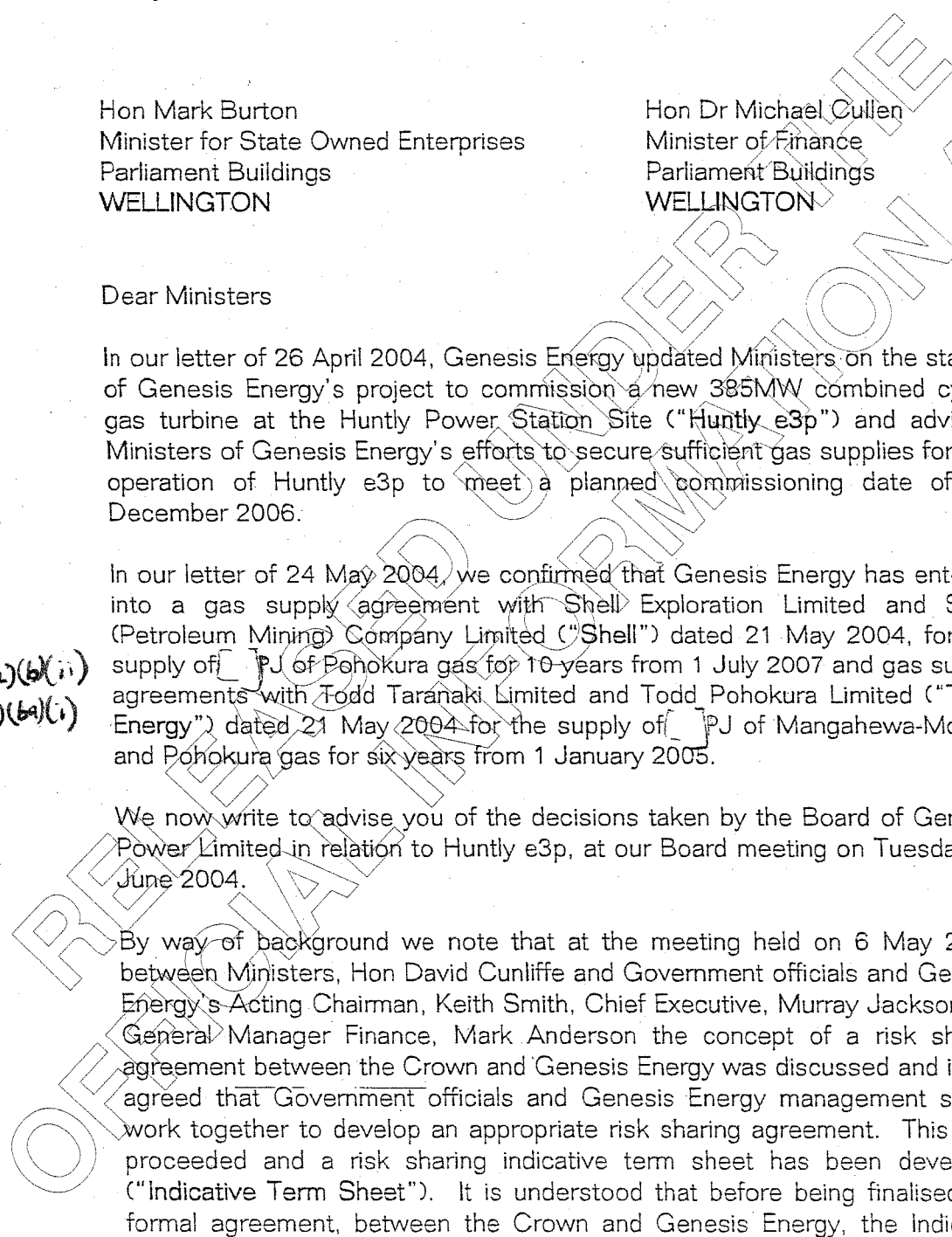
In our letter of 24 May 2004, we confirmed that Genesis Energy has entered into a gas supply agreement with Shell Exploration Limited and Shell (Petroleum Mining) Company Limited ("Shell") dated 21 May 2004, for the supply of [] PJ of Pohokura gas for 10-years from 1 July 2007 and gas supply agreements with Todd Taranaki Limited and Todd Pohokura Limited ("Todd Energy") dated 21 May 2004 for the supply of [] PJ of Mangahewa-McKee and Pohokura gas for six years from 1 January 2005.

We now write to advise you of the decisions taken by the Board of Genesis Power Limited in relation to Huntly e3p, at our Board meeting on Tuesday 29 June 2004.

By way of background we note that at the meeting held on 6 May 2004, between Ministers, Hon David Cunliffe and Government officials and Genesis Energy's Acting Chairman, Keith Smith, Chief Executive, Murray Jackson and General Manager Finance, Mark Anderson the concept of a risk sharing agreement between the Crown and Genesis Energy was discussed and it was agreed that Government officials and Genesis Energy management should work together to develop an appropriate risk sharing agreement. This work proceeded and a risk sharing indicative term sheet has been developed ("Indicative Term Sheet"). It is understood that before being finalised in a formal agreement, between the Crown and Genesis Energy, the Indicative Term Sheet may require the approval of Cabinet and in that event a decision from Cabinet may be possible by 19 July 2004.

Since the meeting held on 6 May 2004, Genesis Energy management has also provided Government officials with an update of the Investment Proposal for Huntly e3p, being an independent report by ABN AMRO, first prepared in

s.9(2)(b)(i)
s.9(2)(b)(i)



September 2001 ("Revised Investment Proposal"). Through the provision of that update and further supplemental information, Genesis Energy addressed all of the issues identified in Ministers' letter dated 4 December 2001, being issues shareholding Ministers would expect to be answered or reviewed before a final decision to proceed with Huntly e3p is made.

Genesis Energy management has also kept officials informed of the financing arrangements being put in place to cover the Huntly e3p investment and Genesis Energy's ongoing general corporate and working capital requirements. The combined funding requirement of the company to meet the cost of commissioning e3p and absorb our existing credit facility is \$675 million. A Revolving Cash Advances Facility for up to \$675 million, to be entered into with Westpac Banking Corporation ("Westpac"), requires Genesis Energy, under section 129 of the Companies Act 1993, to seek and obtain formal shareholder approval of the transaction as it gives rise to obligations over the term of the agreement in excess of half of the value of the assets of Genesis Energy before the agreement.

At the meeting of the Board of Genesis Power Limited, held on Tuesday 29 June 2004, the Directors considered the Revised Investment Proposal for Huntly e3p, the terms of the proposed Revolving Cash Advances Facility, to be entered into with Westpac, the terms of the proposed risk sharing agreement, to be entered into with the Crown and the terms of the Engineer Procure and Construct ("EPC") contract and Long Term Maintenance Agreement ("LTMA") that have been negotiated with Mitsubishi Corporation ("Mitsubishi").

Please now be advised that at the meeting of the Board of Genesis Power Limited held on Tuesday 29 June 2004, the Directors resolved as follows:

1. In relation to Huntly e3p, and subject to shareholding Ministers' approval, the Directors approved the company entering into a Revolving Cash Advances Facility for up to \$675 million with Westpac on substantially the terms advised to the Board at the meeting and recorded in an indicative term sheet ("Facility") and resolved to recommend to shareholding Ministers that they approve the company entering into the Facility.
2. In relation to Huntly e3p, the Directors approved the company entering into a risk sharing agreement with the Crown on substantially the terms, as developed with Government officials, advised to the Board at the meeting and recorded in the Indicative Term Sheet dated 29 June 2004, ("Crown Risk Sharing Agreement").
3. Subject to shareholding Ministers approving the company entering into the Facility, subject to shareholding Ministers, and Cabinet if necessary, approving the Crown entering into the Crown Risk Sharing Agreement with Genesis Energy and subject to shareholding Ministers being satisfied

that all the issues raised in their letter dated 4 December 2001 have been answered or reviewed to their satisfaction, the Directors approved the company issuing to Mitsubishi a final notice to proceed with Huntly e3p and entering into the EPC and LTMA before 15 August 2004 to achieve a Time for Completion of 15 December 2006.

On behalf of the Board of Genesis Power Limited, I recommend shareholding Ministers approve the company entering into a Revolving Cash Advances Facility for up to \$675 million on substantially the terms advised to Government officials and record their approval by way of a special resolution under section 122 of the Companies Act 1993. The form of the special resolution requiring shareholding Ministers' signatures, is attached to this letter.

With regard to Crown approval of the proposed Crown Risk Sharing Agreement and shareholding Ministers' continuing support of the Genesis Power Limited Board's intention to proceed with Huntly e3p, Ministers will note that despite delays to the project, due to fuel uncertainties, Huntly e3p remains capable of being commissioned by 15 December 2006. Huntly e3p is the only major new generation investment that can be delivered to the New Zealand market in the next three years.

Genesis Energy has agreed the terms of the contracts for the construction and ongoing maintenance of Huntly e3p, consented and cleared the site at the Huntly Power Station ready for the construction works to begin and commenced the works necessary to provide a heavy haulage route for the transportation of the plant required for Huntly e3p from the Ports of Auckland to Huntly Power Station. In addition, Genesis Energy issued a limited notice to proceed to Mitsubishi to carry out preliminary contract works valued at \$25 million. Although unable to issue a final notice to proceed when those works were completed on 15 February 2004, Genesis Energy did secure a position at the Mitsubishi factory on the gas and steam turbine production line to achieve a Time for Completion for Huntly e3p of 15 December 2006. This completion date is subject only to the execution of the contract for the full works before 15 August 2004.

Finally, following the announcements by the Pohokura Joint Venture partners in April 2004 that they would now sell their entitlements from the Pohokura gas field separately, Genesis Energy has entered into gas contracts with Shell and Todd Energy for significant tranches of gas from the Pohokura and Mangahewa-McKee gas fields. This adds to existing gas entitlements under contracts with NGC New Zealand Limited and Swift Energy New Zealand Limited and to the gas contract entered into by Genesis Energy, following the sell down of 50% of Genesis Energy's interest in the Kupe field, for 81% of the gas production from Kupe for () years with an expected start date of 2007.

§ 9(2)(b)(i)
§ 9(2)(b)(i)

Notwithstanding significant volumes of contracted gas from diversified fields which, subject to deliveries commencing on the expected dates, mean Genesis Energy [

] and in the expectation that additional gas or LNG will be brought to market to fill such shortfalls, then the key risk to Genesis Energy's investment in Huntly e3p remains the certainty of long term gas supplies. Both the Kupe and Pohokura gas fields are unproven fields and the fields have not yet been developed. Failure to deliver, or a delay in delivery, under any one of Genesis Energy's gas supply contracts following a commitment to proceed with Huntly e3p would expose Genesis Energy to substantial negative impacts to its financial position. The proposed Crown Risk Sharing Agreement will provide mitigation against the financial loss incurred in the event of such a gas shortfall.

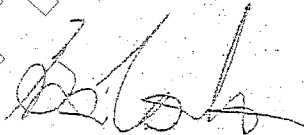
s 9(2)(b)(ii)
s 9(2)(b)(i)
s 9(2)(j)

Genesis Energy is continuing to work closely with Mitsubishi to ensure that all necessary documentation and processes are in place to facilitate the execution of the EPC and LTMA contracts and the issue of a final notice to proceed with Huntly e3p before 15 August 2004. This timing is critical to ensure a Time for Completion of 15 December 2006 and to prevent any further escalation in the cost of the project.

Early consideration and approval by shareholding Ministers is therefore critical in the project timeline of Huntly e3p. Government officials have indicated a timetable for approvals leading to a Cabinet decision on or about 19 July 2004. During this period I would appreciate your officials keeping Genesis Energy management informed of the progress of the Crown approval process.

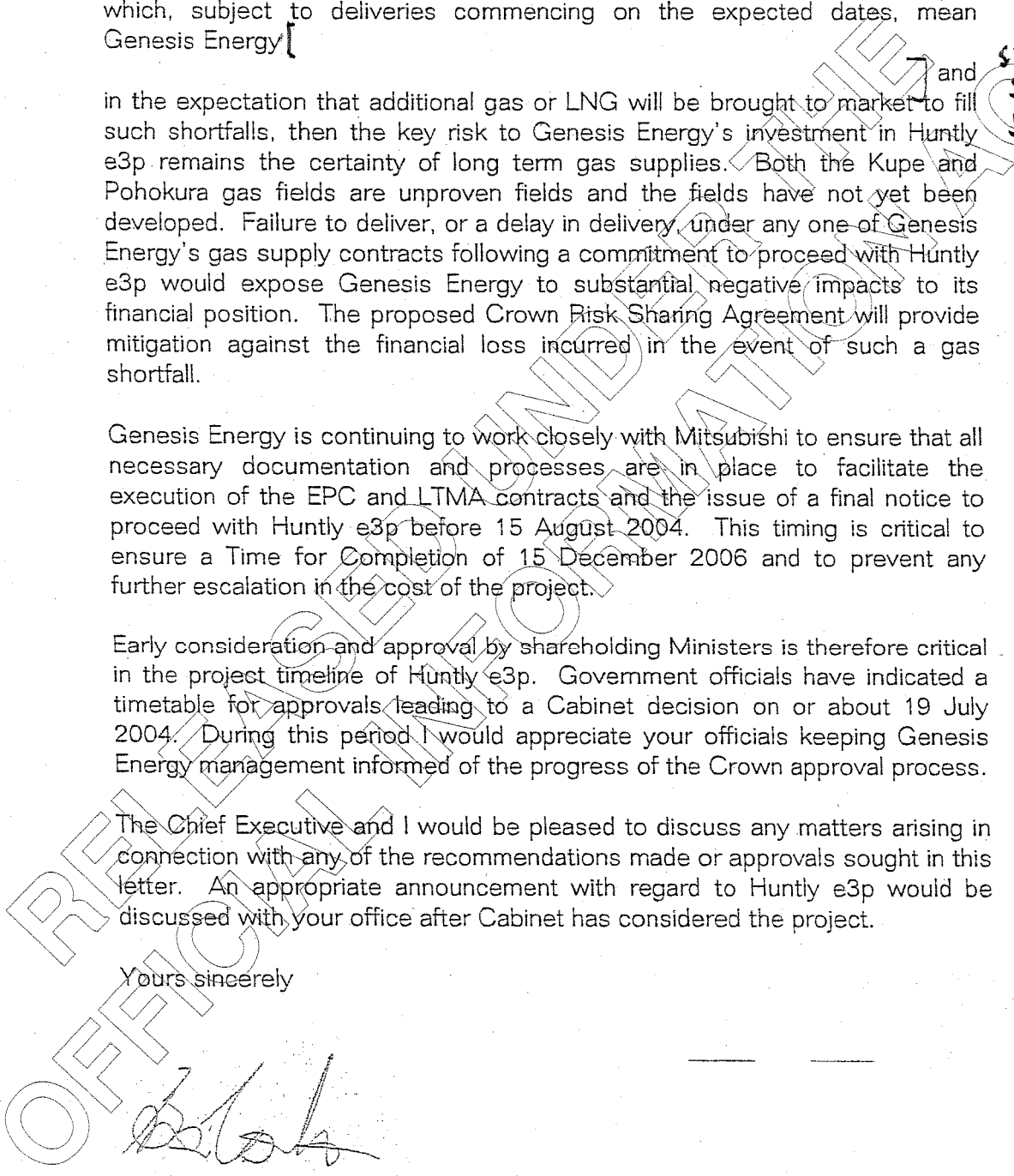
The Chief Executive and I would be pleased to discuss any matters arising in connection with any of the recommendations made or approvals sought in this letter. An appropriate announcement with regard to Huntly e3p would be discussed with your office after Cabinet has considered the project.

Yours sincerely



Brian Corban, QSO
Chairman

cc: Hon Pete Hodgson
Encl: Special Resolution Approving a Major Transaction



GENESIS POWER LIMITED
("Company")

SPECIAL RESOLUTION APPROVING A MAJOR TRANSACTION

(Section 129 of the Companies Act 1993)

The Shareholders of Genesis Power Limited resolved as a special resolution in writing in accordance with section 122 of the Companies Act 1993 as follows:

To approve Genesis Power Limited entering into a Revolving Cash Advances Facility with Westpac Banking Corporation for up to \$675 million ("Facility") which gives rise to obligations over the term of the Facility the value of which is more than half the value of the assets of Genesis Power Limited before the Facility.

DATED:

2004

SIGNED

Hon Mark Burton
Minister for State Owned Enterprises

Hon Dr. Michael Cullen
Minister of Finance

INDICATIVE TERM SHEET – RISK SHARING AGREEMENT

Dated this 29 day of June 2004

This document is an indicative draft term sheet ("**Indicative Term Sheet**") in relation to a risk sharing arrangement between Genesis Power Limited ("**Genesis Energy**") and the Crown in order to progress Huntly e3p based on Genesis Energy's existing portfolio of Gas contracts.

It contains some of the principal terms and conditions and sets out the respective contributions of the parties between Genesis Energy and the Crown that, once this Indicative Term Sheet has been accepted by the parties, will substantially comprise the risk sharing agreement recording the allocation of risk between the parties. ("**Agreement**").

This Indicative Term Sheet does not contain, summarise, or finalise all of the provisions that may be contained in the Agreement.

Genesis Energy seeks support against the substantial negative impacts to its financial position that would result should a Gas shortfall eventuate following a decision to construct Huntly e3p. Genesis Energy therefore seeks to obtain financial assistance (as revenue, with no obligation on the part of Genesis Energy to repay) from the Crown where there is insufficient Gas to meet its existing Gas requirements and new Gas requirements brought about by the commissioning of Huntly e3p.

The Crown seeks to encourage the construction of Huntly e3p by supporting Genesis Energy through this risk sharing arrangement.

Defined terms used in this term sheet are either defined in Schedule 1 or in the body of the term sheet, and are indicated by the use of initial capital letters.

A. PARTIES

Crown:	The Crown (the " Crown ")
Genesis Energy:	Genesis Power Limited (" Genesis Energy ")

B. BACKGROUND

The Project:	Genesis Energy is considering committing to the construction and commissioning of a 385MW combined cycle gas turbine at its Huntly site (" Huntly e3p ").
---------------------	------------------------------------------------------------------------------------------------------------------------------------------------------------------

Genesis Energy has expressed concern to the Crown that the financial viability of Huntly e3p may be undermined by uncertainties over the long-term Gas supply due to possible Gas supply shortfalls in certain years and Genesis Energy's exposure to purchase significant quantities of Gas from Gas fields that have not yet produced any Gas (see schedule 2).

Genesis Energy has already incurred expenditure of \$41 million (as at 30 April 2004) by way of issuing a limited notice to proceed to Mitsubishi Corporation to carry out certain preliminary engineering design works carrying out site enabling work. Genesis Energy has indicated that it is not prepared to issue a final notice to proceed, thereby committing to the full construction of Huntly e3p, without support from the Crown.

Genesis Energy has also endeavoured to reduce the likelihood of a future Gas shortage by entering into supply arrangements with multiple parties in relation to multiple Gas fields.

Due to the need to increase the level of electricity generation in New Zealand and the current and projected electricity supply and demand balance, the Crown wishes to support Genesis Energy to commit to the Huntly e3p project despite uncertainties in Gas supply.

Genesis Energy and Mitsubishi Corporation have agreed the form of the EPC and that for completion of Huntly e3p to occur in December 2006 the EPC must be executed by 15 August 2004.

Genesis Energy is in the process of negotiating a syndicated facility with Westpac Banking Corporation ("Westpac"), as arranger and underwriter, for the funding of its general corporate purposes, including the construction of Huntly e3p. This facility (the "Huntly e3p Facility") is subject to the following conditions precedent:

s.9(2)(b)(i)
s.9(2)(b)(ii)
s.9(2)(j)

C. DISTRIBUTION POLICY

Distribution Policy: The Crown acknowledges that the Directors of Genesis Energy may (pursuant to their Companies Act 1993 obligations), at any time, determine not to pay distributions or may determine to reduce the level of distributions payable. In particular, the Crown acknowledges that due to the construction of Huntly e3p the Board of Genesis Energy may determine not to pay distributions in the 2005 and 2006 financial years.

Genesis Energy acknowledges that pursuant to its obligations under the State Owned Enterprises Act 1986, it is required to specify its dividend policy in its Statement of Corporate Intent (SCI), and that it shall consider any comments from shareholding Ministers on its draft SCI.

D. RISK SHARE

Gas Contract Support: Where the amount of Gas Genesis Energy receives in any Semi-Annual Period is less than half of the Base Case for that period, Genesis Energy may on a semi-annual basis call upon the Crown by issuing an invoice.

Genesis Energy will not make a call upon the Crown in a Semi Annual Period where the amount payable by the Crown would be less than:

[] s.9(2)(b)(i)

Commencement, Term and Release Conditions:

The Agreement will commence upon the satisfaction of the conditions precedent and will continue in force until the earlier of:

(a) Where Genesis Energy enters into Gas supply contracts

[] s.9(2)(b)(i)
s.9(2)(j)

(b) the Huntly e3p Facility or any successor agreements on substantially the same terms expires; or

(c) the date ten (10) years from the date Huntly e3p is completed,

(such period being the "Term").

Conditions Precedent: The Agreement will be subject to and conditional upon:

- (a) Genesis Energy executing the Huntly e3p Facility, EPC and LTMA contracts; and
- (b) Satisfaction of all conditions precedent contained in the Huntly e3p Facility, EPC and LTMA.

Contracted Gas:

As at the date of this Indicative Term Sheet Genesis Energy has the Gas supply contracts for its existing business and Huntly e3p as set out in Schedule 2:

Maximum Semi-Annual Payment Amount:

The Maximum Semi-Annual Payment Amount will be based on the

The intention of the parties is that Genesis Energy is free to manage its funding and interest rate profiles independent of the proposed risk sharing agreement, so that it can independently manage its financiers and cost of financiers, and interest rate hedging profile.

The Maximum Semi-Annual Payment Amount over the term of the Agreement as the Huntly e3p Facility has been arranged to cover Genesis Energy's corporate requirements

The Huntly e3p Facility term expires in 2009, though it may be extended or refinanced on substantially the same terms or on maturity on different terms from sources such as capital markets, other banks, or alternative funding sources.

Shortfall Gas:

Shortfall Gas will occur where a negative quantity is determined by subtracting half of the Base Case amount from the actual amount of Gas supplied in the relevant Semi-Annual Period.

Projected Shortfall Gas is set out in Schedule 2 and will be updated every quarter following the commencement of the Term.

Shortfall Gas must not exceed **10PJ** in any Semi-Annual Period.

S.9(2)(b)(i)
S.9(2)(ba)(i)
S.9(2)(c)

S.9(2)(b)(ii)

Maximum Potential Obligation:

The Crown's maximum potential obligation under the Agreement will be [] million, calculated over the 10 year period as follows:

§ 9(2)(b)(ii)

10 * (Maximum Semi-Annual Payment Amount * 2)

Genesis Energy's maximum potential obligation (excluding non-capitalised interest, maintenance and fuel commitments) is set out at Schedule 3 and is likely to be \$509.9 million.

Excluded Gas:

Excluded Gas will be Gas that is represented in the Base Case that Genesis Energy is unable to take as a result of the failure of Huntly e3p to operate for any reason (including mechanical failure of Huntly e3p, Gas transmission failure, electricity transmission failure, Resource Management Act issues, Genesis Energy's decision not to run for economic reasons [

§ 9(2)(b)(ii)

]"Excluded Gas").

The amount of Shortfall Gas the Crown will be asked to support pursuant to this agreement will be directly reduced by the amount of Excluded Gas in the same Semi-Annual Period.

LD Payment:

CS [

]

§ 9(2)(b)(i)
§ 9(2)(j)

Obligation to mitigate Shortfall Gas:

Genesis Energy must use reasonable endeavours to minimise the volume of Shortfall Gas by pursuing and securing Gas supplies to minimise the amount of Shortfall Gas provided that Genesis Energy will not be required to purchase Gas where the price and available volumes of such Gas would result in the unprofitable operation of Huntly e3p. Huntly e3p will be considered to be unprofitable where the costs of running Huntly e3p (including Gas and other costs) exceed the expected revenues.

Semi-Annual Payment Amount:

The Semi-Annual Payment Amount in any Semi-Annual Period:

[

] § 9(2)(b)(i)

For the avoidance of doubt no allowance has been made for "overs and unders" between Semi-Annual Periods. Gas cannot be stored and Huntly e3p cannot use more than 10PJ in any Semi-Annual Period.

Payment: Within 30 days of the end of each Semi-Annual Period, Genesis Energy may issue an invoice to the Crown for the Semi-Annual Payment Amount (plus GST if any).

The Crown in the absence of manifest error shall pay that invoice within 30 days of the invoice date.

Taxes: Any payments under the Agreement are based on the assumption that the payments are subject to income tax

E. GENERAL:

Warranties: Genesis Energy will provide appropriate warranties to the Crown.

Undertakings: Genesis Energy would use all reasonable endeavours to obtain Gas supplies for power generation purposes during the Term of this Agreement.

Reporting: Genesis Energy undertakes to keep the Crown informed on a 3 monthly basis (or more regularly if the information is of sufficient importance) during the Term in relation to:

- (a) its progress towards procuring additional Gas supplies for power generation at Huntly e3p including the Gas volumes set out in Schedule 2; and
- (b) the Kupe Joint Ventures' progress in developing and producing Gas from the Kupe oil and gas field; and
- (c) any other matter relevant to the Agreement.

Boilerplate Terms: The Agreement will contain the normal range of boilerplate terms.

Governing Law: Laws of New Zealand.

Schedule 1: Definitions

Note: Not all capitalised terms used in this term sheet are defined in this Schedule. Some are defined within the clauses of this term sheet. Where a term is not defined, it will bear its generally accepted or recognised meaning or may be later defined in the Agreement.

Base Case:	Means the numbers in the column in the table at Schedule 2, titled "Base Case".
EPC	Engineering Procure and Construct Agreement
Gas:	means natural gas meeting the specification imposed by the owner of the Maui Pipeline.
Huntly Power Station:	means the Huntly Power Station site where Huntly e3p will be located.
LTMA:	Long Term Maintenance Agreement
PJ:	means 10^{15} joules where one joule equals the work done by a force of one newton displaced through a distance of one metre.
Semi-Annual Period:	means the period from the 1 st day of July to the 31 st day of December and the 1 st day of January to the 30 th day of June in the same calendar year.

Schedule 2: Base Case Gas Schedule

RELEASED UNDER THE
OFFICIAL INFORMATION ACT

Actual gas usage may vary from indicative

Schedule covers 11 years (as first and last period are partially covered)

This table is based on the best information available as at the date of this Indicative Term Sheet. Notwithstanding the annual quantities set out above it is important to note that the delivery profiles of all of Genesis Energy's gas contracts are expressed in TJ/day. If gas is not delivered on a particular day it would not necessarily be made up at a later date. Further, Genesis

S. 9(2)(b)(i)
S. 9(2)(b)(i)
S. 9(2)(i)

Energy's Base Case requirements for gas are based on a constant daily delivery profile but are expressed as an annual figure for the purposes of this Schedule.

Projected Shortfall Gas does not take into account failure to deliver contracted sources of gas.

* **NB:** The Kupe and Pohokura gas fields have not yet achieved first gas.

RELEASED UNDER THE
OFFICIAL INFORMATION ACT

Schedule 3: Huntly e3p Cost Schedule

RELEASED UNDER THE
OFFICIAL INFORMATION ACT

s.9(2)(b)(i)
s.9(2)(b)(i)

Genesis Energy (Owner costs) is based on actual costs incurred to date, tendered prices and best estimates. The following is a more detailed breakdown:

RELEASSED UNDER THE
OFFICIAL INFORMATION ACT

s. 9(2)(b)(ii)
s. 9(2)(ba)(i)

Consultation on Cabinet and Cabinet Committee Submissions

Certification by Department

Departments consulted: The attached submission has implications for the following departments whose views have been sought and are accurately reflected in the submission:

CCMAU, Ministry of Economic Development

Departments informed: In addition, the following departments have an interest in the submission and have been informed:

Others consulted: Other interested groups have been consulted as follows:

Signature	Name, Title, Department	Date
J. L. L.	DAVID TAYLOR, MANAGER, THE TREASURY	14/7/04

Certification by Minister

Ministers should be prepared to update and amplify the advice below when the submission is discussed at Cabinet/Cabinet committee. The attached submission:

Consultation at Ministerial level	<input type="checkbox"/> did not need consultation with other Ministers <input type="checkbox"/> has been the subject of consultation with the Minister of Finance <i>[required for all submissions seeking new funding]</i> <input checked="" type="checkbox"/> has been the subject of consultation with the following Minister(s)	
Consultation with Government MPs	<input type="checkbox"/> does not need consultation with the government caucuses <input checked="" type="checkbox"/> has been or will be <i>[specify which]</i> the subject of consultation with the following government caucuses: <input type="checkbox"/> Labour caucus <input type="checkbox"/> Progressive Coalition caucus	
Consultation at Parliamentary level	<input type="checkbox"/> does not need consultation at parliamentary level <input type="checkbox"/> has been or will be <i>[specify which]</i> the subject of consultation with the following other parties represented in Parliament:	
Signature	Portfolio	Date
		/ /

Most submissions to Cabinet and Cabinet committees are relevant to departments other than the initiating department. It is important for the quality of decision making that all interested departments are involved in developing a submission. Departments should consider the schedule of interests of all departments in chapter 11 of the Cabinet Office *Step by Step Guide* for every submission for which they are responsible. Particular attention should be paid to the need to consult the departments listed below, which have a broad "horizontal responsibility".

The Cabinet Office will reject submissions if the necessary consultation does not appear to have taken place.

Department	Issues on which they must be consulted
Crown Law Office	Proposals having legal implications for the Crown
Ministry of Consumer Affairs	All policy proposals likely to affect the economic welfare of consumers
Ministry of Foreign Affairs and Trade	All proposals having implications for New Zealand's external relations, trade policy and international legal obligations
Ministry for the Environment	All proposals having significant environmental implications
Ministry of Maori Development (Te Puni Kokiri)	All proposals with implications for Maori, as individuals, communities or tribal groupings, with particular focus on reducing inequalities, and Treaty of Waitangi issues
Ministry of Pacific Island Affairs	All proposals with implications for Pacific peoples as individuals and communities with particular focus on closing the gaps issues
Parliamentary Counsel Office	Proposals for legislation or amendments to legislation
Department of Prime Minister & Cabinet	All policy proposals which are likely to have implications for the government as a whole, or for the coordination of the activities of two or more departments
Ministry of Research, Science and Technology	All proposals having implications for science policy or funding, or which might be significantly influenced by scientific or technological input
Senior Citizens Unit, Ministry of Social Policy	All matters relating to the well-being of older people
State Services Commission	All proposals with an impact on organisational structures, Chief Executive accountability or departmental performance specification and industrial relations in the state services
The Treasury	All proposals having economic, financial or fiscal (expenditure or revenue) implications
Ministry of Women's Affairs	All proposals that relate to the economic and social status of women, especially Maori women
Ministry of Youth Affairs	All proposals dealing with issues of concern to 12-25 year olds

COMMERCIAL SENSITIVE

14 July 2004

MEMORANDUM FOR CABINET

GENESIS POWER AND SHAREHOLDER SUPPORT FOR E3P

Introduction

1. Genesis Power (Genesis) has approached shareholding Ministers about a way forward for commissioning **e3p**, a 385 MW Combined Cycle Gas Turbine at Huntly, by December 2006. **e3p** is a nationally significant power station from the perspective of medium term security of electricity supply, as there are no other power stations of the same size at such an advanced stage of development. In addition, the market is expecting **e3p** to proceed.
2. While this matter is a shareholder issue, it does have significant policy implications, so shareholding Ministers are approaching Cabinet to seek delegated authority to negotiate with Genesis, in consultation with the Minister of Energy, to ensure that **e3p** can be built on time, but only if the risks associated with it can be managed and shared between the Company and the Crown in an appropriate manner.

Proposal

3. Despite having in place a number of long-term gas contracts for Kupe, Mangahewa, McKee and Pohokura gas, the Genesis Board and its financiers (Westpac) still consider there is insufficient certainty around the gas supply arrangements for Genesis to commit to building and financing **e3p**. This uncertainty arises from two sources; firstly contracted gas might not be delivered because the Pohokura and Kupe gas are not proven fields currently in operation, and secondly post () Genesis does not have sufficient contracted gas.
s. 9(2)(b)(ii)
s. 9(2)(ba)(i)
4. For Genesis and its financiers to be satisfied that the risk associated with committing to **e3p** is acceptable, it requests that the Crown enter into a risk sharing arrangement with Genesis regarding the gas supply risk well before 15 August 2004 to enable Genesis to contract with Mitsubishi to complete the final stage of building the power station on schedule¹⁸. If the 15 August 2004 deadline is missed, it is not clear when **e3p** can be built, as Genesis will lose its position in the worldwide queue for building similar power stations.

¹⁸ Genesis is not seeking equity from shareholders to finance **e3p** as this would still not resolve to its satisfaction the risk to the Company arising from building **e3p**, unless a risk sharing agreement in place.

Policy Implications

5. We consider that the main issues facing the Government include:

- **Security of Supply:** Energy security of supply analysis to date suggests that **e3p** is desirable for medium-term energy security, but not strictly necessary as there are number of alternative ways that security could be achieved if **e3p** is not built by December 2006. However, **e3p** is considered at this point in time to offer the most secure route to meeting the nation's energy needs, and the market is expecting **e3p** to proceed. Crucially, while the gas outlook for the country and Genesis is at some risk, it is not sufficiently at risk to rule out the building of another CCGT from a national security of supply perspective.
- **Energy Policy:** Building **e3p** could adversely impact on incentives for other generators to build new baseload¹⁹ generation plants, an outcome that the Government would wish to avoid for competitive neutrality as well as security of supply.
- **Commercial and ownership:** a cornerstone of the Government's SOE policy is that shareholding Ministers generally only support proposals from SOEs that have strong commercial merits and are relatively low risk. Key tests are that Boards are willing to recommend to shareholding Ministers that proposals, on a stand alone basis, are in the commercial interests of the Company, and financiers like banks are willing to risk their own capital on a project without legal recourse to the shareholder. The fact that a risk sharing arrangement is required before Genesis or Westpac can commit to **e3p** is a clear indication that the proposals carries more risk than shareholding Ministers are usually willing to countenance. Nevertheless, leaving the gas uncertainty aside, the business case appears adequate subject to some standard caveats.
- **Fiscal risk** The risk sharing arrangement creates a number of potentially significant fiscal risks for the Crown if Genesis cannot access gas beyond its proven contracts, or the gas companies cannot meet contracted obligations. However, these extreme risks are also very remote as it is extremely unlikely that the new gas fields are devoid of gas, and new gas fields will not be found or an LNG²⁰ facility is built to meet shortfalls in the gas market. Of greater concern is that currently under Genesis' proposed risk sharing arrangement the Crown bears too great a share of smaller less unlikely gas risks. As a result, to avoid poor outcomes there are a number of issues and principles that we need satisfaction on before we could enter into a risk sharing arrangement including:

¹⁹ As **e3p** is intended to be baseload plant it falls outside the jurisdiction of the Energy Commission, which is required to ensure that there is sufficient reserve plant to meet a 1 in 60 dry year.

²⁰ Liquefied Natural Gas (LNG) is manufactured from natural gas. Gas is cooled so that it condenses to a liquid state. This reduces the volume to 1/600th of original, enabling it to be transported via ship to a destination with a regasification plant, where it can be re-heated to restore it to its gaseous state and distributed through the existing natural gas pipe networks. New Zealand does not currently have infrastructure to support LNG. Genesis and Contact Energy announced in October 2003 that they were initiating a joint study to investigate the feasibility of developing an LNG receiving facility in New Zealand.

- *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-* Minimum risk transfer is to ensure that Genesis retains very strong incentives to avoid problems in the first instance, purchase gas beyond existing contracts when needed, and to minimise the potential adverse impacts of the risk sharing arrangement on generation investment more broadly.
- *avoiding risk transference with respect to non-delivery on existing gas contracts-* the risk around delivery on existing gas contracts is in the realm of normal commercial risks for which SOEs are generally expected to bear.
- *avoiding risk transference with respect to the gas supply for existing requirements* – while the Government may be prepared to consider sharing the gas supply risk for e3p, we are reluctant to share gas supply risk for existing uses resulting in de facto financial support to other non-e3p use of gas.
- **Timing and Process:** Because Genesis' proposal has a short time frame for which to be resolved, we suggest that shareholding Ministers, in consultation with the Minister of Energy, have power to act on behalf of Cabinet to seek and execute a risk sharing arrangement that has a better allocation of risk between the parties has sought above.

Conclusion

6. Genesis has provided the Government with the opportunity to consider a proposal to build a nationally significant power station from the perspective of security supply. The proposal may provide significant national benefits, but there are also other broader policy implications to be considered. While there are good security of supply reasons why the Government may wish to support e3p, which override normal SOE policy considerations, this should not be achieved at any cost. To this end, we expect Genesis to consider what concessions it can make, and what are the constraints to doing so, such that Ministers can assess the merits of the arguments to arrive a mutually acceptable position.

Recommendations

7. Shareholding Ministers recommend to Cabinet that:

a **note** that Genesis Energy (Genesis) has approached shareholding Ministers about a way forward for commissioning **e3p**, a 385 MW Combined Cycle Gas Turbine at Huntly, by December 2006;

b **note** that while **e3p** has potentially significant national benefits from the perspective of security supply, the risk sharing arrangement that Genesis and () seek before they can commit to build it has significant policy implications; and

c **agree** that Cabinet provide shareholding Ministers delegated authority to negotiate with Genesis and execute, in consultation with the Minister of Energy, a risk sharing arrangement such that **e3p** can be built on time, but only if the risks associated with it can be managed and shared between the Company and the Crown in an appropriate manner.

RELEASED UNDER THE
OFFICIAL INFORMATION ACT

s. 9(2)(b)(ii)
s. 9(2)(ba)(i)
s. 9(2)(j)



Office of Hon Dr Michael Cullen
Deputy Prime Minister
Minister of Finance
Minister of Revenue
Leader of the House of Representatives

19 JUL 2004

Mr Brian Corban
Chairman
Genesis Power Limited
PO Box 17-188
Greenlane
AUCKLAND

By Fax: 09 580 4898

Dear Brian

SHAREHOLDER SUPPORT FOR E3P

Thank you for your letter of 2 July 2004 in which you propose a way forward for commissioning ~~e3p~~, a 385 MW Combined Cycle Gas Turbine at Huntly, by December 2006. For this to occur you require the Crown to enter into a risk sharing arrangement with Genesis Power (Genesis) by 15 August 2004 on substantially the same terms as discussed with officials in an Indicative Term Sheet dated 29 June 2004. Together with a shareholder resolution for a major financing transaction, Genesis would be able to contract with Mitsubishi for the completion of the power station on schedule.

Despite having in place a number of long term gas contracts for Kupe, Mangahewa, McKee and Pohokura gas, we understand that the Board and your financiers (Westpac) still consider there is insufficient certainty around the gas supply arrangements for Genesis to commit to building and financing ~~e3p~~. However, if the Crown signs the contemplated risk sharing arrangement covering Genesis long-term gas supply these concerns will be satisfied. We understand that the gas risk of concern arises from two sources; firstly contracted gas might not be delivered because the Pohokura and Kupe gas are not proven fields currently in operation, and secondly post
} you do not have sufficient contracted gas.

s 9(2)(b)(i)
s 9(2)(b)(i) At the outset, we would like to thank you for providing the Government with the opportunity to consider a proposal to support a nationally significant power station with significant supply security implications. Your proposal merits serious consideration, but raises some significant issues.

A cornerstone of the Government's SOE policy is that shareholding Ministers generally only support proposals from SOEs that have strong commercial merits and are relatively low risk. Key tests are that Boards are willing to recommend to shareholding Ministers that proposals, on a stand alone basis, are in the commercial interests of the Company, and financiers like banks are willing to risk their own capital on a project without legal recourse to the shareholder.

59(2)(b)(ii)
59(2)(ba)(i)
59(2)(j)

The fact that a risk sharing arrangement is required before Genesis or { } can commit to *e3p* is a clear indication that the proposal carries more risk than shareholding Ministers are usually willing to countenance. However, in this particular situation there are other energy security of supply reasons why the Government may wish to support *e3p*, which override normal SOE policy considerations, but not at any cost.

We appreciate that the Indicative Term Sheet dated 29 June 2004 reflects the appetite of the Board and financiers to bear risk. However, we consider there are a number of issues and principles that we need satisfaction on before we would enter into an arrangement such that we can be confident that there is an appropriate allocation of risk between the parties regarding *e3p*.

Given the complexity of the arrangements we consider it preferable to provide an indication of some high level principles that if adhered to should deliver the outcomes the Government is seeking. In particular, outcomes the Government wants to achieve are that:

- Genesis retains strong incentives to resolve any gas supply issues itself by seeking to purchase gas supply beyond existing contracts as needed; and
- that any risk sharing arrangement with Genesis does not deter investment in generation by other market participants.

The principles include:

- *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 the commercial interest of Genesis* – We understand why Genesis desires the Crown to share the risk of improbable but very costly gas constraints, but do not consider that it is necessary for the Crown to bear such a large proportion of the risk associated with small but more likely gas constraints (or other problems). In other words, Genesis should bear the consequences for anything but material risks.
- *avoiding risk transference with respect to non-delivery on existing gas contracts* - the risk around delivery on the contracts that you entered into for Kupe, Mangahewa, McKee and Pohokura gas are in the realm of normal commercial risks which you considered when agreeing on price and liquidated damage terms. Moreover, for the period up to { }, when the fields are most at risk of delay, Genesis has a significant excess of contracted gas as a buffer against non-delivery.
- *avoiding risk transference with respect to the gas supply for existing requirements* – while the Government is prepared to consider sharing the gas supply risk for *e3p*, we are reluctant to share gas supply risk for existing uses. We acknowledge that Genesis is free to choose where it uses its gas, but it is undesirable for the Crown to enter into an arrangement whereby it may end up compensating Genesis for gas that could have been used at *e3p*, but you choose to use it elsewhere. For example, in the estimates for existing requirements in the base case to the risk sharing arrangement, considerable growth is built into the forecast needs for retail gas sales, and generation gas includes existing Huntly and P40, the latter being a less efficient user of gas than *e3p*. Not differentiating between where the gas is used would mean that the Government could be providing de facto financial support to other non-*e3p* use of gas.

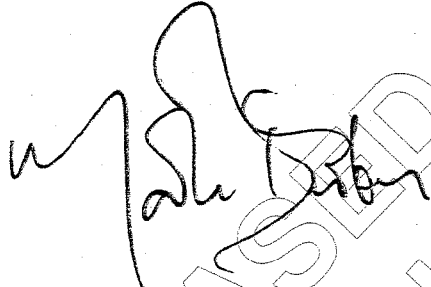
54(2)(b)(ii)
59(2)(ba)(i)

A principled approach over a prescriptive one should provide some flexibility in achieving the outcomes. To this end, we expect Genesis to enter into discussions with officials about how it can satisfy these principles, and if not why not in some detail.

Subject to the matters covered in the risk sharing arrangement, we concur with Genesis that the business case for **e3p** looks robust, and you have broadly met the conditions attached to our 2001 letter of support. However, for the avoidance of doubt we would like to reiterate our expectation that the conditions of our support in 2001 remain valid. In particular, we continue to expect Genesis to select technology options that do not jeopardise plant reliability, to seek appropriate contractual remedies for non-performance from **e3p's** contractors and to report regularly on progress relative to budgets and timetables/milestones as part of Genesis' regular quarterly reports to shareholders.

Lastly we are pleased that, subject to the negotiation of a more appropriate risk sharing arrangement incorporating the principles outlined above, we have moved substantially closer to concluding the shareholder consultation process on **e3p**. We hope that with good will and common sense we can come to some mutually acceptable position and execute the necessary legal documentation prior to 15 August 2004.

Yours sincerely



Hon Mark Burton
Minister for State Owned Enterprises



Hon Dr Michael Cullen
Minister of Finance

cc: Murray Jackson
Chief Executive Officer
Genesis Power Limited

Maureen Shaddick
General Counsel
Genesis Power Limited