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18 April 2011

Adrian Kloeden
Chairman
Forestry Tasmania
79 Melville Street
HOBART Tas 7000

Dear Adrian

Re - Gunns Limited and Forestry Tasmania

Thank you for taking the time to meet with me on 12 April 2011.

I am encouraged by your comment that FT's official position and history is one of continuing support for our development of the pulp mill.

I reiterate my comment that it is clear to me that the relationship between Gunns' and FT's management has become strained. Efforts to resolve the various disputes between the parties at management level have been unsuccessful. Therefore, while I note that the FT board are precluded from taking a pro-active role in the activities of FT, I propose that we take steps to resolve the dispute at board level. To this end, I set out in this letter Gunns' proposal for the termination of Contracts of Sale 917 (CoS 917) and 918 (CoS 918) and the resolution of all outstanding issues between our organisations.

I have outlined below some of the developments that have occurred in recent past to provide context for my candid assessment of the current relationship and Gunns' settlement proposal.

Take or Pay

FT has been pursuing a claim for [REDACTED] under the take or pay provision of CoS 917.

It is clear that the combination of global and domestic events has resulted in the decimation of the woodchip export market. Its impact on industry participants in Tasmania is well documented, and in fact was recognised by FT in FT's *Incoming Government Brief* dated March 2010.

We have initiated a number of meetings between the Managing Directors and senior management of Gunns and FT, seeking the cooperation and assistance of FT to address these difficult market conditions. Unfortunately, these meetings have not been constructive.

GUNNS LIMITED | ABN 29 009 478 148

PO Box 572 Launceston Tasmania Australia 7250 | 78 Lindsay Street Launceston, Tasmania Australia 7250

T 03 6336 5201 | F 03 6336 5406 | www.gunns.com.au

Gunns has made numerous proposals to protect Tasmania's woodchip export markets but FT management have not been receptive to these proposals, nor have they made any counter proposals. Instead, FT management have been preoccupied with extracting payment from Gunns under the take or pay penalty regime. The result has been the forced closure of sawmills and significant job losses in the industry.

Gunns has had a long and productive relationship with FT. This relationship formed the basis of CoS 917 and 918. The contracts contemplate that the parties will perform their contractual obligations in a cooperative manner, particularly in the face of tough economic conditions. Based on mutual good will, our management have sought to work with FT to resolve any issues that have arisen.

However, Gunns efforts at good faith negotiation have not been reciprocated. FT management have adopted an approach which has strained the relationship between FT and Gunns and could lead to irreconcilable conflict. The initiation of the formal dispute resolution process pursuant to CoS 917 is typical of the hostile approach taken by FT management. The parties' nominated representatives are due to exchange detailed submissions on the sum involved. I will not burden you with our views here but confirm that there are a myriad of factors (most of which are directly due to FT's conduct) which contributed to our inability to take up the volume previously contemplated.

FT's intention to enter the woodchip export market

I note your comment that Gunns has been a large customer of FT and that FT wishes to diversify its customer base. FT has the flexibility to do this under CoS 917 and 918. However, FT must also recognise FT's dominant role in the market place. FT is a large supplier to Gunns and Gunns has been a captive customer, both in terms of available native forest pulpwood and also as a result of Gunns' obligation under the take or pay provisions of CoS 917 and 918.

We have been significantly disadvantaged by FT's decision to sell directly and indirectly into China and Japan in direct competition with us. Our agreement with FT requires that we disclose our selling price into these markets to FT and it appears that FT has inappropriately used that information to undercut Gunns' prices. This has resulted in a deterioration of our market share. Further, FT now seeks to make a windfall from its direct and indirect export sales in competition to Gunns by enforcing the take or pay regime.

We also understand that senior managers of FT have been approaching some of our customers directly, seeking to establish a trading relationship with them. During the course of soliciting our customers, FT management have been making false, adverse comments about Gunns' business which inevitably jeopardises our relationship with those customers and actively dissuades any future business opportunities we may have with them. Gunns' investment in, and capacity to bring the pulp mill development to fruition, has been at the core of FT's adverse comments.

This conduct is misleading and defamatory and is causing Gunns significant embarrassment and prejudice. It is also clearly inconsistent with FT's statements of support for our construction of the pulp mill.

General performances under CoS917 and 918

Since the commencement of CoS 917 and 918, we have been faced with numerous difficulties due to FT's unwillingness and/or inability to comply with its contractual obligations. I will not recount Gunns' various complaints of defective performance and non-performance by FT but I wish to highlight one issue which has caused Gunns significant loss of market share: FT's refusal to assist Gunns obtaining FSC certification.

The ongoing campaign by ENGOs against native and old growth logging in Tasmania posed a clear risk to the brand of Tasmanian native forest woodchip. The reputation and marketability of Tasmanian native forest woodchip products is, and has always been, directly affected by FT's forestry management practices and only FT had the power to alleviate the concerns of our woodchip customers. In the circumstances, it was incumbent on FT to take steps to protect the reputation of Tasmania's woodchip export industry. As I have noted previously, its failure to do so has caused Gunns to lose export sales, resulting in the significant job losses and mill closures that the industry has suffered in recent years.

FT was aware of the damage that its forestry practices were causing to the reputation of Tasmanian woodchip products and had the opportunity to address the problem. Our Japanese customers raised concerns (both with us and FT) over a number of years about the need for our product to be sourced from FSC certified forests. Gunns worked with its customers to achieve an acceptable position but our attempts to do likewise with FT were met with indifference. Notwithstanding the parties express undertaking to adapt CoS 917 and 918 to meet changing market conditions, FT management has taken the position that they are guaranteed sales revenue under the take or pay provision and therefore have no interest in maintaining actual sales volumes.

Due to the change in market conditions, CoS 917 and 918 reflect outdated standards and do not permit us to meet our customer needs. We have now lost those customers. While I note that FT has now chosen to go down the same certification path, this decision is 18 months too late and the damage is already done.

Termination of CoS917 and 918

In light of the decimation of the market for Tasmanian native forest woodchip, and the deterioration of the relationship between FT and Gunns, it seems desirable that Gunns and FT separate. Gunns therefore wishes to terminate CoS 917 and 918, noting our agreement that construction of the pulp mill did not commence by 30 November 2010.

To the extent that FT requires formal notice, please treat this letter as notice of termination under clauses 3.3(b)(i) of CoS917 and 3.3(b)(ii) of CoS918.

While Gunns remains ready, willing and able to perform its contractual obligations under CoS 917 and 918 during the notice period, we consider that an immediate separation would be in the best interests of Gunns, FT and the Tasmanian forestry industry generally.

In particular, I am cognisant of the outstanding disputes between the parties and the further disputes that are likely to arise if CoS 917 and 918 continue in force during the notice period. Unless a commercial resolution can be reached, I fear that these disputes will ultimately result in court proceedings. I do not believe that this is the desired course for either of our organisations.

I therefore propose that CoS 917 and 918 be terminated immediately on a full release and indemnity basis in respect of any and all outstanding issues.

Settlement on this basis would immediately free up volumes for FT to utilise in pursuing the Chinese woodchip export market. Gunns is willing to assist FT develop its position in this market by providing FT with introductions to our existing customers if FT requires. At the same time, FT will receive the benefit of substantial infrastructure, worth in excess of \$200 million, established by Gunns in anticipation of harvesting pulpwood from State Forests pursuant to CoS 917 and 918.

If you are open to this proposal please let me know as soon as possible so our respective boards can give appropriate instructions to our senior executives to work together on an end date for all operations.

I look forward to your cooperation in separating the interests of our respective organisations for the mutual benefit of each.

Yours sincerely

A handwritten signature in cursive script, appearing to read "C Newman".

Chris Newman
Chairman

BRIEFING NOTE

NOTED

Bryan Green MP
Minister for Energy and Resources

.....
(Minister)

Date:/...../11

SUBJECT: Termination of Gunns Contracts of Sale 917 & 918

Purpose:

To inform the Minister that Gunns Limited has provided formal notice of termination for CoS 917 and CoS 918, and to provide copies of an exchange of letters between Gunns and Forestry Tasmania regarding same; and

To advise the Minister of Forestry Tasmania's intended communications strategy to deal with the termination.

Background:

Gunns' chairman Chris Newman wrote to FT's chairman Adrian Kloeden on April 18 2011 advising the following:

- That the letter constituted formal notices of termination for contracts 917 and 918.
- That Gunns proposes, as an alternative, the contracts be terminated immediately on a full release and indemnity basis in respect of any and all outstanding issues.

Mr Kloeden responded with a letter to Mr Newman on May 4 2011, advising the following:

- Under the terms of the contracts, it is incumbent on the parties to attempt to negotiate in good faith terms of a new agreement for supply. This obligation to negotiate is extinguished if Gunns' alternative proposal (above) is accepted.
- That FT is prepared to meet Gunns at Board level to explore whether outstanding issues can be resolved.

The terms of the contracts provide a 180 day period during which the parties would seek to negotiate a new supply agreement. Unless otherwise negotiated, the contracts remain "on foot" until October.

The 918 contract also covers supply to Gunns' sawmills and it's unclear whether Gunns intends to:

- Negotiate new supply contracts for sawmills
- Sell the sawmills without a wood supply
- Close the sawmills.

However, the termination of CoS 917 and 918 means that from October, there is no contractual obligation to supply any Gunns' sawmills.

In fact, that situation currently exists. Under these contracts, sawmill supply is directly linked to pulpwood. There is no obligation on FT to supply Gunns' sawmills, while it is not taking pulpwood.

Communications:

It is unlikely the exchange of letters between Gunns and FT will become public. However, it is possible that stakeholders will be informed that Gunns Limited has provided contract termination notice.

In the event that stakeholders become aware of the termination notice, Forestry Tasmania intends to release the following statement.

Gunns to terminate wood supply contracts

Forestry Tasmania has received written notification from Gunns Limited that it intends to terminate its wood supply agreements.

Chairman Adrian Kloeden said the FT Board had resolved to publicly announce the notice of termination, consistent with FT's commitment to transparency.

"When the contracts were negotiated four years ago, Gunns and FT agreed to make the documents public and available through our website.

"It is therefore appropriate that the notice of termination is also made public."

Mr Kloeden said the contracts remain in force for 180 days after a formal notice of termination had been received, during which time the parties are obliged to negotiate in good faith terms of a new agreement for supply, but are not obliged to agree.

"If an agreement is not reached, wood supply to four of Gunns' sawmills and its veneer mill will terminate in October when 918 contract terminates.

"The notice of termination does not in any way absolve Gunns of its financial obligations to FT."

Recommendation:

For the Minister to note.