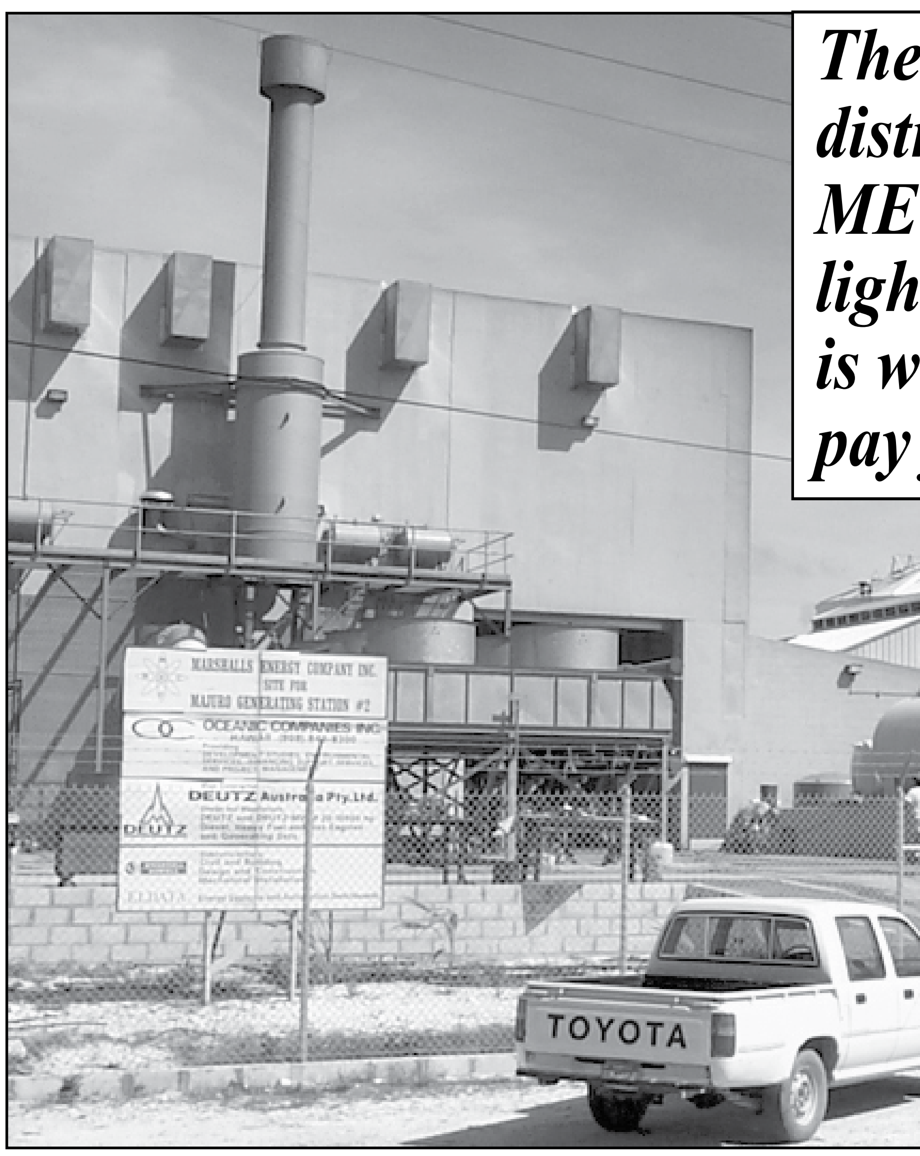
Marshalls Energy Company



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Q: What is the status of MEC's insurance claim for the fire, and MEC's long-term plan for the three damaged engines?

The fire damaged all five engines in Plant #1, which has a total capacity of 13 megawatts (MW). MEC repaired two of the engines in-house within three weeks of the fire. During the three-week period there where some minor brownouts to some areas but no blackouts. During this period MEC staff worked around the clock to clear the debris and repair two of the engines. The reason that power was not disrupted is the Plant #2 engines handled the total load, with essential maintenance carried out at night when the power demand was lower. The other reason this was possible is MEC's ongoing maintenance program meant the engines in Plant #2 could perform to their full capacity and MEC maintains a large inventory of spares and equipment to ensure it has the spares available for maintenance and unforeseen breakdowns.

The damaged plant would have suffered further damage had it not been for the outstanding fire fighting carried out by the MEC generation and distribution crews and the fire and police department.

The insurance assessor has finalized the claim with regard to the power station building structure while a separate claim for the damaged generating equipment is more complex but nearing completion. The insurance assessor has advised that the company should be ready to discuss a settlement proposal with management in the coming month.

The building claim received cost estimates from several local as well as international companies that were brought to Majuro several times to assess the damages involved. Some portions of the building have all ready been repaired to allow the surviving engines to be utilized for normal power generation operations.

The generating equipment claim has required a lot more research to determine whether or not the damaged equipment could or could not be repaired. Generating equipment of this size, including the hundreds of minor parts needed to form the complete system required to use the large engines, has all had to be inspected, examined and assessed as to whether it is salvageable or not. Most of this work is nearing completion and pricing for these items is almost complete. MEC and the insurance assessors brought in some independent engine specialists from Singapore along with various equipment suppliers for the smaller items to assess the level of damages. The engine specialists have dismantled many components from the damaged engines and have even been inside the engines testing components to check to see if the engines can be repaired economically.

These inspections have determined that the generating equipment can be repaired and the specialists are currently finalizing the list of numerous parts that will be needed to achieve this.

These prices will be compared to the pricing requests received from generating equipment manufacturers for replacement units to make the best decision to proceed with the insurance claim at the upcoming meetings planned to finalize the claim.

Q: What is MEC's vision for the future provision of power and fuel sales in the RMI?

Management believes the common vision for the future of MEC is for the corporation to remain as a Government entity and be self-sustaining, without compromising the quality of the service provided to the customers. The corporation should continue to run each division as a separate profit center with profits from the fuel farm to be used for capital improvements and to establish a reserve fund of at least $5 million. This goal is achievable, but it requires the Government to continue to provide subsidies to selected operations, such as the power plants at Jaluit and Wotje, to ensure continued financial viability. Without governmental support, these operational centers will need to be shut down.

Q: Discuss how MEC intends to attract fishing vessels that have shifted to other suppliers over the past two years?

MEC is now actively working to attract the fishing companies to purchase fuel through MEC. The main reason MEC lost the sales is it could not afford to purchase enough fuel to meet the fishing industry's demand and therefore had to suspend fuel sales four times in 12 months, forcing the fishing companies to find alternative fuel suppliers. The first priority is to convince the companies that MEC is back in the fuel business, the same as it was prior to June 2005 and then work with them to secure the best possible selling price that is both viable and cost effective. MEC anticipates securing a supply contract with at least one of the major fishing companies within the next few weeks, and is currently talking to

plans for the future

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three other companies, as well as talking to the US and Taiwan navies. Any excess revenues from fuel sales will be used to a) carry out repairs and maintenance that MEC could not afford to perform over the last two years and b) establish a reserve fund.

Q: What are the specifics of MEC's recovery plan (including strategy regarding loan payments, fuel sales, electric system losses, organizational plans/staff restructuring, and staff training, etc.)?

The MEC Board will carry out a regular in-depth review of the financial progress of MEC so as to determine if it can remain self-sufficient. Among other developments and plans MEC intends to:

• Refinance all of MEC's short-term debts into a single long-term debt at a greatly reduced interest rate. This will allow for MEC's financial recovery together with the resumption of consistent fuel sales to fishing and other vessels.

• Use of the Cabinet-approved tariff template, which allows MEC to change electric rates based on world market prices for fuel. This is a key element for MEC's recovery because it gives MEC the ability to quickly control tariffs in response to fluctuations in fuel costs.

• Hire an experienced bunkering/tank farm manager, who will be responsible for developing the vessel bunkering sales and also implementing international standards with regards to operations, safety, pollution control, etc.

• Address the energy distribution losses through an MEC management plan of action. To implement the program will mean the hiring of a professional engineer who specializes in this field and also an increase in capital expenditure for the purchase of transformers and other related equipment. The largest single distribution loss for MEC is the streetlights. The dilemma is who is going to pay for them? Consideration may be given to a small increase in tariffs to cover this cost. The challenge is that to simply turn off the lights will likely result in a high social cost of an increase in vehicle accidents, burglaries and other problems.

• Hire more power professionals. MEC plans to hire additional trade professionals not only to assist with increased daily operation demands of managing MEC, MWSC, KAJUR, Jaluit, Wotje and the outer islands solar installation and maintenance program, but also to reintroduce training programs to boost skill levels of staff. Staffing levels, salaries and training opportunities will be evaluated and revised where necessary to secure long-term staff requirements for the present and future operation of MEC.

• Give consideration by the RMI government and MEC Board as to whether or not to sell shares in MEC. The pros and cons of privatization of small utilities is a worldwide debate and Asian Development Bank and World Bank consultants both have different opinions as to whether it should or should not be done in an area with only one utility due to the small customer base.

Conclusion

Everyone must learn from the lessons of the past and move forward. MEC must not continue to subsidize operations at the cost of its core business. MEC must be allowed to establish a capital reserve fund; additionally the rational of delaying tariff increases because they are unpalatable even when justified is no longer acceptable.

The assertions made in the past by public servants that if MEC makes a profit that profit should go into the General Fund should not be considered until a capital reserve fund is established of at least $5 million. The establishment of a capital reserve fund in the past was inhibited by the above factors.

However in saying this, do we believe the late President Amata Kabua's vision wrong, when he said develop the fuel sales market and use the monies to improve the distribution system, minimize tariffs to attract investment, develop the economy and make electricity affordable to the Marshallese people? Would businesses such as the Bank of Hawaii, Gibson's and the PMOP loining factory have opened for business in Majuro if reliable power and low tariffs were not a contributing factor in starting a business here?

In 1986 Majuro had a new power plant with an ailing distribution system and there was no power from the airport to Laura. These systems have all been installed and upgraded over the years. So who paid for these capital improvements? Not the MEC electrical consumers. These improvements were made with the income generated from fuel sales to foreign fishing vessels — was this bad for the economy?

The latest buzz words in the Pacific are: "more private sector involvement" and "the Government and private sector should work together." Was a Government agency allowed to subsidize the private sector with low tariffs from 1986 until 2005 and did this contribute to the private sector's development?

We have to seriously ask ourselves what would have happened to the health and education infrastructure in Majuro if the Jaluit and Wotje high schools were closed down, which would have happened had MEC not subsidized the power in these community centers. Likewise with MWSC, they can now start to pay back their overdue electricity accounts because their inherited liabilities to MISSA are now paid in full and the MWSC retirees can now get their entitlements. Cynics will say "but look at the mess MEC got into because of the subsidies and not establishing a reserve fund." MEC says read the independent Nelson report and what factors changed in 2003 that where exacerbated in 2005, which caused the majority of the problems.

On behalf of the Board, Management and Staff of MEC, we thank the Government and all those customers and friends who have supported MEC during these difficult times. We at MEC are committed to continuing to serve you, our customers, while providing reliable and efficient services in the future.