Corporatisation Manual

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PREFACE

Since 1988 New South Wales has had a policy to corporatise its major Government Trading Enterprises (GTEs). The State Owned Corporations Act establishes the legislative framework for the implementation of this policy. Seven GTEs were corporatised under this legislation up to 1995, with many others undergoing commercialisation reforms in preparation for full corporatisation.

In the June 1995 Financial Statement the Government identified a number of GTEs as candidates for corporatisation. This, combined with the Government's commitment to implementation of the National Competition Policy (see section 1.4) and recent amendments to the State Owned Corporations Act, provide a clear demonstration of the Government's intention to actively pursue the reform of GTEs through the policy of corporatisation.

Corporatisation is a challenging and complex process. It requires a full review of all aspects of a GTE's business and operating environment. This involves identifying and valuing the GTE's core and non-core businesses, establishing an appropriate capital structure (including the setting of debt to equity ratios) and financing arrangements. The legal structure, board composition and corporate governance issues also need to be addressed. Decisions with respect to non-commercial services and Social Program policies, if any, to be provided by the GTE need to be made. The GTE also needs to be prepared to operate in an increasingly competitive market and action may be required to increase contestability within that market. Frequently the regulatory environment within which a GTE operates its businesses also needs to be examined and reformed. Consideration and management of staff issues throughout the change process is also vital to successful corporatisation.

The range of issues and complexity of the reform process varies widely between GTEs and is to some extent a function of how far the GTE has already progressed down the commercialisation path. In setting out the issues which need to be considered and the key steps that must be taken to achieve corporatisation, this Manual draws on the experiences of past corporatisations. It also has regard to the recent amendments to the State Owned Corporations Act and the processes which have been adopted by the Government for the implementation of the corporatisation program.

This Manual is intended to assist GTE management, implementation steering committees and other interested parties in preparing for and implementing corporatisation.

The GTE Reform Unit of Premier's Department and the Commercial Sector Division of Treasury are responsible for the Government's commercialisation / corporatisation program.

To ensure the continuing relevance of this Manual it will be regularly updated to incorporate changes to corporatisation processes and to take account of the experiences of further corporatisations. Comments on how this Manual might be improved for the benefit of future users are welcome and should be made to the Director, GTE Reform Unit, Premier's Department, Level 31, Governor Macquarie Tower, 1 Farrer Place, Sydney NSW 2000.

1 WHAT IS CORPORATISATION?

1.1 The Principles of Corporatisation

Whilst 'incorporation' under the State Owned Corporations Act 1989 ('SOC Act') is an important milestone in the process of corporatisation, five principles of reform have to be satisfied before a GTE can be said to be truly corporatised. Satisfaction of the first four principles results in a fully commercialised entity and a number of GTEs are now, after several years of reform, much closer to satisfying these principles. However, it is not until the fifth principle has been satisfied that the organisation can be regarded as corporatised.

The five principles are:

(i) **Clear commercial objectives:** This principle requires the "unbundling" of conflicting commercial, social, policy, advisory and regulatory functions which GTEs have often undertaken. Separating these functions and giving the GTE clear commercial objectives provides a direct focus for management and ensures that clear performance targets can be set for the organisation.

(ii) **Appropriate managerial authority and autonomy:** This involves giving boards of directors and management greater responsibility and authority for accomplishing the GTE's objectives within the commercial parameters set by the Government as shareholder. The principle requires that key internal operating decisions are made by Boards and management.

(iii) **Effective performance monitoring:** There must be a rigorous, independent (of the Board and management) monitoring regime that permits comparative assessment of the GTE's performance against agreed targets.

(iv) **Rewards and sanctions on performance:** A vigorously applied system of rewards and sanctions must operate in order to effectively promote good commercial performance and to sanction poor performance. Such rewards and sanctions can be achieved in remuneration and employment arrangements, the tightening or relaxing of reporting and monitoring requirements, and liberalising or restricting management's decision making ability in regard to future investment decisions.

(v) **Competitive neutrality in input and output markets:** Any special advantages or disadvantages applying to GTEs by virtue of their Government ownership must be removed. GTEs are encouraged to be efficient through exposure to competition. The Government has in place explicit policies to level the playing field between GTEs and their competitors. For example, a corporatised entity is required to pay tax at rates equivalent to those of a private company. GTEs are also required to pay a commercial return to the Government as shareholder on the assets employed in each business. Through the payment of dividends and guarantee fees the full costs of capital and debt are transparently reflected in the costs of the business. GTEs which operate as monopoly service providers will have their pricing policies referred to the

Government Pricing Tribunal. This is necessary to prevent exploitation of market power once a GTE is established with a clear profit motive.

This final reform principle will become increasingly relevant to the operation of all GTEs as implementation of the new National Competition Policy takes effect. Under this policy all GTEs, not only SOCs, will be exposed to the Trade Practices Act and competitive pressures on all GTEs will increase.

1.2 Key Features of the State Owned Corporations Act

The SOC Act provides the legislative framework for implementing the five key principles of corporatisation and facilitates the establishment of state owned corporations ("SOCs") in which Ministers hold shares on behalf of the Government.

The SOC Act was amended with the passage of the State Owned Corporations Amendment Act of 1995. A principal objective of the amendments was to improve the accountability of SOCs, particularly to the portfolio Minister.

The fundamental intent of the Act is to establish SOCs within an environment which promotes their efficient performance through maximising their productive and allocative efficiency. Sections 8 and 20E of the Act provide that the principal objectives of every SOC are:

(i) to be a successful business and, to this end, operate at least as efficiently as any comparable business and maximise the net worth of the State's investment in the SOC;

(ii) to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates;

(iii) where its activities affect the environment, to conduct its operations in compliance with the principles of ecologically sustainable development contained in section 6(2) of the Protection of the Environment Act 1991; and

(iv) to exhibit a sense of responsibility towards regional development and decentralisation in the way in which it operates.

The SOC Act also specifies that each of these principal objectives are of equal importance.

The amended SOC Act allows for the establishment of two types of SOCs, namely Statutory SOCs and Company SOCs. Previously the SOC Act only provided for the establishment of what are now known as Company SOCs. Company SOCs are incorporated under the Corporations Law and their names inserted in Schedule 1 of the SOC Act by an Act of Parliament. Sydney Water and the Hunter Water Corporation are the only Company SOCs currently scheduled under the SOC Act.

Statutory SOCs are established as corporations under separate legislation. Unlike Company SOCs, section 20G of the SOC Act provides that "[t]he provisions of the Corporations Law do not apply to a statutory SOC, except as expressly provided by or under this or any other Act."

As the Government has indicated that future SOCs will be established under the Statutory SOC model, this Manual focuses on Statutory SOCs rather than Company SOCs.

The key features of the Act applying to the Statutory SOC model are summarised in the following table.

KEY CHARACTERISTICS OF STATUTORY SOCS

- Established by means of a separate Act which inserts the name of the SOC in Schedule 5 of the SOC Act.
- Corporations Law does not apply unless an Act or regulations provide otherwise.
- Each Statutory SOC is to have issued share capital, a memorandum and articles of association, and a Board of Directors.
- Two Shareholders: Treasurer and one other Minister nominated by the Premier. Equal shareholdings and voting power. Cabinet has agreed that the portfolio Minister is not to be a voting shareholder. Voting Shareholders have responsibility and oversight of the Statutory SOC's commercial performance within the parameters set out by the Statement of Corporate Intent. Portfolio Minister has responsibility for the regulatory/policy framework within which the SOC operates and as defined by such instruments as the regulatory legislation, operating licence and other licences (eg: environmental).
- Directors are appointed by the Governor on the recommendation of the voting shareholders. There are to be no fewer than three and not more than seven directors. Of these directors one shall be a staff director and one may be the CEO. Apart from the staff director, all directors are to be persons who, in the opinion of the voting shareholders, will assist the SOC to achieve its principal objectives. The Board is accountable to the voting shareholders. Directors' duties and responsibilities are set out in the Act.
- CEO to be appointed by the Governor on the recommendation of portfolio Minister and Board. CEO's remuneration determined by the portfolio Minister on Board's advice. Other conditions of employment fixed by the Board with the approval of the portfolio Minister.
- Portfolio Minister is empowered to give Board written notifications or directions, with the approval of the Treasurer, in respect of noncommercial activities, public sector policies and public interest issues. The SOC may be compensated for the costs of complying with such notifications or directions by agreement between the Treasurer, the portfolio Minister and the Board.
- The SOC does not represent the State except as agreed with the voting shareholders or as otherwise provided by an Act, other than for limited exceptions. It is not exempt from State taxes, etc. It cannot render the State liable for debts or other obligations unless otherwise provided by an Act. Where Government does guarantee debt a fee will be charged.
- A Statement of Corporate Intent is required to be agreed between the Board and the shareholders each financial year.
- Financial reporting must be in accordance with Part 4 and Section 59B of the Public Finance and Audit Act 1983. Treasury's regular reporting / monitoring regime applies.
- Treasurys Financial Policy Framework, including Tax Equivalent Regime and dividend distribution policies, apply.
- Annual Reports (Statutory Bodies) Act 1984 applies.
- Subject to the FOI Act except for commercially sensitive information.
- Subject to Part 9A of the Anti Discrimination Act 1977.

By establishing GTEs as Statutory SOCs the Government is deliberately exposing its commercial businesses, so far as is possible, to the same financial and commercial pressures as exist for privately owned companies. That is, it is establishing competitive neutrality with the private sector. The framework to achieve this comprises three main elements. These are the Financial Operating Policy, the Government Pricing Tribunal and Competition Policy Principles, including application of the Trade Practices Act.

1.3 State Owned Corporations

In NSW GTEs which have been corporatised under the SOC Act are:

- Hunter Water Corporation
- Sydney Water Corporation
- NSW Grain Corporation Limited
- State Bank
- Lower Murray Irrigation Corporation
- Murray Irrigation Corporation
- Jemalong Wyldes Plains Irrigation Corporation.
- Three regional port authorities (corporatised as the first Statutory SOCs on 1 July 1995).

Of these the Hunter Water Corporation, the Sydney Water Corporation and the three regional port authorities remain in Government ownership.

The Government's June 1995 Financial Statement sets out a comprehensive corporatisation program. It also states that "corporatisation is not to be regarded as a path to privatisation". The Statement lists the following candidates for corporatisation:

- Pacific Power
- the electricity distributors (following amalgamation and restructure)
- Electricity Transmission Authority
- Powercoal
- the three regional Port Authorities
- TAB
- NSW Lotteries
- Freight Rail
- State Forests - commercial pine tree operations
- the remaining two irrigation schemes administered by the Department of Land and Water Conservation
- Office of the Public Trustee
- Waste Service
- Dairy Corporation

1.4 National Competition Policy Reform and Corporatisation

Following a review of national competition policy by the Hilmer Committee, a National Competition Policy Framework intended to improve the competitiveness of the public and private sectors of the Australian economy has been endorsed by the Commonwealth and all State and Territory Governments. The principles reflected in this Framework have been enshrined in amendments to the Trade Practices Act and a Competition Principles Conduct Code Agreements entered into by those Governments.

The six principles underpinning the Framework are:

- Limiting anti-competitive conduct of firms;
- Reforming regulation which unjustifiably restricts competition;

- Reforming the structure of public monopolies to facilitate competition;
- Providing third party access to certain monopoly facilities that are essential for competition;
- Restraining monopoly pricing behaviour; and
- Fostering competitive neutrality between Government and private business when they compete.

A general explanation of each of these principles is contained in Attachment 2.

Two of these principles relate particularly to the issue of the corporatisation of GTEs. Firstly, the third of the above principles, which involves the structural separation of regulatory and commercial functions undertaken by public monopolies, accords with the first principle of corporatisation identified in paragraph 1.1. With regard to that principle the Hilmer Committee recommended that:

(i) Before competition is introduced to a sector traditionally supplied by a public monopoly any responsibilities for industry regulation should be removed from the incumbent. The location of regulatory functions should place special weight on the need to avoid conflicts of interest.

(ii) Before competition is introduced to a sector traditionally supplied by a public monopoly there should be a rigorous, open and independent study of the costs and benefits of separating any natural monopoly elements from potentially competitive activities. Where the natural monopoly element is vertically integrated with potentially competitive activities there should be a presumption in favour of separation at the ownership or control level.

(iii) Before competition is introduced to a sector traditionally supplied by a public monopoly there should be a rigorous, open and independent study of the costs and benefits of separating potentially competitive activities of the monopoly enterprise.

(iv) Where privatisation of a substantial public monopoly is proposed, there should be a rigorous, open and independent study of all related structural issues. There should be a presumption in favour of vertical separation.

These recommendations are reflected in the Competition Principles Agreement, whereby it has been agreed that before a Government introduces competition to a sector traditionally supplied by a public monopoly it will remove from that public monopoly any responsibilities for industry regulation. Further, the relevant Government will re-allocate industry regulation functions so as to prevent the former monopolist enjoying a regulatory advantage over its (existing and potential) rivals.

Similarly, the Competition Principles Agreement provides that before a Government introduces competition to a market traditionally supplied by a public monopoly, it will undertake a review into:

(i) the appropriate commercial objectives for the public monopoly;

(ii) the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;

(iii) the merits of separating potentially competitive elements of the public monopoly;

(iv) the most effective means of separating regulatory functions from commercial functions of the public monopoly;

(v) the most effective means of implementing the competitive neutrality principles set out in the Competition Principles Agreement (in which regard see further below);

(vi) the merits of any community service obligations undertaken by the public monopoly and the best means of funding and delivering any mandated community service obligations;

(vii) the price and service regulations to be applied to the industry; and

(viii) the appropriate financial relationships between the owner of the public monopoly and the public monopoly, including rate of return targets, dividends and capital structure.

Secondly, the last of the above principles, which is concerned with the fostering of competitive neutrality between Government-owned and private businesses, accords with the fifth principle of corporatisation identified in paragraph 1.1 above. With regard to that principle the Hilmer Committee recommended that:-

(i) Government-owned businesses should not enjoy any net competitive advantage by virtue of their ownership when competing with other businesses;

(ii) Government-owned businesses competing against other firms within their traditional markets should be subject to measures that effectively neutralise any net competitive advantage flowing from their ownership. Unless exceptional circumstances exist, those advantages should be neutralised as follows:

- where the Government-owned business has traditionally provided services directly to the public, there should be a presumption that competitive neutrality should be achieved through corporatisation; and

- where the Government-owned business has traditionally provided services only to other Government entities, competitive neutrality may be achieved through corporatisation or the application of effective pricing directions.

(iii) Government-owned business should not compete against other businesses outside their traditional markets without being subject to measures that effectively neutralise any net competitive advantages flowing from their ownership. Those advantages should be neutralised as follows:

- where the Government-owned business has traditionally provided services directly to the public, there should be a presumption that competitive neutrality should be achieved through corporatisation; and
- where the Government-owned business has traditionally provided services only to other government agencies, competitive neutrality may be achieved through corporatisation or the application of effective pricing directions.

These recommendations were also largely adopted in the Competition Principles Agreement, which provides in part that Governments will (where practical) adopt a corporatisation model for relevant GTEs and will impose on those businesses:

(a) full tax or tax equivalent obligations;

(b) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and

(c) social and economic regulations on an equivalent basis to their private sector counterparts.

Thus corporatisation under the Statutory SOC model accords with both the Government's policy of making GTEs more efficient and its obligations under the Competition Principles Agreement.

The ME&GTERC is supported with attendance at meetings by the:

- Director-General, Premier's Department;
- Director-General, The Cabinet Office;
- Secretary, The Treasury; and
- Other officials as required.

The proceedings of the ME&GTERC are subject to the usual rules of Cabinet confidentiality.

2.3 Role of Steering Committees

To implement particular corporatisation projects the ME&GTERC establishes implementation Steering Committees. These are typically comprised of the following officials:

- chairperson - a senior officer of one of the central agencies (either the departmental head or deputy);
- senior officers of Premier's Department, The Cabinet Office and Treasury;
- a representative of the GTE to be corporatised (usually the CEO);
- a representative of the portfolio Minister's Office and /or Department;
- a representative(s) of key stakeholder department(s) or agencies such as the EPA or other regulatory bodies which will impact on the business; and
- an officer of the GTE Reform Unit of Premier's Department, who acts as the executive officer to the Steering Committee.

The ME&GTERC has authorised the Director-General of the Premier's Department to appoint the chairpersons of the Steering Committees.

Each Steering Committee chairperson is required to ensure that the ME&GTERC and the relevant portfolio Minister are kept adequately and regularly informed of the progress of the corporatisation project.

As these Steering Committees are part of the Cabinet process their proceedings, minutes, reports and other papers are subject to Cabinet confidentiality.

2.4 Role of Government Agencies

In terms of the role of individual agencies the ME&GTERC has assigned the following key responsibilities to particular agencies.

- Premier's Department has responsibility for overall management of each corporatisation project and for providing policy advice and executive support to the Steering Committees.
- The Cabinet Office has responsibility for policy development and the passage of necessary legislation.
- Treasury has responsibility for issues relating to the financial interests of the Government as shareholder during the corporatisation process. Treasury also

undertakes the on-going monitoring of the SOCs and provides regular advice on their commercial performance to the shareholding Ministers. Each year the Treasury also negotiates of the Statements of Corporate Intent on behalf of the shareholding Ministers.

- The GTE is required to assist the Steering Committee in undertaking the corporatisation by providing information about the GTEs business and by implementing the decisions of the Steering Committee which relate to the organisation at a business and operational level.

2.5 Resources

Resources for implementation are derived from a number of sources.

- Each Steering Committee member will be called upon to take responsibility for performing certain implementation tasks related to their specific skills and organisational perspective. These are generally performed at the cost of the agency concerned.
- In appropriate cases a dedicated task force drawn from the agencies represented on the Steering Committee will be established to assist the Steering Committee and specifically undertake the many detailed tasks which must be completed before the GTE is corporatised.
- The GTE Reform Unit of the Premier's Department, as well as providing executive support, project management and policy advice to the Steering Committee, has responsibility for administering and funding certain external consultancies associated with each corporatisation. These generally have a broad policy orientation and particularly relate to issues concerning the interests of the Government as shareholder/owner of the GTE. Such consultancies may include advice on business valuation, capital structuring, and development of the legal/regulatory operating framework.
- A GTE may also incur consultancy fees on its own behalf in preparing its internal affairs and systems for corporatisation. For example, it may use consultants to set up its financial systems, for surplus asset identification, asset allocation between business ventures and for staff management throughout the transition period.
- The GTE should also assign to an individual, or establish a dedicated unit with specific responsibility for co-ordinating and implementing the corporatisation project within the GTE. This individual or unit should ideally report directly to the CEO and provide the day to day point of contact between the GTE and the other agencies involved in the reform process.
- External consultants are used in cases where the Steering Committee is of the view that:

  (i) the expertise required to undertake a particular task is not available (or is not available within the requisite timeframes) elsewhere in the public sector; or

  (ii) it would be prudent and in the Government's interest to have a particular task undertaken by an independent party with specialist expertise.

The Government's guidelines on the selection and engagement of consultants issued by the Premier's Department are to be followed in these cases.

3. IMPLEMENTATION ISSUES

Corporatisation involves addressing a wide range of issues including:

- defining the nature, scope and value of the commercial business which the SOC is to undertake;
- undertaking a detailed examination of the market place in which the GTE operates;
- setting up the appropriate capital structure and debt and equity ratios for the SOC;
- considering the application of the Social Program Policy to any non-commercial functions;
- considering (and possibly reforming) the legal, regulatory and policy framework within which the SOC will operate;
- reviewing and (often) reorganising the financial and other operating systems of the business to accommodate the new financial and operating environment of the SOC;
- communicating with staff and other stakeholders concerning the purpose, benefits and changes which corporatisation will bring.

Many of these issues are inter-related. Broadly speaking, however, they can be categorised under three headings: commercial; legal / regulatory and other issues.

Whilst each corporatisation will have issues particular to it, Attachment 1 sets out a comprehensive checklist of common issues and actions which need to be addressed by implementation Steering Committees and GTEs during the corporatisation process.

3.1 Commercial Issues

The many commercial issues associated with corporatisation are comprehensively dealt with in the context of a business valuation study. This is a key element in the corporatisation process and critical to understanding the key risks to which the business will be subject once the SOC is established.

The key elements of this study involve:

- undertaking an assessment of the market place in which the SOC will operate, taking into account likely changes to the SOC's commercial and regulatory operating environment;
- identifying core and non-core assets;
- advising in relation to the appropriate capital structure;
- assessing the impact on the SOC of the application of the Financial Distribution Policy (including the effect of tax or tax effective obligations on business viability); and
- assessing the likely financial effects of undertaking Social Program Policies.

A key output from the valuation study is a detailed financial model. This is available for future use by the SOC and Treasury. It provides the basis for developing the Statement of Corporate Intent, as well as the Corporate and Business Plans of the SOC. These in turn form the basis for the on-going performance monitoring regime undertaken by Treasury.

External financial consultants are usually retained by the implementation Steering Committees to undertake the business valuation study.

3.1.1 Market Place Assessment

In undertaking the market place assessment a range of issues needs to be considered. These include:

- the extent to which the SOC will be subject to market competition (ie will the SOC be a monopoly supplier or will it be subject to market competition, and if so, to what extent?);
- the extent to which the current economic and environmental arrangements will need to be altered so as to encourage improved commercial performance and to facilitate the application of competition principles;
- where the SOC will act as a monopoly supplier mechanisms for protecting customers and/or resources from exploitation need to be developed and their costs and impacts factored into the business valuation (such mechanisms could include customer charters, operating licenses and oversight by the Government Pricing Tribunal);
- the extent to which competitive-neutrality and other competition principles can be introduced into the SOC's operations and market place; and
- the likely impact of corporatisation, the Trade Practices Act, competitive neutrality and other competition principles on the business operations of the SOC.

SOCs with monopolistic characteristics will be subject to price determinations by the Government Pricing Tribunal. Such determinations can have a substantial impact on a SOC's commercial performance and rate of return. Accordingly, the likely impacts of potential pricing controls on business viability need to be factored into the business valuation study.

Further, proposed policy changes, the emergence of alternative technologies and the appropriateness of a SOC's asset base will also influence the SOC's ability to respond to competitive pressures and will therefore impact on the viability of the SOC's business. With increasing competition SOCs will face more rigorous performance standards and may therefore have to expand or alter their range of services in order to maintain (and increase, where competition exists) market share. Alternatively, in order for the SOC to focus on its core business, it may be required to discontinue some of the activities which it undertook as a GTE.

Consequently, the market place assessment also needs to have regard to how the value and viability of the GTE may be affected by changes in:

- the range of products and services provided;
- key competitors and customers;
- levels of competition and lowering barriers to entry and exit from the market place;
- price controls; and
- the application of the Trade Practices Act and other competition principles.

Once completed this assessment will assist in the Steering Committee in making recommendations to Government regarding such matters as:

- the structure of the SOC's business;
- the external legal, operating and regulatory environment required for the SOC;
- requirements for competitive reform in the SOC's market place; and
- the SOC's future viability and value to the Government as shareholder.

3.1.2. Core and Non-Core Businesses and Assets

As well as the external market place assessment the business valuation also needs to identify the core and non-core activities undertaken by the GTE. Non-commercial activities will either be discontinued, funded under the Social Program Policy or transferred to another organisation which can more appropriately undertake such activities. Some commercial, but non-core, activities may also be discontinued to allow the SOC to focus on its core business.

Alternatively, improving commercial focus might be achieved by splitting the business into several corporate entities. If this occurs then each separate business will need to be defined and valued (as has been done with the port authorities).

Identification of core assets (ie those necessarily required by the SOC to undertake its business) and those surplus to the SOC's commercial requirements needs to be undertaken. This can mean that real property assets, particularly those which are of major importance to the business, need to be sufficiently identified to enable them to be registered in the SOC's name.

The shareholder performance requirement for an adequate return on assets creates a strong incentive for identifying and divesting surplus assets before the SOC is established. Strategies for dealing with surplus assets and non-core business undertakings need to be developed. Usually surplus assets will, on corporatisation, be separated out from those assets to be vested in the SOC and vested in a separate Ministerial Corporation for appropriate management and, possibly, subsequent disposal.

Undertaking this process prior to corporatisation simplifies performance target setting and monitoring. Also, the development of accurate asset registers and asset values for the purposes of depreciation is an important determinant of future tax liabilities and dividend returns to Government.

The business valuation also needs to take account of the likely future revenues and costs of employing the assets of the business. The valuation study will look at various scenarios having regard to changes to the regulatory / operating environment and the impact these will have on the way the assets of the business are used and the costs associated with operating the business. This will also assist the Steering Committee in making recommendations to Government on the preferred regulatory framework which is to apply to the SOC.

3.1.3 Capital Structure Policy

As with any other commercial entity, an appropriate mix of debt and equity is essential to optimising a SOC's efficiency. Excess debt can put the organisation at financial risk while too little can restrict growth and reduce financial returns to the Government as shareholder. Determination of the capital structure requires:

- development of a business profile of the GTE (discussed above);
- a review of the GTE's business plans and forecasts;
- a business risk analysis;
- construction of a financial model to analyse cash flows;
- a sensitivity analysis of the impact of key variables on the cash flows; and
- establishment of the national credit rating applicable to the GTE as a stand alone entity.

Treasury has identified a number of criteria for determining the appropriate level of debt for SOCs. These include that such debt:

- enables the SOC to sustain a good investment grade credit rating over the long term;
- enables the financing of the approved capital expenditure program and takes into consideration the current phase of the GTE's investment cycle;
- is capable of being repaid within a reasonable period (usually 7 years); and
- provides flexibility for relevant contingencies.

Determining the appropriate capital structure and debt / equity ratios is an important outcome of the business definition and valuation process. On this will depend a range of other matters which are critical to implementing corporatisation such as: determining the appropriate level of share capital for the SOC; determining how much debt is to be retained or apportioned to the SOC; and the likely future anticipated return to Government through tax equivalents and dividends. Consequently it is one of the essential inputs in the development of the Statement of Corporate Intent.

3.1.4. Financial Distribution Policy

One means of creating incentive structures to encourage improved commercial performance is the requirement that SOCs comply with the Government's Financial Distribution Policy. This exerts a further commercial discipline on the SOCs to pay tax and dividends to the Government in the same way as is required of private sector commercial businesses. Accordingly, this is also a key mechanism in achieving the corporatisation principle of competitive neutrality.

The Government's Financial Distribution Policy deals explicitly with the relationships arising from the Government's roles as owner, banker and tax collector. The essence of the policy is to subject SOCs to the discipline of meeting a number of financial distributions, thereby making more transparent the opportunity cost of the capital employed in the SOC's business.

Under the Financial Distribution Policy distributions to Government made by SOCs comprise:

- interest on outstanding debt;
- payment of a financing risk fee (ie guarantee fees);
- dividend payments; and
- taxation equivalent payments.

The extent to which a GTE may already be subject to such financial distributions prior to corporatisation will depend largely on the how far the GTE has progressed towards commercialisation/corporatisation. This will in turn determine the extent of work that needs to be undertaken in this area to prepare for corporatisation. It is noted, however, that the Financial Distribution Policy is being applied to increasing numbers of GTEs.

3.1.5. Social Program Policy

As SOCs have commercial charters and do not provide social or regulatory services (unless specifically directed and funded to do so by Government) non-commercial activities which may qualify as Social Programs delivered by a GTE need to be identified, assessed and costed.

Social programs can include activities defined under the following three categories: Community Service Obligations ("CSOs"); quasi CSOs; and community services.

To qualify as a CSO an activity must satisfy the following criteria:

- it would not be pursued by a GTE on commercial grounds;
- it has a specified objective;
- there is an explicit Government directive to the GTE that the activity should be pursued; and
- funding is from the Budget, or internal funding over the transitional period has been approved by the Treasurer.

To qualify as a quasi CSO a non-commercial activity must fulfil only the first three of the above criteria.

A community service must be a non-commercial activity which has a social objective but is not the subject of an explicit Government objective. Community services need to be considered for Social Program funding only if the GTE proposes to continue to provide them post corporatisation.

The Steering Committee should advise the Government on options in respect of these programs. Options could include:

- funding the SOC to provide the programs under contract from the Portfolio Minister;
- discontinuing the product or service (ie. as an automatic consequence of corporatisation unless there is a benefit to the SOC that justifies the continued provision of the non-commercial service);
- alternative options for delivery of the relevant service or product (eg contracting out, or transfer of the provision of this service to another Government organisation); or
- alternative options for satisfying the objective behind the provision of the proposed Social Program.

Clearly the extent to which the SOC will be required, if at all, to undertake the performance of Social Program, how they are to be delivered, the costs they will incur and the means by which such costs are to be met are all important issues in defining and valuing the SOC business.

Accordingly, at the time of corporatisation the SOC should have in place contracts for the delivery of the non-commercial products and services which the Government wishes it to provide after the SOC is established.

3.2 Legal and Regulatory Issues

The complexity and range of legal and regulatory issues requiring resolution during corporatisation will vary considerably between GTEs. These will be more complex where GTEs operate as monopolies and/or where they have undertaken in the past a mixture of commercial, and regulatory functions. Experience has shown that where a GTE's activities have a significant impact on the environment establishing the legal and regulatory framework work becomes the most complex.

These implementation issues can be grouped into three categories:

- establishing the SOC;
- establishing the SOC's operating framework; and
- establishing the monitoring and accountability framework.

The issues and steps required for consideration in each category are discussed below.

3.2.1 Establishing the SOC

Statutory SOCs are established by means of an Act which creates the corporation and inserts its name into Schedule 5 of the SOC Act. The legislation also usually sets up the regulatory framework within which the SOC is to operate.

The SOC is formally established on the proclamation of the relevant legislation. The assets, business and undertaking of the organisation are transferred to the SOC by

way of ministerial vesting order, which takes effect at the same time as the legislation is proclaimed.

It is at this time as well that the share capital is issued to the voting shareholders and the memorandum and articles of association are signed and come into effect.

3.2.2 Operating Framework

Corporatisation may require modification of a GTE's operating framework. Such a framework would supplement the rules of business contained in the SOC Act, the Corporations Law (if applicable), the Public Finance and Audit Act, the monitoring and accountability framework and other legislation impacting on SOC operations.

A new legal operating framework may be required to:

- Protect customers where a SOC is a monopoly service provider.

  For instance, a customer contract has been established between Sydney Water Corporation ("Sydney Water") and its customers. Its purpose is to define the relationship between Sydney Water and its customers. Thus the contract defines minimum service standards that customers will receive from Sydney Water and specifies penalties that will be incurred by the organisation if it breaches the contract conditions. The contract is considered necessary in the absence of alternative water and sewerage providers in the Sydney region as there is no other mechanism through which customers can seek redress from Sydney Water for poor service standards.

- Establish a new regulatory regime, the need for which may arise as a result of the separation of commercial and regulatory responsibilities at corporatisation.

- Limit the capacity of regulatory agencies to vary licence conditions capriciously and/or without notice.

  Memoranda of Understanding between several SOCs and the EPA as their key regulator have been developed in an attempt to improve the predictability of the business environment in the face of annual reviews of licence conditions. It is not intended, however, that such arrangements give SOCs any special advantages over their competitors as the principle of competitive neutrality clearly requires the regulatory regime to be consistent for SOCs and private sector businesses. Such arrangements may be of most value in cases where natural monopolies are to be corporatised.

- Give a SOC special powers in order to enable it to perform its charter. For example, to facilitate access to infrastructure assets on private land some corporations have had special powers conferred on them by statute.

- Establish an operating licence which effectively establishes a SOC as the Government's agent for the purpose of using particular infrastructure for performing certain services.

For instance, the Hunter Water Corporation's ("HWC") operating licence provides for:

- an agreement for HWC to gain access to raw water;
- an agreement in respect of waste water discharges;
- service standards together with monitoring provisions;
- price constraints;
- return commitments and CSO provisions; and
- for a mid term review of licence conditions to determine compliance and to amend the licence as required.

- Facilitate the achievement of competitive neutrality principles and compliance with national competition policy. For example by:

  - establishing a legal framework which promotes competition or which removes regulatory barriers to competition (eg it may be necessary to revoke legislation that gives a GTE monopoly powers);
  - establishing an access regime for key infrastructure prior to corporatisation. This can ensure compliance with future national competition laws and promote competition by facilitating access to infrastructure that is critical to market participation by alternative service suppliers; and/or
  - the referral of pricing policies for monopoly services to the Government Pricing Tribunal.

3.2.3 Monitoring and Accountability Framework

The primary accountability of SOCs is to their shareholders. The keystone of the monitoring and accountability framework is the Statement of Corporate Intent ("SCI"). The SCI is a negotiated agreement between the shareholders and the Board of the SOC which under the SOC Act is required to be in place within three months of the commencement of each financial year.

The elements of a SCI are defined in the SOC Act as:

- the objectives of the corporation and its subsidiaries;
- the main undertakings of the corporation and of its subsidiaries (if any);
- the nature and scope of the activities to be undertaken;
- the accounting policies to be applied;
- the performance targets and other measures by which the performance of the corporation and its subsidiaries may be judged in relation to their stated objectives;
- the kind of information to be provided to the voting shareholders by the corporation, including the information to be included in each half yearly report; and
- such other matters as may be agreed on by the voting shareholders and the Board from time to time.

In addition to the SCI, contracts between the SOC and portfolio Ministers for the funding and delivery of any Social Programs that the SOC is to deliver after corporatisation will need to be in place before corporatisation is effected.

The Treasury, on behalf of the shareholders, negotiates with the Board on the terms of each annual Statement of Corporate Intent.

Also, once a SOC is established it is subject to Treasury's monitoring regime which is similar to that which also applies to non-corporatised GTEs.

Under this regime the SOC is required to provide quarterly, half yearly and annual reports to Treasury. These reports include information such as:

- the current Statement of Corporate Intent (or variations thereto);
- medium (3-5 year) business plans (updated annually) covering corporate strategy, marketing, competitive strategy, pricing, service standards, resource plans, etc;
- a summary of the organisation's annual operating budget and quarterly reports of performance against this budget;
- quarterly cash flow estimates for current fees and medium term projections with reports of actual results against estimates;
- summaries of key items for the profit and loss account, together with a corresponding balance sheet;
- final year-end reports of performance against budget, together with commentary as appropriate; and
- an annual report with full audited financial statements including balance sheet profit and loss account and cash flow statements.

On the basis of this and any other information which is required, Treasury provides advice to the shareholders (and the portfolio Minister, as required) on the commercial operations and performance of the SOC.

The Statement of Corporate Intent (and any amendments made during the year), the memorandum and articles of association (and any amendments made from time to time), the half yearly report, the annual report and any Ministerial directions are all required to tabled in Parliament.

3.3 Other Issues

The checklist attached to this Manual deals with a range of other matters. However, in terms of importance the need to manage the change process, particularly in relation to staff issues, requires special mention.

The implementation of corporatisation requires change management across the organisation. As with any organisational change, corporatisation will be much more successful if staff are supportive of, and well prepared for, the changes that corporatisation will bring to the organisation.

A change management process needs to be designed at an early stage by the corporatising entity. It should comprise processes for regular consultation and communication with staff concerning the changes to the organisation, the reasons for those changes, the desired future state of the organisation, the impacts on individual employment status, benefits and conditions, the relationship with the rest of the public sector and future expectations.

3.3.1 Employment arrangements

As a SOC, an organisation's employment and staff management practices operate within a framework set by:

- Circular No. 95 - 12 to all CEOs: Application of Premier's Memoranda to all Ministers;
- Circular No. 95-21 to all CESs: Use of Recruitment and Publicity/Public Relations Consultants;
- Government policy in relation to excess employees policy and guidelines (Premier's Memorandum No. 93-36 and Premier's Department Memorandum 93-17) which covers redeployment and voluntary redundancy;
- Schedule 4 of the SOC Act 1983;
- Occupational Health and Safety Act 1983:
- Workers Compensation Act 1987;
- Part 9A of the Anti - Discrimination Act 1977; and
- Industrial Relations Act 1991.

Some GTEs already have more flexible employment arrangements than other Government agencies. However, on corporatisation SOC employees are no longer be public servants within the meaning of the Public Sector Management Act. Other than for the purposes of superannuation and a limited right for former public servants to apply for positions within the public service as if they were public servants for a period of three years after corporatisation, the SOC Act leaves the issue of employment conditions to be determined by individual SOCs.

In relation to superannuation and leave entitlements the SOC Act expressly preserves the accrued entitlements of individuals who, immediately before becoming employees of a SOC, were public sector employees. Accordingly, SOC employees continue to be members of the relevant state superannuation schemes of which they were members immediately before corporatisation. In order to achieve this the corporatisation legislation establishing the SOC needs to make provision for the name of the new SOC to be included in the schedules of the relevant superannuation legislation.

ATTACHMENT 1

CHECKLIST FOR IMPLEMENTATION STEERING COMMITTEES

Preliminary/Planning Issues

- Establish Steering Committee - membership to include key stakeholders of corporatisation.
- Clarify terms of reference and confirm understanding of approval points that will be required from Cabinet.
- Prepare project plan and implementation timetable.
- Allocate tasks amongst team members and identify sub-team and consultancy requirements.
- For sub-projects involving consultancies:
    - develop Terms of Reference;
    - define tender process;;
    - conduct tender selection:
    - ensure appropriate approval for appointment of consultant is obtained:
    - issue consultancy contract;
    - manage consultant(s) during project, ensuring they fulfil the terms of reference;
    - obtain appropriate payment approvals.

Commercial Issues

- Business Definition and Valuation
    - Undertake market place assessment, and develop appropriate framework to improve commercial performance and take account of competition principles.
    - Identify core assets and liabilities necessary for the commercial operation of the business and vesting into the SOC.
    - Value business assets for accounting and tax purposes
    - Determine appropriate capital structure, debt / equity ratios.
    - Determine appropriate dividend policy
    - Assess the impact of taxation on the viability of the business;
        - consider business structuring for tax purposes;
        - consider if there is a need for special taxation rulings.
    - Identify, assess and cost Social Program Policy.
    - Resolve issues relating to unfunded superannuation liabilities.
- Develop corporate plan and detailed business plans.
- Negotiate and agree Statement of Corporate Intent.

Legal & Regulatory Issues

- Develop appropriate regulatory framework for SOC.
- Prepare legislation to create SOC, and to establish the regulatory framework within which the SOC is to operate and to dissolve GTE.
- Arrange for transfer of assets to new entity:
    - draft and arrange for Minister to sign vesting orders transferring assets and liabilities;

- identify and survey land to be transferred and issue Certificates of Title;
- bank accounts and funds to be identified and transferred;
- intellectual property needs to be identified and transferred;
- cars, vehicles and other plant to be identified and transferred.

- Review and resolve any issues arising from current contracts, including indemnities, leases, covenants, etc.
- Assign / transfer /novate all current contracts.
- Determine outstanding liabilities/contingent liabilities (eg, environmental audit).
- Review and assess any current and pending litigation.
- Determine currency of all requisite operating licences and arrange for transfer/issue of same.
- Negotiate and prepare Social Program Policy contracts.
- Develop licences necessary to establish new operating and regulatory framework for the SOC (eg operating and environmental licences).
- Establish mechanism or vehicle (eg Ministerial corporation) for management (including disposal) of surplus assets of GTE, if any.

Corporate Governance

- Determine voting shareholders and portfolio Minister.
- Draft and arrange signing of Memorandum and Articles of Association taking into account the requirements of the SOC Act.
- Select a new Board.
- Select CEO.
- Appoint company secretary.
- Establish corporate records, adopt common seal, establish "registered office".
- Arrange issue of shares.

Industrial Relations/Human Resources

- Institute a communications program to inform staff, clients and the media about corporatisation.
- Resolution of staff issues to obtain a motivated commercially focussed and flexibly deployed workforce, eg:

  - decide which staff to be transferred to new entity;
  - transfer staff to new entity;
  - transfer of personnel records;
  - appoint new staff (if any) and address any redundancy issues;
  - all leave entitlements, superannuation benefits etc., to be identified and quantified;
  - arrange for the name of the SOC to be included in appropriate schedules to relevant superannuation legislation to ensure continuity of membership for continuing employees;

- Review current status of Enterprise Agreement and awards, as appropriate.

Administration

- General business administration:
  - determine and arrange for appropriate insurance for business risks;
  - establish banking arrangements;
  - arrange public liability and other insurance;
  - arrange Directors' indemnity insurance;
  - review adequacy of accounting and management systems.

ATTACHMENT 2

THE KEY ELEMENTS OF NATIONAL COMPETITION POLICY

Limiting anti-competitive conduct

The prohibitions on anti-competitive conduct in Australia are currently largely contained within Part IV of the Trade Practices Act (TPA). In general, the TPA prohibits arrangements or agreements which adversely affect competition. In the past the TPA has not generally applied to State-owned entities.

The National Competition Inquiry conducted by the Hilmer Committee concluded that the general conduct rules of a national competition policy should apply to all business activity, whether public or private, with exemptions being granted only where a clear public benefit could be demonstrated.

Reforming regulation which unjustifiably restricts competition

The Hilmer Committee identified the greatest impediment to enhanced competition in many areas of the economy as being the restrictions imposed by Government regulation or ownership.

Under national competition policy it is intended that any regulation which restricts competition must be clearly demonstrated to be in the public interest.

As part of its GTE reform policy the New South Wales Government has undertaken regulatory reform in a number of areas. For example, egg marketing has been deregulated and legislation has been passed to deregulate fish marketing in New South Wales by 1997. Already the assets of the Fish Marketing Authority have been sold and that Authority dissolved. Other areas of regulatory reform include: long distance bus services, taxi services, grain handling and transportation, bread manufacturing, dairy industry, retail food outlets and the gas industry. This process will continue as part of the corporatisation and competition policy reform program.

Reforming the structure of public monopolies to facilitate competition

The Hilmer Committee identified the need to create competitive market and industry structures as a critical component of a national competition policy. This involves separating regulatory and commercial functions and breaking up natural monopoly and potentially competitive activities into a number of smaller independent business units.

New South Wales has separated electricity generation and transmission businesses. Three separate generating businesses have been established. These compete to supply electricity to the transmission grid through a spot market. There are also major structural reforms being implemented in the electricity distribution sector.

In the area of rail, steps are being taken to encourage competition in freight carriage. A network access unit has been created to manage the freight rail network and

define the rules under which State-owned and private operators can use the railway system.

Providing third party access to certain monopoly facilities that are essential for competition

The Hilmer Committee identified the need for competition policy to assure competitors of access to essential facilities (ie. infrastructure which cannot be economically duplicated) such as electricity transmission grid networks and railway systems.

The separation of the transmission network from power generation through the establishment of the Electricity Transmission Authority in New South Wales is an important step towards establishing a competitive electricity market and allowing open and fair access to essential infrastructure.

Restraining monopoly pricing behaviour

Competitive markets by their very nature prevent businesses pricing above long run average cost, and so prevent them from achieving above commercial returns. Where competition is absent or the level of contestability is low, businesses may be able to charge prices which reflect more than a commercial rate of return.

The Hilmer Committee recommended that a national competition policy should include a carefully targeted prices monitoring and surveillance process and that this process should apply where other elements of competition policy are insufficient to prevent monopoly pricing.

In New South Wales the Government Pricing Tribunal determines the maximum prices which government monopolies, including SOCs, may charge for their services.

Fostering competitive neutrality between Government and private business when they compete

This principle concerns creating a level playing field between public and private enterprises to ensure that neither has a competitive advantage or disadvantage vis-a-vis the other by reason of the nature of its ownership. To replicate the competitive pressures of the private financial market SOCs face an array of measures within the Financial Reporting Framework which effectively negate the traditional advantages of Government ownership (eg no taxes, cheap finance, no required rates of return on assets).

ATTACHMENT 3

References

A Policy Framework for Improving the Performance of Government Trading Enterprises

Guarantee Fees for Commercial Sector Agency Debt

A Tax Equivalent Regime for NSW Government Trading Enterprises

Monitoring Policy for NSW Government Trading Enterprises

Capital Structure Policy for NSW Government Trading Enterprises

A Financial Distribution Policy for NSW Government Trading Enterprises

A Social Program Policy for NSW Government Trading Enterprises

State Owned Corporations Act 1989

State Owned Corporations Amendment Act 1995

2. THE CORPORATISATION PROCESS

There are many issues which need to be addressed before a GTE is fully corporatised. In fact, the better the organisation and management are prepared before this occurs, the smoother will be the transition and the greater the success of the organisation once it is corporatised. In order to achieve effective implementation it is important to have:

- a clear implementation process; and
- a good understanding of the issues which need to be addressed.

This section sets out the implementation process whilst Section 3 discusses the main issues which need to be addressed during the course of implementation.

2.1 Role of Cabinet

Cabinet approval is essential before a GTE can be corporatised.

The Micro-Economic and GTE Reform Committee ("ME&GTERC") is a sub-committee of Cabinet with responsibility for overseeing the Government's corporatisation and competition policy reform program. In some cases the ME&GTERC may require a scoping study to be undertaken to assess the feasibility, potential benefits and issues likely to arise as a result of corporatisation before approval is given to proceed with corporatising a GTE.

Where a corporatisation proposal is approved the ME&GTERC will oversee the implementation. Often there will be a report back Minute to the ME&GTERC or Cabinet on specific issues such as valuation and the financial impacts on Government of the particular corporatisation, as well as issues relevant to the legislation necessary for the establishment of the SOC.

2.2 Micro-Economic and GTE Reform Committee

The ME&GTERC membership comprises:

- Premier, Minister for the Arts and Minister for Ethnic Affairs (The Hon Bob Carr);
- Treasurer, Minister for Energy, Minister for State Development, Minister Assisting the Premier, Vice President of the Executive Council (The Hon Michael Egan);
- Minister for Public Works and Services, Minister for the Olympics, Minister for Roads (The Hon Michael Knight);
- Minister for Urban Affairs and Planning, Minister for Housing (The Hon Craig Knowles);
- Minister for Small Business and Regional Development, Minister for Ports, Assistant Minister for Energy, and Assistant Minister for State Development (The Hon Carl Scully).

- Reforming the structure of public monopolies to facilitate competition;
- Providing third party access to certain monopoly facilities that are essential for competition;
- Restraining monopoly pricing behaviour; and
- Fostering competitive neutrality between Government and private business when they compete.

A general explanation of each of these principles is contained in Attachment 2.

Two of these principles relate particularly to the issue of the corporatisation of GTEs. Firstly, the third of the above principles, which involves the structural separation of regulatory and commercial functions undertaken by public monopolies, accords with the first principle of corporatisation identified in paragraph 1.1. With regard to that principle the Hilmer Committee recommended that:

(i) Before competition is introduced to a sector traditionally supplied by a public monopoly any responsibilities for industry regulation should be removed from the incumbent. The location of regulatory functions should place special weight on the need to avoid conflicts of interest.

(ii) Before competition is introduced to a sector traditionally supplied by a public monopoly there should be a rigorous, open and independent study of the costs and benefits of separating any natural monopoly elements from potentially competitive activities. Where the natural monopoly element is vertically integrated with potentially competitive activities there should be a presumption in favour of separation at the ownership or control level.

(iii) Before competition is introduced to a sector traditionally supplied by a public monopoly there should be a rigorous, open and independent study of the costs and benefits of separating potentially competitive activities of the monopoly enterprise.

(iv) Where privatisation of a substantial public monopoly is proposed, there should be a rigorous, open and independent study of all related structural issues. There should be a presumption in favour of vertical separation.

These recommendations are reflected in the Competition Principles Agreement, whereby it has been agreed that before a Government introduces competition to a sector traditionally supplied by a public monopoly it will remove from that public monopoly any responsibilities for industry regulation. Further, the relevant Government will re-allocate industry regulation functions so as to prevent the former monopolist enjoying a regulatory advantage over its (existing and potential) rivals.

Similarly, the Competition Principles Agreement provides that before a Government introduces competition to a market traditionally supplied by a public monopoly, it will undertake a review into:

(i) the appropriate commercial objectives for the public monopoly;

(ii) the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;

(iii) the merits of separating potentially competitive elements of the public monopoly;

(iv) the most effective means of separating regulatory functions from commercial functions of the public monopoly;

(v) the most effective means of implementing the competitive neutrality principles set out in the Competition Principles Agreement (in which regard see further below);

(vi) the merits of any community service obligations undertaken by the public monopoly and the best means of funding and delivering any mandated community service obligations;

(vii) the price and service regulations to be applied to the industry; and

(viii) the appropriate financial relationships between the owner of the public monopoly and the public monopoly, including rate of return targets, dividends and capital structure.

Secondly, the last of the above principles, which is concerned with the fostering of competitive neutrality between Government-owned and private businesses, accords with the fifth principle of corporatisation identified in paragraph 1.1 above. With regard to that principle the Hilmer Committee recommended that:-

(i) Government-owned businesses should not enjoy any net competitive advantage by virtue of their ownership when competing with other businesses;

(ii) Government-owned businesses competing against other firms within their traditional markets should be subject to measures that effectively neutralise any net competitive advantage flowing from their ownership. Unless exceptional circumstances exist, those advantages should be neutralised as follows:

- where the Government-owned business has traditionally provided services directly to the public, there should be a presumption that competitive neutrality should be achieved through corporatisation; and

- where the Government-owned business has traditionally provided services only to other Government entities, competitive neutrality may be achieved through corporatisation or the application of effective pricing directions.

(iii) Government-owned business should not compete against other businesses outside their traditional markets without being subject to measures that effectively neutralise any net competitive advantages flowing from their ownership. Those advantages should be neutralised as follows:

- where the Government-owned business has traditionally provided services directly to the public, there should be a presumption that competitive neutrality should be achieved through corporatisation; and

- where the Government-owned business has traditionally provided services only to other government agencies, competitive neutrality may be achieved through corporatisation or the application of effective pricing directions.

These recommendations were also largely adopted in the Competition Principles Agreement, which provides in part that Governments will (where practical) adopt a corporatisation model for relevant GTEs and will impose on those businesses:

(a) full tax or tax equivalent obligations;

(b) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and

(c) social and economic regulations on an equivalent basis to their private sector counterparts.

Thus corporatisation under the Statutory SOC model accords with both the Government's policy of making GTEs more efficient and its obligations under the Competition Principles Agreement.