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Corporatization and Privatization of State-Owned Enterprises: Some Australian Perspectives

By Tony Greenwood (Melbourne), David Williamson (London), Jim Armitage (Sydney), Gary Rumble (Canberra), and Donald Magarey (Brisbane)

I. Introduction

Australia has throughout this century been a federation with three tiers of government — federal, state, and municipal. For most of the century, we have had a mixed free enterprise economy, with government ownership of major service utilities such as electricity, gas, water, post, telecommunications and all forms of transport. Often the government enterprises have had monopoly power in relation to these utilities. In addition, there has been a strong element of government ownership in the banking and insurance fields.

One of the probable political reasons for government involvement in banking and insurance has been an implied suspicion of capitalism, which has given rise to a desire to provide a "people's" alternative to institutions driven solely by profit. The government, thus, provides the competitive incentive to private sector institutions to match fees and standards of services which have been set with broad social good in mind as well as profit.

In the last decade in particular, it has been recognized in Australia by governments of all political persuasions, as in many other countries, that state ownership of an enterprise does not necessarily deliver the optimum level of service or cost effectiveness to consumers; that government enterprises involved in service delivery may benefit from reorganization along corporate lines; that government monopolies may perform better if faced with private sector competition; that optimum development of some services requires equity capitalization that can best be supplied by the market; and that hard pressed government budgets can make better use of the capital funds released by the trans-

* Partners in the Privatization Group of Blake Dawson Waldron.
fer of service-delivery entities to the private sector. Each of these factors has led to a restructuring of some of the government enterprises in Australia towards corporatization and privatization.

This change in climate has seen a range of government business enterprises (GBEs) molded into a corporate form, operating either under the general Corporations Law, or under statutes that impose similar requirements. It has witnessed the sale of fifty percent of the largest bank in Australia — the Commonwealth Bank, owned by the Federal Government — in a staged stock market float; the creation of a structure for a private sector competitive framework for Australia’s national telecommunications carrier (Telecom); and the privatization by sale and float of insurance companies owned by some Australian States. Major restructuring by way of corporatization has also occurred in the electricity industry. A fifty-one percent interest in one major power station in Victoria has been sold to a private operator. Private sector involvement is also under way in a number of other power projects.

Nevertheless, it is the process of transforming a government unit into a shareholding corporation, rather than the underlying philosophy or ideology, which holds perhaps the most comparative legal interest. We therefore wish to begin with some reflections that may be of use to those considering whether to embark on the process. We will draw from our experience in advising governments, both at the political and enterprise level, as well as private sector buyers.

II. Planning for Corporatization and Privatization

Careful planning is the key to any successful corporatization or privatization program. An effective and realistic plan is an essential prerequisite. The price of “planning on the run” can be enormously high. Many factors must be taken into account.

Corporatization and privatization are two distinct processes, each with different objectives and organizational demands. A logical sequence and process should be designed for each stage. If the ultimate goal is privatization, it is important to distinguish between corporatization tasks and privatization tasks to ensure clear accountability and direction throughout the program.

To be ready for privatization, most public sector bodies need to be reorganized and private sector compliance systems need to be installed. Ideally, these steps should be taken before the privatization process begins. Attempting all steps at once can be unmanageable.
Moreover, many facets of a privatization transaction, such as the establishment of regulatory systems and the transfer of assets and liabilities, are best undertaken while the business is still government owned.

Corporatization and privatization inevitably involve a large number of government departments and numerous stakeholders. It is vital, therefore, to develop and enforce a protocol for the process of negotiation with stakeholders. This allows realistic time-frames to be set. It also reduces the overall transaction time and cost. A critical early decision is to decide at what point or points responsibility for various decisions and actions passes from the government to the newly corporatized or privatized entity.

At some stage, a full audit (or “due diligence”) of the organization, structure, and systems of a GBE to be corporatized or privatized is necessary. Our experience suggests that the earlier this audit is performed the better. The audit should identify and value all assets and liabilities, including intangible assets such as intellectual property, contractual rights, and contingent liabilities such as possible litigation. Importantly, the audit should establish whether assets and liabilities reside in the jurisdiction or elsewhere. Business interests beyond the reach of the laws of the local jurisdiction may extend the timetable significantly.

As a related matter, continuity of leadership is needed to manage the process, be it corporatization or privatization. The early appointment or confirmation of appropriately experienced directors is important to give both continuity and accountability to the process. Similarly, the full commitment of the GBE’s senior executives is critical to its success.

III. A Miscellany of Anecdotal Experience

We have encountered a range of specific issues that should be addressed early in the planning process:

A. Contracts

Contracts which depend on the continuing status of the GBE as a government-owned entity may be fundamentally and adversely affected by the transition to a new corporate entity. Contractual arrangements which are neither binding nor at arm’s length (for example, “grace and favor” accommodation and out-sourcing arrangements commonly found between different arms of government) will need to be identified and negotiated on an arm’s length basis as
part of the corporatization process prior to privatization. For example, Victoria’s sale of an interest in the Loy Yang B. Power Station involved formalizing the arrangements between the power station and parts of the State Electricity Commission in fundamental areas such as the supply of power, the acquisition of fuel, and site services.

B. Conflict Between Government and Enterprise Goals

Almost inevitably there will be conflict, at least at the practical level, between the interests of the government as owner of a privatizing GBE (the government pursues broad social and revenue goals), and the interests, duties, and responsibilities of the GBE's directors and officers (whose loyalty is directed towards the continuance and prosperity of the entity). Directors and officers are likely to require an indemnity or other protection in the course of the privatization process.

A case in point is the reported tension between the Federal Government and the board of Qantas Airways Limited regarding the timing and method of the privatization of Qantas. Similar issues were experienced in connection with the proposed privatization of Australian Airlines prior to its acquisition by Qantas. In both cases the Government inserted provisions into the articles of association of the bodies, which were already incorporated, requiring the directors to comply fully with government directives given in connection with the sale of the government’s shares on such matters as the disclosure of confidential business information to potential buyers who also happened to be strong competitors.

C. Data Management

A large amount of information and paper is unearthed and generated during any corporatization or privatization. Sophisticated data management systems can be used to manage this information and to facilitate third party due diligence requirements. Any failure to put in place effective systems will entail significant extra resources and may lead to the assumption of greater risk by the directors.

The experience of the corporatization and subsequent privatization of the major insurance corporation owned by the government of the State of New South Wales (GIO Australia) underscores the importance of an early due diligence review and the establishment of an appropriate information technology system during the corporatization phase. The GIO Australia database indexed thousands of key source
documents. This database (prepared with the assistance of our firm) has proved to be a valuable management resource. It has been maintained by GIO Australia as a method of organizing its collection of “cornerstone” company documentation for the ongoing use of its board and management.

D. Regulatory Framework

Where a GBE has the dual roles of service provider and regulator, the regulatory framework may need to be redesigned. The continuing regulatory role, if any, of a corporatized or privatized entity should be reviewed, especially if new competitors are to be introduced. One option is to create a new regulator. Another option in a deregulated environment is to do without any regulator, leaving disputes to be resolved within the existing legal framework. The right regulatory structure is a crucial early decision for policy makers.

With the introduction of competitors to Telecom Australia, the previous Federal telecommunications monopoly, Austel was established as the primary government regulator of Australia’s telecommunications industry.1 In contrast, the option of reliance on the general legal framework was followed in New Zealand. Critics have suggested, however, that the New Zealand model can be exploited by a former monopolist prepared to use litigation as a commercial weapon.

If private-sector competitors are to be introduced into a particular industry for the first time, the regulations governing competition should be reviewed. Policy makers should decide, for example, whether the former GBE and its competitors need special powers not available to ordinary corporations.

The Telecommunications Act gave the new Australian entrant, Optus, as well as Telecom Australia, the right to construct facilities on land owned by third parties. It also required Optus to contribute to the cost of providing community service obligations.

E. Employment Structure

Employees are major stakeholders in a corporatization or privatization. Some of the employment-related problems arising when a government enterprise is sold to the private sector include the effect

1. Our Trade Practices Commission also deals with critical matters such as misleading advertising. Telecom was found by that Commission to have breached statutory standards on numerous occasions during the phase in which its chief competitor was establishing initial market share.
on existing employment contracts; accrued entitlements; special benefits; and rights of appeal and review in relation to appointment, promotion, grading, and disciplinary action. The continuing effect of affirmative action and anti-discrimination laws, which have particular application to government employment, and the processes for setting remuneration, job classification, industrial awards and determinations, and union coverage will all require resolution.

Beyond these technical issues is the reality that a different labor-relations culture commonly exists in the public sector from that in the private sector. The successful adoption of a new culture requires delicate handling and skillful management.

In the case of the corporatization of GIO Australia, an important early task was the transfer of union coverage of employees from state and federal public sector unions to the finance sector union.

A major employee-related issue is the transfer of superannuation arrangements. This can give rise to very complicated issues and industrial negotiation. The transfer of employee entitlements from public sector funds to other funds may require legislation and the favorable exercise of the discretion vested in the Insurance and Superannuation Commissioner. Moreover, until recently many public servants have been beneficiaries of retirement benefit schemes under which promised benefits, including generous pensions, have been funded by governments only as actual liabilities arise. The severance of employees from such benefits, which have often been understood as part of the trade-off for a lower remuneration structure in government services, may present an issue that can only be resolved by acceptance by the government of long term liabilities for the individuals concerned.

This problem was dealt with in the State of Victoria by special legislation which provided that State Insurance Office employees transferring to the purchaser (GIO Australia) remained members of the State Superannuation Fund for a limited period or, in the case of longstanding members, for a longer period.

**IV. Legal Implications of Corporatization**

Although commonly regarded as a mere stepping stone in preparation for privatization, corporatization also has substantial reasons for being adopted for its own sake. Apart from being an overt, or covert, preparation for privatization, the principal motive for embarking upon the corporatization of an existing statutory corporation or other government entity is said to be to increase the general efficiency
of the operation. This is to be achieved in particular by introducing a much higher degree of accountability, with emphasis on performance-oriented requirements and requiring the corporatized body to compete on an equal, or substantially equal, footing with corresponding non-government-owned enterprises. Corporatization can also provide an opportunity to remove inappropriate elements from an existing entity or operation.

A. Methodology

The most obvious way to work toward these objectives, and the one which has so far been adopted by the Federal Government and by the State of New South Wales, is to establish the corporatized body as a corporation under the ordinary legislation governing the formation of corporations. (The State of Victoria, on the other hand, has adopted a more complex staging process that will be discussed separately below.)

Incorporation as a company can be achieved in either of two ways. The first is “incorporation and vesting.” This is incorporating in the ordinary way, with appropriate government nominees as the shareholders, and then vesting the relevant enterprise, with its attendant assets and liabilities, in that company by or pursuant to special legislation. The second way is “conversion.” This entails “converting” an existing statutory corporation into a company by deeming it, by or pursuant to special legislation, to be registered under the ordinary companies’ legislation when specified requirements have been satisfied, including the lodging of appropriate memoranda, articles of association, and the allotment of share capital to the relevant government or its nominees.

New South Wales has opted for the incorporation and vesting method, as evidenced by the State Owned Corporations Act of 1989 and the consequent Corporatisation Acts of the State Bank and the Grain Handling Authority; whereas the Commonwealth has in the cases of Australian Airlines, OTC (a telecommunications company), ANL (a national shipping line), and the Snowy Mountains Engineering Corporation, adopted the conversion method.

The conversion method is simpler, more direct, and has the major advantage that it does not involve the introduction of a new legal entity.

The incorporation and vesting method, on the other hand, may have the advantage of flexibility. It could be more appropriate, for
example, where there is difficulty in identifying the assets and liabilities of the existing entity, where the existing entity or operation is accustomed to using assets or facilities which do not belong to it, or where it is not intended that the whole of the existing enterprise or the whole of its assets be transferred to the new entity. It is also more appropriate where it is desired to divide up the existing enterprise into two or more parts, each of which can either be corporatized separately or omitted from the corporatization exercise.

B. Incorporation and Vesting — Extra-Territorial Operation

Apart from being more cumbrous, the major problem with the incorporation and vesting method is that the transfer of assets and liabilities, by force of a statute or of some action provided for in the statute, and the substitution of the new entity for the previous one in all existing legal relationships, may be effective only in the jurisdiction where that statute can apply. If the existing entity has activities outside that jurisdiction, the enabling statute alone may not be sufficient to complete the transfer of the enterprise to the new entity.

This difficulty appears to be recognized in the Australian Industry Development Corporation Amendment Act 1988 (strictly a case of direct provision for disposal and privatization, rather than for corporatization) which contains a provision for extra-territorial operation “to the greatest extent possible,” and for the existing entity to “take such steps as are necessary to ensure that [the legislation] is fully effective, particularly in relation to its operation outside Australia.” That last mentioned obligation requires the existing entity to take whatever action might be necessary in another jurisdiction, where the Australian Act does not operate, to effect the transfer to the new entity of assets situated in that other jurisdiction. Of course, action by the existing entity may not in some cases be effective by itself to achieve the transfer of an asset. For example, the transfer might require the consent of a third party in which case the achievement of the full transfer of the assets to the new entity could be frustrated.

A more formidable problem arises where the existing entity has liabilities to parties in a jurisdiction where the enabling legislation — despite its proclaimed extra-territoriality — is simply not effective. The parties to whom those liabilities are owed, or with whom contracts exist, may not be prepared to accept the substitution; and if the Australian legislation purports to dissolve the existing entity
its responsibilities in other jurisdictions being effectively transferred to the new entity, serious complexities can result.

The New South Wales Investment Corporation (Sale) Act of 1988 contains provisions as to the vesting of assets and liabilities and the substitution of the new entity as required, but does not either attempt to claim extra-territorial operation or oblige the transferring authority to take such steps as are necessary to ensure that the vesting provisions of the Act are fully effective. The New South Wales State Owned Corporations Act similarly ignores the problems with respect to assets, liabilities, and arrangements outside New South Wales.

This particular problem does not arise where the conversion method of corporatization mentioned above is employed, that is, where the entity conducting the enterprise does not change, but merely has its status changed to that of an incorporated company. Nevertheless, even in such a case a corresponding problem arises if it is intended that some part of the assets or liabilities or other commitments should not be retained by the corporatized entity, but should be transferred to some other entity nominated by the relevant government. In that case there would be the same difficulties as mentioned earlier regarding the effectiveness of the relevant legislation in other jurisdictions where assets and liabilities are situated.

C. Conversion — Asset Title

The conversion method of corporatization has its own problem. In each particular case it needs to be determined whether the assets which the entity to be corporatized holds at the time of its translation into an ordinary company are in fact beneficially owned by it and not merely held on behalf of the state or some other entity owned or controlled by the government.

This is not just a matter of identification of the relevant assets. Even if the entity concerned is fully constituted as a statutory corporation with the power and authority to acquire, hold, and dispose of assets, it does not necessarily follow that the assets held by it belong to it in the ordinary way. Further statutory or other legal action might be necessary to achieve that result either at the stage when corporatization is effected or at the later stage of privatization.

In some cases, all of the assets are in fact beneficially owned by the relevant entity. However, this conclusion cannot flow merely from the fact that under its constituting statute the existing entity has a stated amount of capital which, under the statute converting it to a
company, is to be converted into shares allotted to the relevant government or its nominees in satisfaction of the obligation under the constituting statute to repay that capital as and when required. It would appear, at least in some circumstances, that the beneficial ownership of the relevant assets by the corporatized body may be limited to the amount of the capital which was converted into shares, and may not extend to the assets insofar as their value exceeds that amount unless this result is expressly provided for by legislation.

D. The New South Wales and Federal Approaches

Because of the method adopted by the Federal Government to convert existing entities into ordinary corporations under the General Corporations Law, each case has been dealt with by legislation amending or replacing the statute under which the relevant body was constituted. The arrangements made for OTC (overseas telecommunications), ANL (shipping), Snowy Mountains Engineering Corporation, and Australian Airlines were substantially the same.

In contrast, the New South Wales State Owned Corporations Act provides an umbrella structure for the corporatization of any New South Wales authority or enterprise, but the creation of any particular state-owned corporation can only be affected by a special statute which inserts the corporation's name in the First Schedule to the State Owned Corporations Act. That special statute can also make any other provision, whether in addition to, or in variation or exclusion of, the provisions of the State Owned Corporations Act in relation to the establishment of the relevant body as a state-owned corporation.

The State Owned Corporations Act authorizes the making of regulations providing for the transfer of assets and liabilities to a state-owned corporation and for the substitution of the state-owned corporation for the state in contracts and other existing legal proceedings. For the corporatization of the State Bank of New South Wales and the Grain Handling Authority, provision for the transfer of assets and liabilities and other associated arrangements have been made by special statutes designating State Bank of New South Wales Limited and NSW Grain Corporation Limited as state-owned corporations. In each case, it is provided that the transfers and other arrangements will take effect by authority of the relevant statute. The trigger will be an order by the relevant minister which will detail that which is to be transferred, the consideration for the transfer, and the value or amount of assets and liabilities.
The point made earlier about the extra-territorial difficulties under the incorporation and vesting method of corporatization is more significant in the case of a State entity than in the case of a national entity, because it applies to assets, liabilities, and other arrangements outside the State concerned, and not merely to those outside Australia.

In the case of federal bodies, the only stipulation with regard to ownership of the corporatized body is that the shares created from the original capital must be issued to the Commonwealth (i.e., to Australia as a political entity) or to nominees of the Commonwealth. It is not entirely clear whether the expression “nominees of the Commonwealth” means merely persons nominated by the federal government, or whether it also implies that the shares will be held by such persons as trustees for the Commonwealth. Assuming that the term “nominees” has the implication that the shares are to be held in trust, which is the way the government sees the matter, there is no stipulation in any of the relevant Federal statutes that the memorandum and articles of association of the relevant bodies must require the shares to continue to be so held until a departure from that requirement is authorized by a statute. In contrast, the New South Wales State Owned Corporations Act does contain such a stipulation.

The New South Wales State Owned Corporations Act makes a number of other stipulations concerning the contents of the memorandum and articles of association, not only of the corporatized body, but also of any subsidiaries which it may have or acquire. None of the relevant federal statutes make any such stipulations, specifying only that the body being corporatized must lodge “a proposed memorandum, and proposed articles” with the Australian Securities Commission, which administers the Corporations Law.

The various Commonwealth statutes affecting conversions to incorporated companies generally make no provisions regarding government guarantees. However, an exception was made in the case of Australian Airlines. Provision was made for a Commonwealth guarantee to apply in respect to any liabilities which were already guaranteed by the Commonwealth, but which were redistributed to different members of the group. On the other hand, while the State Owned Corporations Act expressly provides that the obligations of a state-owned corporation or any of its subsidiaries are not guaranteed by the State of New South Wales, the Act qualifies this by adding: “except to the extent that the Board of the Corporation and voting shareholders agree in writing.” Of the two examples of corporatization under that
Act which have been considered, the State Bank (Corporatization) Act provides for a general guarantee of the obligations of the corporatized body to continue "until a day to be appointed by the Governor by a proclamation." The Grain Handling Authority (Corporatization) Act made no reference to any such guarantee.

V. Corporatization — The Victorian Legislation

The processes established by the Victorian State Owned Enterprises Act of 1992 are worth reviewing in more detail since the Act is the most recent Australian legislative treatment of corporatization and appears to have drawn on the earlier experience of both federal and state jurisdictions.

The Victorian Act is considerably more flexible than the corporatization legislation in other jurisdictions. It provides choices from amongst three models of corporate form: (1) a specially created statutory corporation known as a State Body; (2) a statutory corporation established under its own Act; and (3) a company incorporated under the Corporations Law known as a State Owned Company (SOC). Either of the first two may be corporatized and known as a State Business Corporation.

There are also two possible processes of corporatization: (1) conversion, and (2) incorporation and vesting. These two processes may be used in combination.

There are also various methods of "unbundling" existing government business enterprises. An overview of the choices and the relative characteristics of the entities regulated by the Act are set out in Diagram 1.

Phased implementation of corporatization is made possible by the ability to convert through more than one process to more than one model. It is also possible to temporarily designate an enterprise a "reorganizing body" for the purposes of its commercialization or unbundling while under Government control.

A. Entities Regulated by the Act

The Act regulates statutory corporations and companies which are brought within its operation by a Reorganizing Body, a State Body, a State Business Corporation (SBC), or a State Owned Corporation (SOC).
1. **Reorganizing Body**

An existing statutory corporation may be designated a Reorganizing Body under the Act. It is an intermediate step to an SBC or SOC, permitting commercialization or unbundling in preparation for corporatization. It may be unbundled by the transfer of assets to subsidiaries, other entities, or the state. A Reorganizing Body ceases to be designated as such upon a further declaration, most likely when being converted to an SBC or SOC.

2. **State Body**

This is a new form of statutory corporation which may be established pursuant to the Act. It has a flexible form, determined by the Governor in Council (i.e., Executive Government), including the possibility of a share capital. It also has the ability to be a subsidiary of another statutory corporation whether or not it has a share capital. It is principally intended to be a repository of functions of a reorganizing body which is being unbundled and may remain as a statutory corporation or be converted to an SBC or SOC. Its flexible form enables it to be established according to commercialization and corporatization principles at the outset, or to take a more traditional form for the performance of regulatory functions. A State Body may have subsidiaries. These can be other State Bodies, SOCs, or ordinary companies.

3. **State Business Corporation (SBC)**

An SBC is an existing statutory corporation, or State Body, which, by designation under the Act, comes to owe its structure, organization, procedures, and certain other features of newly corporatized status to the Act. It is an end in itself, being a corporatized entity, but may be converted into an SOC. It generally has a fixed form of constitution, board, objectives, powers, corporate planning, reporting processes, dividend mechanism, tax equivalent and other features of a corporatized body. An SBC may have subsidiaries (State Bodies, SOCs, or ordinary companies). In contrast with an SOC, an SBC is wholly regulated by Victorian legislation — by this act and potentially other acts — with, in theory, greater scope for Ministerial involvement, despite corporatized “arm’s length” status.

4. **State Owned Company (SOC)**

An SOC is a company incorporated, or deemed to be incorporated, under the Corporations Law. It can be created by conversion
**Diagram 1**  
**Characteristics of Entities Regulated by the Act**

<table>
<thead>
<tr>
<th>Type of Entity</th>
<th>Transitional Step</th>
<th>Final Status</th>
<th>Reach By Conversion</th>
<th>Newly Established</th>
<th>Fully &quot;Corporalized&quot; Characteristics</th>
<th>Possible Subsidiaries</th>
<th>Directly Saleable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reorganizing Body</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>[State Body, SOC, Company]</td>
<td>Subsidiary may be sold</td>
<td></td>
</tr>
<tr>
<td>State Body</td>
<td>✓</td>
<td>Possibly</td>
<td>✓</td>
<td>[State Body, SOC, Company]</td>
<td>Subsidiary may be sold</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SBC</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>[State Body, SOC, Company]</td>
<td>Subsidiary may be sold</td>
<td></td>
</tr>
<tr>
<td>SOC</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>[SOC, Company]</td>
<td>SOC itself, or subsidiary, may be sold</td>
<td></td>
</tr>
</tbody>
</table>

from a traditional statutory corporation, State Body, or SBC; or it can be established under the Act or, in the case of a pre-existing company, brought within the scope of the Act. Arrangements may be made to vest public sector assets and liabilities in an SOC, whether it be converted from an existing GBE or a new "shell." An SOC has most of the features of a non-government-owned company and is subject to company law. However, within the flexibility permitted by that law, some aspects of its affairs are regulated by the Act, and other matters may be controlled by the government as shareholder through its articles of association. It may have a subsidiary company which is not itself an SOC by definition, but is subject to similar requirements under the Act. This is a form which can be wholly privatized by the sale of shares in the company rather than particular assets.
B. Creation of Corporatized Entities

The four types of entities regulated by the Act acquire their status by different routes. State Bodies are created by the exercise of powers conferred by the Act. SOCs are either created afresh by incorporation under the Corporations Law, or are created by conversion under the Act from any of the other types of entities. Diagram 2 summarizes these possibilities and the scope for "change of status."

Diagram 2
Enterprise Transformation

A State Body may be designated a Reorganizing Body. However, as a practical matter that option would not be pursued since it would not advance the extent of corporatization. In fact, the Governor in Council's powers over a State Body far exceed the powers over a Reorganizing Body.

C. Possible Unbundling of Reorganizing Bodies

Designation of a statutory corporation as a Reorganizing Body empowers the Governor in Council to direct the creation of subsidiaries and the unbundling of responsibilities and activities of the Reorganizing Body into new or existing subsidiaries or other parts of the
public sector. Diagram 3 summarizes the options available to the Government.

Diagram 3
Enterprise Assets Reorganization

Broadly speaking, there are the following seven unbundling options to which an asset of a Reorganizing Body may be transferred: (1) a wholly owned subsidiary company; (2) a wholly owned subsidiary State Body; (3) a State Body not controlled by the Reorganizing Body, but controlled by the state, a traditional statutory corporation, an SBC or its subsidiary, or another State Body; (4) a wholly owned
subsidiary SOC; (5) an SOC not controlled by the Reorganizing Body, but controlled by the state, a traditional statutory corporation, an SBC or its subsidiary, or a State Body; (6) a traditional statutory corporation, SBC, or a subsidiary of an SBC; or (7) the state.

D. Possible Unbundling of an SBC or SOC

Once a reorganizing body has become an SBC or SOC, or where assets and activities reside in an SBC or SOC, unbundling is still possible but not at the immediate direction of the government. Examples of such unbundling are the transfer of assets and activities into a subsidiary or the sale of assets, including the sale of shares in a subsidiary.

In the case of an SBC, the government would effect the unbundling through the corporate plan process, in which the relevant minister and treasurer (in consultation with the board or ultimately by direction) may cause the adoption of a business plan to effect unbundling, restructuring, or divestiture of assets.

Unbundling of an SOC would require action by the board of the SOC, as for any company. Such action may, of course, be suggested by the government, and it is subject to the government's controls in the articles of association with some requirements of shareholder approval for matters relating to ownership of subsidiaries and sale or disposal of main undertakings.

E. Assimilation to Federal Law

An objective of the Act is to establish SOEs as fully "corporatized" entities. On that basis, a tax equivalent provision provides that the treasurer may direct the payment to the Consolidated Fund of an amount equivalent to the federal taxes an enterprise would pay if it were subject to federal tax. The Act provides for the appointment of a tax assessor, and it is expected that further machinery provisions will be set out in regulations under the Act.

Since corporatization may take an enterprise outside the protection of the shield of the Crown, a provision is included for giving temporary relief from the application of the restrictive trade practices provisions of the Trade Practices Act. The relief is intended to be for an interim period while the enterprise prepares for compliance.

VI. State (Crown) Immunity

The special immunity of the Crown must be reviewed as part of the corporatization process.
The Crown, including ministers and many statutory bodies, can be subject to statutory law. In each case, however, it is a matter of ascertaining the legislature's intent, taking into account the presumption that the Crown is not bound except by express words or by necessary implication. The presumption of Crown immunity from statute is not subject to an exception with respect to commercial activities of the Crown. In a very recent decision, however, the High Court has questioned the appropriateness of the presumption in the context of commercial activities.

A Crown servant is subject to the law, and merely acting in the course of his employment will not entitle the servant to the Crown's immunity. He is entitled to immunity only if it can be established that compliance with a statute would prejudice the Crown. The Crown is, however, subject to the common law.

In the context of Australia's Corporations Law, the Crown is expressly bound only by the provisions governing arrangements and reconstructions; and the provisions which may be broadly categorized as "external administration," such as receivership and winding up.

From the government's point of view, the shield of the Crown doctrine has the following advantages with respect to its ownership and control of shares in a privatized corporation: if the privatized corporation is listed, the government, as a substantial shareholder owning five percent or more, is not required to disclose its entitlement and changes in its entitlement to shares in the company, as required by the substantial shareholding provision of the Act; the Government, as a shareholder, can acquire shares in the privatized corporation without complying with the takeover provisions; and the government, as a shareholder, is not exposed to some of the remedies available to disgruntled minority shareholders who consider, and can satisfy a court, that the affairs of the company are being conducted in a manner that is oppressive, unfairly prejudicial, or unfairly discriminatory with respect to a member or members, or in a manner that is contrary to the interests of the members as a whole.

As noted above, since the crown is expressly bound by the winding up provisions in the companies' legislation, the government, as a shareholder, is subject to the right of a minority shareholder to seek an order that the company be wound up on the "just and equitable"
ground (i.e., on the basis that the affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or members, or in a manner that is contrary to the interests of the members as a whole). Furthermore, the government is liable to contribute to a winding up to the extent of any unpaid calls on any partly paid shares held by the government in the company.

The “shield of the Crown” rules are unlikely to apply to the corporation itself once privatized through the introduction of non-government equity, unless special legislation expressly makes the corporation an “agent of the Crown” or it can be established that it operates under a very high degree of ministerial control. Unless ministerial control is total, a court is unlikely to find the privatized corporation to be a Crown Agent.

Similarly, the Corporations Law is applicable to non-government owners and controllers of shares in the privatized corporation.

The question of state immunity from the application of statutes is one of some difficulty, and the difficulty of determining whether it applies in a particular case appears to have been increased rather than reduced by the Australian High Court in its most recent ruling. The flexible approach enunciated by the High Court appears to aggravate the uncertainty not only as to whether a particular statute applies generally to a particular body representing the state, but also as to whether, if the body itself is immune from that statute, it may nevertheless apply to certain actions of persons acting on behalf of that body.

When corporatized bodies are still wholly-owned and controlled by the relevant government, a way of avoiding the problem of determining whether or not state immunity applies is for the corporatizing statute to specify clearly that the corporatized body will not be a manifestation of the state or otherwise represent it. This has been done in each of the statutes relating to the conversion into companies of Australian Airlines, OTC, ANL, and Snowy Mountains Engineering Corporation, but with the qualification “except so far as express provision is made by a law or the Commonwealth, State or Territory, as the case may be, or the Regulations otherwise provide.”

The New South Wales State Owned Corporations Act contains a similar provision with a corresponding qualification, but the principal stipulation that an SOC “is not and does not represent the State” is further qualified by the words “except by express agreement with the voting shareholders of the corporation.” The implications of the last
mentioned qualification are uncertain. It is difficult to come to terms with the concept that the government and the relevant corporation can determine by agreement that the corporation will acquire immunity from those statutes which do not bind the Crown, if that is in fact what the qualification purports to mean.

VII. Legislative Power

In a federal system such as Australia's, the issue of legislative power must be kept in mind in preparing a statutory approach.

It is obvious that constitutional questions can arise in corporatization legislation as to the competence of the relevant legislature. However, if the existing legislation constituting the body now to be corporatized and authorizing its activities is within the powers conferred on the Federal Parliament, then the legislation translating that body into an incorporated company should also be within those powers. This assumption is founded on the proposition that the body could have been established pursuant to federal legislation as an incorporated company in the first instance. Therefore, legislation merely changing the body's status, but not its authorized activities, must still relate to the same head or heads of federal legislative power on which the original legislation was based.

None of the Commonwealth statutes relating to the conversion of Australian Airlines, OTC, ANL, and Snowy Mountains Engineering Corporation to companies stipulates that the authorized activities of those companies are to be confined in any way by their memoranda or articles of association. Accordingly, the full range of powers available under the Corporations Law can be conferred on them if their memoranda and articles do not in fact restrict them. That is to say, such legislation can be regarded as legislation authorizing the establishment of a body capable of carrying on activities which might have no relationship at all to the activities which that body had originally been constituted to conduct, and on which the connection with the relevant head or heads of Federal legislative power had depended. If this is so, it might be doubted whether the legislation to effect the translation of the body into an incorporated company with unrestricted powers is within the powers of the Federal Parliament unless some head or heads of power, other than those relied on for the original establishment of the body, can be invoked. Since federal legislation powers do not extend to the incorporation of corporations, the government's act of establishing a corporation by incorporation under the Corporations
Law must be undertaken for some other valid legislative purpose. On the other hand, once the certificate of incorporation has issued, the corporation so created would seem to have the full range of ordinary corporate powers held by any corporation, and it is unlikely that an attack on corporate activity itself as being unconstitutional would be successful.

VIII. Financial Issues

Any corporatization or privatization will in many cases require a renegotiation of existing financing arrangements of the public enterprise in question. The following legislative, quasi-legislative, and administrative matters will need to be addressed:

A. Methodology

The enterprise’s obligations under its existing financing arrangements will be a major part of the overall liabilities of the enterprise. Any legislation to corporatize or privatize an enterprise will generally require fewer amendments to the existing financing documentation, and fewer consents from the relevant lenders, if it retains the same legal entity for the enterprise and simply changes its status into a company subject to the Corporations Law, rather than creating a new legal entity to which the assets and liabilities of the public enterprise need to be transferred.

B. Capital Adequacy Guidelines

The Reserve Bank of Australia (RBA) has issued guidelines which impose capital adequacy requirements on all Australian Banks. These are broadly in line with the corresponding requirements introduced by the Bank for International Settlements. Under the RBA guidelines, a bank’s loan assets are rated according to the risk weighting attaching to the particular borrower.

A weighting of ten percent applies to most claims on federal or state governments. Claims on Australian local governments and non-corporate public sector entities carry a twenty percent weighting. Importantly, however, public sector trading enterprises which have corporate status or are required to operate on a commercial basis carry a hundred percent weighting.

Accordingly, an enterprise which is currently subject to the twenty percent risk weighting is likely, upon corporatization, to move into the hundred percent category. This will impose an extra cost on
the banks which lend to the enterprise, and in most cases the banks will be entitled to be reimbursed by the enterprise for that increase in cost under the terms of the loan documentation.

C. Borrowing Levy Act

Under this legislation, many Federal Government enterprises are liable to pay to the Federal Government a levy, not exceeding 0.5 percent per annum, on their borrowings. It is understood that the rationale for this is that the federal ownership of these enterprises carries an implicit government guarantee, if not an express one, and that the enterprises have therefore been able to raise funds at a lower cost than would be the case in the absence of federal ownership. The levy is intended as a fee to the Federal Government for providing the source of this benefit.

If an enterprise which is currently subject to the levy is privatized, it would be appropriate for the Act to be amended to remove the imposition of the levy on that enterprise. Where an enterprise is only partially privatized, the question becomes less clear. Logically, at least some reduction in the rate of levy applicable to that enterprise would seem appropriate.

D. Loan Council Global Limits

The Loan Council represents the federal and state governments as a mechanism to regulate the overall level of Australian sovereign debt.

Under the “Global Limit” approach adopted by the Loan Council in 1984, borrowing and other methods of financing by federal and state governments and their respective government enterprises have been subject to Global Limits determined by the Loan Council.

The corporatization of a government enterprise will not be enough to remove it from the scope of the Global Limits. However, where the enterprise is wholly privatized, it seems clear that the Global Limits will cease to apply to it.

The position is less clear with a partial privatization. The Federal Treasury has indicated that in determining whether there is sufficient private involvement in a project or enterprise to take it outside the scope of the Global Limits, the primary consideration will be the level of government control over the project or enterprise. This suggests that if a government retains a shareholding of more than fifty percent in an enterprise, the Global Limits would continue to apply to it. A
minority government shareholding, however, should not be sufficient to prevent the enterprise from falling outside the scope of the Global Limits, unless there is some supervening measure of control which the government retains over the enterprise.

In cases of doubt, it is appropriate to seek a ruling from the Loan Council, because any uncertainty in the minds of financiers will likely operate to the detriment of the enterprise.

E. Dealings with Financiers

Perhaps more important to an enterprise than the legislative and administrative matters just mentioned, in terms of the potential impact on the enterprise's borrowing costs, is the enterprise's dealings with its existing financiers and, if applicable, the rating agencies.

Little may be required in this area in the case of a corporatization if the enterprise continues as the same legal entity with simply the adoption of a corporate form. Communication with the enterprise's financiers is, of course, essential to assure them that the enterprise's financial obligations remained unaffected. In many cases the financiers will want to see a legal opinion to this effect.

In the case of a privatization, however, other considerations apply. The enterprise's existing financiers can be expected to be very interested in the extent of the privatization, the structure of the privatization, and the indemnity of any future controlling or significant shareholders. If the enterprise has debt which has been rated by one of the rating agencies, they too will take a very close interest in these matters.

Particular features of the financing arrangements, to which the financiers and rating agencies can be expected to pay close scrutiny, include change of ownership, financial covenants, and negative pledges.

1. Change of Ownership Clauses

Where an enterprise has raised money with an explicit government guarantee, the continued existence and enforceability of that guarantee will invariably be a condition of the financing. If the guarantee is removed, which typically constitutes a default, cross-default clauses in the enterprise's other financing arrangements will be triggered.

Where the enterprise has not had an explicit government guarantee, its existing financing commonly includes a so-called "change of
ownership" clause. These clauses come in a variety of forms. A typical clause is triggered by a reduction of the relevant federal or state shareholding in the enterprise below a specified level. It is common for a reduction in government shareholding to fifty percent or less to be sufficient to trigger the clause.

The effect of triggering such a clause varies depending on the terms of the financing arrangements. In some cases it constitutes a default — again possibly triggering cross-default clauses in other facilities. In other cases it will entitle the financier to require the provision of security to its satisfaction. In other cases again, it will merely trigger, in the first instance, a renegotiation of the terms of the financing.

In almost all cases, however, if the clause is triggered and the enterprise does not agree to any new requirements of the financiers, the financiers are entitled to withdraw their facilities and require repayment of any outstanding debts.

Discussions with an enterprise’s existing financiers are an extremely sensitive and important aspect of any privatization. Properly handled, the existing financing arrangements can be expected to remain in place with minimal additional borrowing cost to the enterprise. If improperly handled, the viability of the entire privatization can be thrown into jeopardy.

2. Financial Covenants

In the absence of government ownership, an enterprise can expect that its financiers will want to impose certain financial disciplines on the enterprise, consistent with their approach to other private-sector corporate borrowers. Typical financial covenants include ratio requirements for working capital, net tangible assets, and interest cover. Agreeing on definitions of these terms, especially any specific inclusions and exclusions, can be a time-consuming process in the loan renegotiations.

After privatization, enterprises can expect much less leniency from financiers when negotiating events of default. The scope of any cross-default clause, the number of days of grace applicable to payment and other defaults, and the inclusion of a general event of default covering a material adverse change in the enterprise’s financial condition, are areas where government-owned borrowers have enjoyed terms which are much less stringent than those typically applicable to private-sector corporate borrowers.
3. Security or Negative Pledge

Where an enterprise has previously borrowed on an unsecured basis, financiers will often seek the provision of security following a privatization. The enterprise will need to decide whether it has any assets which are possible or appropriate to offer as security, and what the appropriate arrangements might be to preserve the intended relativity between the enterprise's various financiers. The conferring of security over existing assets may well have substantial duty implications, depending on the location of the assets in question.

If facilities are to remain unsecured, the financiers can be expected to require significantly more stringent forms of negative pledge than they have from some government-owned enterprises in the past. The negotiation of negative-pledge clauses will assume an increased importance, and the enterprise should ensure that it retains sufficient flexibility, by way of exceptions to its negative-pledge clause, to undertake the types of project financing that it might wish to enter into in the future.

The negotiation of appropriate terms with an enterprise's existing financiers can be expected to take some time. This is particularly true for those enterprises which have numerous and diverse existing financing arrangements. It is more important to get the arrangements right than to have them concluded quickly. If they are concluded quickly at the expense of getting them right, the enterprise will usually give away more than it needs to, which in turn will make the enterprise less attractive to private-sector owners.

Financiers easily become nervous. It takes a careful program of nurturing the financiers through the privatization process to achieve the key objectives of maximizing the value of the enterprise and avoiding the damaging consequences which might result from any precipitous action which the banks might take under the terms of the existing financing documents.

In many cases, an interim solution will need to be found if the privatization is to proceed quickly. One such solution may be the provision of an explicit government guarantee for a transitional period following privatization to allow the loan renegotiations to take place in an orderly fashion. This will be one of the options to be weighed in reaching an appropriate balance between the competing desires of concluding the privatization quickly, minimizing any resultant damage, and maximizing the price achieved.
IX. Conclusion

Legal practitioners in the private sector are always presented with a range of new and interesting legal issues when given the opportunity to give advice on the transfer of a government enterprise into the capital marketplace. The Australian experience has shown, however, that some of the legal issues are sufficiently generic to be addressed by legislation dealing with general principles.