LEGAL ISSUES OF CORPORATISATION AND PRIVATISATION

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1. INTRODUCTION

Corporatisation and privatisation has spread worldwide dramatically since the UK Government commenced to sell public assets in 1979. Asian countries including Malaysia, Japan, Singapore, the Philippines and also Pakistan have embarked on ambitious privatisation programmes. Divestment of State assets is also occurring on a major scale in the former communist States of central and eastern Europe. Extensive privatisation projects are also being implemented in Central and South America.

This same trend is apparent in Australia, with virtually all Governments and Oppositions supporting at least corporatisation, and often privatisation, as valuable ideas which can assist the achievement of microeconomic reform. While privatisation and corporatisation are still in their relative infancy in Australia, and despite pockets of political resistance to privatisation, there is little doubt that both are destined to play a large part in the future development of business in Australia.

The range and complexity of legal issues arising from a privatisation or corporatisation are enormous. At the outset, the fundamental legal document necessary to transfer the Government Business Enterprise ("GBE") into a State Owned Enterprise ("SOE") or a privatised entity, needs to be prepared. The deeds negotiated to date in Commonwealth corporatisations are fascinating legal documents which intermingle elements of a commercial acquisition document and a government deed of transfer. They have encapsulated many areas of law, including contract law, insurance law, companies law, general business law, and the law in foreign countries with which the SOE has business relationships.

A vital matter which should be analysed before the actual restructuring is industrial relations. Management of the transition of a GBE with its particular work-place culture to a privately owned enterprise raises questions of award and union coverage, continuity of employment and the desirability of employee share schemes.

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Trade practices law is also an important aspect, bearing in mind the principal object of competition in both corporatisation and privatisation.

Other regulatory legislation includes taxing and rating, health and safety and foreign investment legislation. Issues of insurance, financing, pricing and community service obligations must also be examined.

This article addresses some of the more strictly legal issues which are the basis of the myriad of practical considerations in any privatisation or corporatisation exercise - some of which are mentioned above. This is a fascinating exercise, in light of the proposed reforms of the *Corporations Law* and competition law in its applicability to state business enterprises, not to mention the major industrial relations reforms currently being mooted by the Federal Government using its external affairs power, and its effect on the reforms being undertaken by the Kennett Government.

2. FUNDAMENTAL CONCEPTS AND TERMINOLOGY

It is necessary at this point to outline the basic ideas of commercialisation, corporatisation and privatisation, and certain terminology to ensure a common understanding of these concepts.

The term Government Business Enterprise applies to public instrumentalities at the Federal and State level. Such entities are sometimes called Government Trading Enterprises (GTEs). Where a public instrumentality has been corporatised it is referred to as a State Owned Enterprise (SOE). The most relevant fundamental concepts are:-

2. 1 Commercialisation

Commercialisation is a directive by the Government to a part of the public service or a statutory authority (i.e. an authority formed by legislation, as distinct from being formed by incorporation under the *Corporations Law*) to conduct its operations on a commercial basis as far as possible.

The directive essentially is to compete in the market place and to operate on a profitable basis. This may involve being able to acquire the services and goods it needs from any source (including a non-Government source), and to sell its services at market prices whether to the public, or to other parts of the Government.

2.2 Corporatisation

The term corporatisation is defined widely. In a legal sense, corporatisation means the creation of a limited liability company incorporated under the *Corporations Law*, and the transfer of the business conducted by the Government (perhaps already commercialised) to that company. Alternatively a GBE can be incorporated by its own special legislation. The ownership and control of

the company remains with the Federal Government or relevant State Government.

The assets and liabilities are owned and borne by the company and the company makes the profits or incurs the losses, but the Government indirectly controls the company by virtue of its share ownership. Examples of corporatisation include ASTA, Australian Defence Industries Ltd, and Australian Airlines Limited. Corporatisation of Australia's energy industry will most likely be a major focus of Government in the 1990's.

2.3 Privatisation

Privatisation can take a number of forms. Partial privatisation occurs when a percentage share of the GBE or SOE is sold to a private investor, which may be a local or a foreign investor. If it is a SOE which is being sold, the shares in that company are partially sold to the private sector. The Government retains some interest in the SOE, sometimes a controlling interest. This is achieved by, for example, the Government retaining a golden share as occurred in the UK in several privatisations, or by the Government selling only 49% of the shares in a SOE.

Full privatisation may occur either immediately (for example, as proposed with Qantas), or may be a further step after partial privatisation.

Further, there are various hybrid forms of private sector involvement. These quasi-equity alternatives include maintaining the original enterprise in Government hands, and floating off parts through issues of securities in subsidiaries, the use of joint ventures, and capital raising through preference share or convertible note issues.

3. SELECTED LEGAL CONSIDERATIONS

3.1 Models of Corporatisation

With privatisation the Government is seeking to turn a GBE into a commercial enterprise operating in the market place in a similar way to private sector corporations. For this aim to be achieved, it is important that there be as little as possible to distinguish the privatised enterprise from its competitors.

However, if the Government decides not to corporatise under the *Corporations Law*, there are a number of ways corporatisation can be handled legislatively. New South Wales was the first State to adopt special legislation to provide a structured basis for corporatisation of SOEs. Other jurisdictions to adopt a similar approach are Victoria and the Australian Capital Territory. Western Australia and Queensland are currently considering which corporatisation model they should adopt.

Summary of Legislative Approaches

The following sections summarise various legislative approaches to corporatisation:

Umbrella Legislation

Umbrella legislation may be enacted in order to provide a general framework and consistent approach to important issues affecting all SOEs. Such issues of particular importance for Government include Federal-State relationships, approaches to financial planning, industrial relations arrangements and management structure. This approach has been adopted in the *State Owned Corporations Act 1989* (NSW), the *Territory Owned Corporations Act 1990* (ACT), the *State Owned Enterprises Act 1986* (NZ), and the *State Owned Enterprises Act 1992* (Vic.) (assented to on 26 November, 1992). An umbrella Act sets out the framework determining the broad objectives and principles of corporatised enterprises. Much of the business activity of SOEs regulated under such an umbrella is subject to, and shaped by, the same requirements of corporate regulation as their competitors.

For instance, under the *State Owned Corporations Act 1989* (NSW) SOEs are corporations under the *Corporations Law*, and subject to all of the requirements there enacted, and able to utilise all of the privileges under that legislation.

Individual Legislation

Individual legislation could endeavour to comprehensively address all issues of corporatisation arising with respect to each SOE. Such legislation could take account of the unique issues arising with regard to each enterprise. However, where individuality is the preferred option, consistency of approach and possibilities for comparative measurement of efficiency and productivity may also be lost.

Individual legislation could be enacted either by comprehensive amendments to existing legislation, or by the creation of a new governing Act for the SOE.

A corporation created by special statute can be the subject of amending legislation if there is a change in the political persuasion of the Government of the day, but a corporation owned by the Government but incorporated under the *Corporations Law* is a far more difficult enterprise to single out for special legislative treatment in the future.

Development of General Principles for Inclusion in Each Individual Legislative Package

This approach envisages the development of general principles for inclusion in each individual legislative package, while allowing gains in consistency. It is unlikely to achieve the uniformity in approach that a piece of umbrella legislation would provide.

Federal Government

The Federal Government has taken a somewhat different approach to the States, relying on Executive powers to form corporations and have them take over Government businesses, passing short enterprise-specific legislation where necessary. The Federal Government has taken the attitude that a corporation formed as a result of its corporatisation programme should operate as nearly as possible as a normal corporation, and that this means special legislation singling out the corporation should be kept to an absolute minimum.

In some instances corporatisation has proceeded without any legislation, with the Government relying on normal commercial mechanisms in the Memorandum and Articles of Association to achieve desired shareholder control aims. It has only been in cases where legislation is required to achieve special requirements that legislation has been passed. The *Australian Airlines (Conversion to a Public Company) Act 1988* (Cwlth) is an example of this approach.

Formation of Australian Defence Industries Ltd, to take over the defence production factories of the Department of Defence, was achieved with virtually no legislative intervention. The only legislation passed in relation to that company was to preserve the Capital Gains Tax position, exempt the company from stamp duties, and provide a period of time for the company to have the factories comply with local government laws with which the Department had not been required to comply.

Victorian Government

The Kirner Government released a discussion paper with draft legislation intended to be introduced into Parliament in the spring 1992 Session. This legislation provided for reduced board powers, and in some circumstances enhanced the powers of ministerial direction.

The new Coalition Government introduced into Parliament as part of a package of reforms a Bill dealing with SOEs. In his second Reading Speech, the Treasurer Mr. Alan Stockdale stated:-

> The government intends to undertake a major corporatisation and privatisation programme to increase the efficiency of public utilities, achieve effective and substantial competition, empower consumers and assist in the reduction of State debt.

The object of the *State Owned Enterprises Act 1992* (Vic.) is to provide an umbrella framework for the reorganisation of specified businesses conducted by the State, based on a modern corporation model, while retaining strong accountability to the Government.

There is a strong emphasis on facilitating a flexible approach to reform and restructuring of any entity. The Act may be applied to existing or new entities. In some cases, the framework allows corporate restructuring as a step to partial or full privatisation. An enterprise may be split into several distinct legal entities, with new entities established as either new statutory corporations, State business corporations (regulated under the Act itself) or State owned companies by incorporation under the *Corporations Law*. There is also provision for the establishment of a further entity known as a State body created by Order of the Governor in Council.

A State business corporation has a board of directors whose powers and functions are set out in the Act. The conduct and duties of the directors will be governed by similar principles to those which apply to companies incorporated under the *Corporations Law*. Accountability mechanisms of such a body include the provision of a corporate plan to be approved by the Treasurer and relevant portfolio minister. Further provisions of the Act relate to financial and accountability mechanisms relevant to the authorisation of dividends, and provision of financial statements and corporate planning documents.

Enterprises will be established under the *Corporations Law* where appropriate, with all relevant private sector rules applying to this body. Companies incorporated in this manner will have specially entrenched provisions in the Memorandum and Articles of Association, relating to the financial and accountability mechanisms of the type applicable to State business corporations. This will provide a standard framework across all State Owned Enterprises.

However, while emphasising flexibility, this Act provides for a greater degree of Ministerial direction than has previously existed.

3.2 Forming the Company

If the SOE is to be formed by incorporation under the *Corporations Law* this involves a routine company registration, but it is important to be sensitive to Government requirements.

Normal commercial practice is to incorporate companies without any specific objects and give them power to do absolutely everything, as is permitted by the *Corporations Law*. However, to date, Governments have, partly through preference and partly for perceived constitutional reasons, insisted on specific objects for their SOEs.

If the aim of Government is to transfer ownership, the Memorandum and Articles of Association should reflect the generally accepted norms of commercial law practice, and where a float is likely, comply with the Stock Exchange Listing requirements.

The Government will need to decide whether it requires any special provision in the Articles of Association. So far Governments have expressed a preference for special controls over the operations of

subsidiaries. As the corporatisation process develops this may be required less frequently.

Government will also have to decide whether it wishes to provide for employee share schemes which may benefit the staff and the SOE through greater staff involvement in the success of the SOE.

Golden shares and restrictions on foreign shareholdings are also relevant in the context of privatisation.

3.3 Industrial Relations Considerations

The clash between the Federal and State Governments as to the jurisdictional limits of their powers with respect to industrial relations has created uncertainty as to the Award coverage, especially of Victorian public servants. The Federal Government argues it has the power to enact legislation under its external affairs power.

This emphasises that industrial relations is an extremely important part of any corporatisation or privatisation. It is one of the first issues which should be resolved.

It is important to note that State Industrial Relations Acts do not affect the rights and obligations of employees and employers whose work places are covered by the provisions of an award or agreement made under the provisions of the *Industrial Relations Act 1988* (Cwlth) and which deal with matters referred to under that Act or an award or agreement made under that Act.

In Victoria, the new *Employee Relations Act 1992* (Vic.) repeals the *Industrial Relations Act 1992* (Vic.) and other related legislation. Sections 1 and 2 of the Act relating to the purposes of the Act and commencement provisions are now in force, with the remaining provisions to come into operation on a day or days to be proclaimed.

One of the stated objects of this Act is to establish an employee relations system for Victoria which facilitates the freedom of employers and employees to choose how they regulate their own affairs.

The Act therefore provides that employers may enter into a collective employment agreement (CEA) with any or all of their employees or an individual employment agreement, with minimum terms set down in a Schedule to the Act.

The definition of "Employer" includes any person employing an employee, including the Crown and a public body. Accordingly the Act is equally applicable to the public and private sectors. This is facilitated by complementary legislation, the *Public Sector Management Act 1992* (Vic.), which has repealed the *Public Service Act 1974* (Vic.) and abolished the Public Service Board. All Victorian public sector employees are to be brought under the general industrial framework established by the *Employee Relations Act 1992* (Vic.).

Generally, a public sector organisation will be covered by a number of awards, which will be a mix of specific enterprise and general public sector awards. These may contain any number of conflicting provisions.

As in most cases a major objective of GBE reform is to change existing culture and work practices, it is desirable that there be a new award or CEA applicable to the new organisation. There will be greater identification with the new corporate structure if there is a new award or CEA put into place rather than the general continuation of pre-existing awards.

Employment Conditions

Award and legislated employment conditions also require consideration.

In the public sector, there are many benefits relating to security and conditions of employment which are contained within legislation (e.g. hours of work, sick leave, maternity leave, superannuation). If it is Government's aim to emulate private sector practice and achieve competitive neutrality for GBEs, these need to be put into an award (or employment agreement), or otherwise amendments need to be made to legislation.

Union Representation

There are three main issues which require attention:

- union rules;
- the question of which unions should have coverage; and
- the actual number of unions involved.

Workers Compensation

It is necessary to determine whether such coverage should be as part of the existing public sector coverage which can only be done by statutory amendment, or whether the employees should move into private sector workers compensation cover. It may be preferable that employees be covered by private sector schemes but it has been our experience that unions prefer the existing benefits of Government schemes such as Comcare (Commonwealth).

The above is not intended to be an exhaustive consideration of all the employment and industrial relations issues which will arise with the context of corporatisation. Each corporatisation will bring with it its own unique set of circumstances depending upon the culture which exists within the work place prior to corporatisation taking place.

Employee Shares

The availability to employees of shares in a SOE or a privatised GBE may warrant consideration both as a desirable social objective, and as an

aid to harmonious industrial relations. That course is currently being canvassed in Victoria.

3.4 The Board of Directors and Directors' Duties

Selecting the Board of Directors is a crucial step in the whole transaction. The independence and the ability to compete fiercely in not only the domestic private sector, but also in international trade, is greatly enhanced by having a strong board of directors covering a range of different interests. The board needs to develop the corporate/commercial strategy with management, and prepare a precise achievable business plan. Most importantly, that strategy and plan must be able to be tested.

Boards of directors have also included senior executives from large private sector corporations, lawyers with experience as independent company directors, independent directors from other GBE's and SOEs and the chief executive officer of the SOE, who should be a person with top management experience in either the private sector or the public sector. At the Special Premiers Conference in 1991, one of the identified prerequisites for corporatisation was that directors 'should be appointed solely for experience, knowledge and skills'.

An issue that has been under debate constantly in recent times is that of directors' duties. The obligations imposed on directors under the *Corporations Law* have been under review by the Federal Attorney-General for some time.

The draft Corporate Law Reform Bill was released in 1992, for public scrutiny, and submission. The substantive parts of the Reform Bill were with respect to directors' duties, related party transactions, annual returns, corporate insolvency and stock exchange settlement procedures.

Submissions by various interest groups expressed general concern as to the length and detail of the proposed reform provisions, particularly with respect to related party transactions. These particular proposals have since been re-drafted and as presently drafted would not become compulsory until 1994.

Many other submissions addressed the omission of the Business Judgement Rule (in its 'pure' form) from the reform proposals. The Business Judgement Rule requires a director to exercise sensible business judgement. It provides a number of criteria by which to judge the performance of directors, and if these criteria are satisfied, directors are protected against shareholder action.

As originally drafted, along with the proposed adoption of an objective standard of care, the Business Judgement Rule was taken into account in developing a series of factors relevant to determining whether the duty had been contravened. In adopting this approach, the Government was of the view that great difficulties were inherent in adopting a common law rule from another jurisdiction in isolation. Further, it was noted that the *Corporations Law* (Section 1318)

conferred a general discretion on the Courts to relieve an officer of civil liability arising out of a breach of duty, negligence or trust.

The arguments advanced by various interested groups against the adoption of the provisions as proposed were persuasive. The Reform Bill as originally drafted failed to distinguish between 'nominee' and other directors. It may have imposed new duties on directors, such as the duty to attend virtually all board meetings, however this was unclear. Further, the reform proposals ignored the distinction between executive and non-executive appointments. This is of particular interest given the 1992 finding of Rogers J in the New South Wales Supreme Court in the *AWA* and *Deloittes* case.[1]

In that case, the former auditors of AWA Limited were found negligent in the performance of their duties, contributing to a $50 million trading loss by AWA, with AWA guilty of contributory negligence due to the conduct of senior management. However the non-executive directors were found not to have been negligent, and were found to have discharged their duties properly. This decision makes a distinction between the legal responsibilities of executive and non-executive directors, and has major implications for issues of corporate governance.

Under the proposed new s. 232(4) of the Corporate Law Reform Bill 1992 an officer of a corporation will be required to exercise the degree of care and diligence a reasonable person in a likely position would exercise in all the circumstances. The duty is therefore to be determined objectively, and on the basis of the circumstances at the time of the decision.

The Government does not intend that these words are to have any effect on the existing law relating to directors' duties. It believes that the new wording confirms the existing law as stated in recent decisions, such as the *AWA* case. Development of the law, including the issue of the implementation of a Business Judgment Rule, has been left to the Court.

3.5 Transfer Documentation

The fundamental legal document necessary to transfer the GBE into a SOE or privatised entity needs to be prepared.

Government lawyers are, understandably, reluctant to advise their government clients to provide usual commercial warranties and indemnities to the corporatised entity in relation to the business it is taking over. On the other hand, the lawyers representing the SOE entity need to ensure that the new entity is properly protected. As a result, negotiations are needed to ensure that an appropriate measure of protection is afforded to the new enterprise. The independent Board of Directors have a duty to seek these protections.

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1. *AWA Ltd v. Daniels* (1992) 10 ACLC 933.

It is possible to assign contractual benefits without the consent of the other party to the contract, but it is not possible to assign liabilities without the other party's consent. Accordingly, there need to be negotiations with the other parties to gain consent to assignment.

Commercial legal transfer is to be preferred over legislative transfer, because it ensures that the assets and liabilities are properly verified in a normal commercial way, providing a sound business base for the new enterprise.

3.6 Regulatory Framework

With many corporatisations and privatisations, there is no specific regulatory framework which needs to be set up. A privatised GBE must compete in an open market situation with both domestic and foreign corporations.

However, in some privatisations there is a continuing regulatory regime which may need adaptation at the time of privatisation. For example, in telecommunications there are many regulatory issues which need to be addressed. In the immediate future one of the main issues is the relationship between a privatised AUSSAT (Optus) and a merged, but publicly owned, Australian and Overseas Telecommunications Corporation (Telecom and OTC).

In addition, the new corporation will be subject to a range of laws and regulations from which the Government activity will previously have been exempt. These may include zoning laws, health and safety laws, dangerous goods legislation, factories and industries legislation and rating laws, all of which will have a material impact on its business. A Government needs to decide whether the new entity will be required to comply with all relevant legislative requirements, or whether it will give the new entity a period of 'grace' in its formative stages.

State corporatisations in New South Wales and the Australian Capital Territory (and now Victoria) have been preceded by umbrella legislation setting out the regulatory framework for corporatisation, and some of the basic rules of ownership, liability, taxation and dividend arrangements which are to apply.

3.7 Trade Practices and the Extension of Competition Law to GBEs

One of the principal objectives of corporatisation and privatisation is to expose utilities to competition. The *Trade Practices Act 1974* (Cwlth) and particularly Part IV of the Act (which regulates restrictive trade practices such as misuse of market power, price discrimination and mergers resulting in a substantial lessening of competition) is, therefore, of paramount importance.

In relation to corporatisation, an assessment will need to be made of the impact of the *Trade Practices Act* on any corporatised entity. In addition, in preparation for any corporatisation, a trade practices compliance programme will need to be implemented. It should be noted

that the conversion of a GBE into a corporation incorporated under the *Corporations Law* will automatically make it subject to the *Trade Practices Act.*

This raises no insurmountable problems in relation to privatisations, except in special highly regulated industries such as telecommunications. However, it is a relevant legal issue in relation to the State corporatisations. Although the trading activities of the Federal Government have always been subject to the *Trade Practices Act*, the same is not true in relation to State trading enterprises.

The Commonwealth *Trade Practices Act* is limited in its effect by the Federal Constitution, so that some economic activity within Victoria is not subject to pro-competition regulation at all. The *Trade Practices Act* has its own internal limitation at sub-s. 51(1)(b) which exempts certain activities authorised under State Acts. Further, some Government authorities and business activities are protected from the reach of the Act by the 'shield of the Crown', although this has been significantly restricted following the High Court case of *Bropho v. Western Australia*[2]. Section 2A has been inserted into the Act to provide that the trading activities of the Commonwealth and Commonwealth agencies are covered, however some state business activities remain exempt.

Recent decisions of the High Court have resulted in extensive reinterpretation of the relevant Federal Constitutional powers, so that the precise extent of the Commonwealth power with respect to trade practices is uncertain. However, in broad terms, the two groups of activity to which the Commonwealth Act does not apply are:-

(1) GBEs and marketing authorities; and
(2) unincorporated persons, including certain professions.

The objective of exposing utilities to competition cannot be achieved if the exception relating to GBE's remains intact. Indeed, there appears to be no strong commercial or legal reason for these exceptions to remain in effect.

A recent Law Reform Commission of Victoria Report (No. 49)* recommended that Parliament enact legislation to overcome the limitations on the operation of the restrictive trade practices provisions of the Commonwealth Act. It considered that it would not be feasible to apply the *Trade Practices Act* to all exempt areas of the Victorian economy at once, and so the Commission proposed that these exempt activities be reviewed over five years.

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2. (1990) 64 ALJR 374.

* Law Reform Commission of Victoria Report (No. 49) '*The introduction of restrictive trade practices legislation in Victoria*', Government Printer, Melbourne, July 1992.

The Commission recommended that the Act be *immediately* applicable to GBEs that compete with the private sector. However, with respect to other non-competitive GBEs, certain political and economic issues remain outstanding, and significant structural changes may be necessary. The recommendation of the Commission was that each enterprise in this position should justify why the Act should not immediately apply to them, and a 'period of grace' of three years allowed for those enterprises able to do so.

The recommended mechanisms for implementation are either by application of the *Trade Practices Act* to Victoria, or a State referral of power to the Commonwealth. Each of these alternatives requires State legislation. The preferred option is the former - application of the existing Act to Victoria. The Commission considered that there is greater certainty in this mechanism. Further, this option makes it easier to preserve a continuing role for each State Government. The referral of power could lead to some uncertainty about the effect and extent of the referral. This option would require clear definition of the matters to be referred, with accompanying difficulties of interpretation.

These recommendations have been vigorously supported by the Business Council of Australia, which has stated that the Victorian approach should be followed by *all* states. The Prime Minister in October 1992 announced a 'National Competition Policy Review' to endeavour to hasten this development. This review comes in the context of an in-principle agreement by all State Premiers that the form of business ownership should be irrelevant, and that universal rules of market conduct should apply as far as possible to all market participants.

The argument in favour of this approach is quite simple. It will assist in exposing the national economy to greater import competition. At present, many of the State sheltered sectors supply goods and services to the trade-exposed sectors, including manufacturing, mining, and tourism. That is, these sheltered sectors feed into the economy's overall international competitiveness. Failure to expose these sheltered sections to vigorous discipline from competition inevitably increases the costs of the trade-exposed industries in meeting increased foreign competition.

3.8 Freedom of Information

Currently, most Australian States and the Commonwealth have Freedom of Information legislation. This enables the public to have access to the documents of a Government agency or department. For instance, in Victoria where the *Freedom of Information Act 1982* applies, Government Departments and 'prescribed' authorities fall within the ambit of the Act. However, where a GBE is incorporated under the *Corporations Law* the provisions of the Act cease to apply.

The *State Owned Corporations Act 1989* (NSW) provides that GBEs scheduled under that *State Owned Corporations Act* are corporations under the *Corporations Law*. Therefore, SOEs are placed on the same

footing as their private sector counterparts, and cease to be subject to strict disclosure requirements and scrutiny.

Whether Freedom of Information legislation applies to SOEs (and to what degree) is ultimately a decision for Government. If a Government envisages passing legislation (eg. such as a State Owned Enterprises Act) and wishes SOEs to remain subject to freedom of information legislation to ensure a high level of public accountability, it will be necessary to legislate for Freedom of Information legislation to apply. For instance, as the Victorian Parliament's Public Bodies Review* Committee's paper points out, in New Zealand the *State Owned Enterprises Act 1986* provides that SOEs are subject to the *Official Information Act 1982* (NZ).

If the Government is concerned over the need for commercial confidentiality, it may wish to strengthen existing provisions of Freedom of Information legislation. It may also wish to place restrictions on the level of requests for information to avoid excessive costs to the enterprise.

On the other hand, if a major Government objective is to ensure that SOEs are run on a fully commercial basis and operate in a competitive environment with the private sector, it may not wish to place SOEs at a potential commercial disadvantage by subjecting them to Freedom of Information legislation. The Victorian Treasurer, Mr. Stockdale, has recently provided for only limited access to information relating to State Owned Enterprises in the *State Owned Enterprises Act 1992* (Vic.) by the exemption of such enterprises from the operation of the *Freedom of Information Act*.

3.9 Taxation

Most GBEs and SOEs are not subject to Commonwealth taxes and charges. In Victoria while public enterprises pay payroll tax, and several pay public activities dividends, they are otherwise virtually exempt from contributing to Commonwealth or State Consolidated Revenue. If one of Government's major objectives is to operate in a competitive environment, it will be seeking to ensure that SOEs are required to pay all the appropriate taxes and charges. The issue of compensation from the Commonwealth is also a matter for Government (i.e. whether the Commonwealth directly reimburses the States for Commonwealth taxes on SOEs, or the taxes which would otherwise be paid to the Commonwealth are paid directly into the State Consolidated Fund).

The Special Premiers' Conference of July 1991 considered a paper prepared by the Federal Treasury and the Australian Taxation Office concerning income tax arrangements for SOEs. The Commonwealth

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* Public Bodies Review Committee, *Report to the Parliament on the 'appropriate model for corporatisation of the State Electricity Commission'*, L.V. North, Government Printer, June 1992.

accepted the principle of compensating the States for any loss of revenue arising from such structural changes to GBEs.

A communique from a meeting of the Premiers and Chief Ministers in Adelaide in November 1991 stated:

> (It is) agreed in principle to apply the full range of Government taxes and charges to all commercial Government Trading Enterprises through the creation of a system of tax equivalent payments encompassing both State and Commonwealth taxes. Such an approach will preserve an important source of revenue, avoid distortion of economic decisions and place commercial Government Trading Enterprises on a more equal footing with their private sector counterparts.

This is provided for in the new Victorian *State Owned Enterprises Act 1992.*

In early 1992 it was reported that the Australian Taxation Office was considering imposing sales tax on GBEs and SOEs previously considered exempt from taxation. An important High Court ruling in February 1992 has, however, cast doubt on the ability of the Commonwealth to impose sales tax and capital gains tax on State GBEs and SOEs[3].

It is expected that the Federal Government will allow companies (including SOEs) to issue tax-free bonds to encourage private sector investment in public infrastructure, in projects such as electricity generation and land transport.

The corporatisation of the operations of the GBE raises a number of other taxation issues which need to be carefully considered:

Assumption of Liabilities

In many cases the transfer of operations will involve the assumption of liabilities by the corporate entity, some of which have not been strictly 'incurred' by the Government at the time of transfer (e.g. provisions for annual leave and long service leave).

It is necessary to examine whether, when the payments are actually made later, they will be tax deductible to the privatised entity. This position is to be compared with that relating to liabilities which had actually been incurred by the Government, but not paid at the time of the transfer of the business operations. In such cases, the payment of these liabilities by the privatised entity could be of a non-deductible capital nature.

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3. *Deputy Commissioner of Taxation v. State Bank of New South Wales* (1992) 174 CLR 219.

Capital Gains Tax

Although there is presently relief from capital gains tax (CGT) for certain limited forms of business restructuring, this relief does not apply to corporatised entities. However, amendments contained in the *Defence Legislation Amendment Act (No. 2) 1989* (Cwlth) provided capital gains tax roll-over relief to Aerospace Technologies of Australia Pty Ltd and Australian Defence Industries Limited. The amendments make provision for roll-over relief for pre-CGT assets acquired by the Commonwealth and transferred to the companies in connection with their establishment. The roll-over relief was the same as that obtained by subsidiary companies when assets are transferred within a company group. Similar provision was made in the legislation establishing Australian Airlines Ltd, OTC Ltd (now part of the Australian and Overseas Telecommunications Corporation), and a number of other Commonwealth SOEs.

In 1992 the High Court held that State GBEs and SOEs are exempt from capital gains tax because s. 114 of the *Commonwealth Constitution 1901* (Cwlth) prevents the Commonwealth taxing the States in regard to property. The court held that capital gains tax represented a tax on property and was not assessable[4].

Stamp Duty

State revenue law plays an important part in any corporate reconstruction in the private sector, and the same applies in relation to any corporatisation or privatisation.

The acquisition by a SOE of Government owned assets will have stamp duty implications. Although owned by the Government at the time of transfer of assets, the company will be treated by the stamp duty legislation in each State and Territory as a usual purchaser, subject to the normal incidence of stamp duty on the assets transferred.

The Victorian Government levies stamp duty on the transfer of land, and the transfer of shares and leases, but there is no significant stamp duty on a transfer of goodwill or other assets.

If SOEs are to achieve competitive neutrality, it is logical that they pay all normal taxes and charges as part of their on-going operations. State owned companies under the *State Owned Enterprises Act 1992* (Vic.) are not exempt from State revenue charges unless otherwise provided. There is provision in the *Stamps Act 1958* (Vic.) for the Government to make an ex gratia refund of stamp duty paid on certain reconstructions, but the guidelines have been successively narrowed.

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4. Ibid.

Sales Tax

In recent times the Commonwealth has been progressively imposing sales tax on State GBEs and SOEs. However, a decision by the High Court in February 1992 means imposition of sales tax on State authorities is unconstitutional. Despite the fact that many State GBEs and SOEs basically operate in a similar environment with the private sector (e.g. insurance) the bodies can still be characterised as "the State" for the purposes of the *Constitution*.[5]

Other issues include the taxation of lump sums received by the SOE other than share subscriptions, the basis of depreciation of assets and the taxation implications of prepayments to the Government for contracts later transferred to the SOE for completion.

3.10 Foreign Investors

Governments make decisions as to whether foreign investors will be allowed to take up shares in a privatised GBE, and if so, what individual limit any one foreign investor may have, and what aggregate level of foreign investment is acceptable. The Federal Government recently limited foreign ownership of Qantas to 25% (from a previous limit of 35%).

Foreign investment is encouraged by Australia, and is recognised as being an important part of Australia's future. Although some investments by foreign interests in Australia are subject to examination by the Government, foreign investment guidelines have been substantially relaxed in recent years, and most investment proposals from overseas are approved, unless they are contrary to the national interest or involve certain key industries, such as civil aviation and the media. It is accordingly easy for foreign investors, both in partnership with local companies and on their own account, to pursue opportunities in Australia.

The Prime Minister's Economic Statement in February 1992 announced a further relaxation of foreign investment restrictions. The threshold for Foreign Investment Review Board (FIRB) scrutiny of investments has now been generally raised to $50 million.

Foreign Investment Policy

The Government's foreign investment policy is primarily contained in the *Foreign Acquisitions and Takeovers Act 1975* (Cwlth) ('the Act') while other requirements are set down by way of Ministerial statement. The Treasurer is responsible for the administration of the policy and is assisted in this task by the FIRB.

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5. Ibid.

The FIRB is a Commonwealth advisory body which administers the Act and determines the acceptability of foreign investment proposals. It has a Chairman and members of various backgrounds and experience. The Executive Member is the head of the Finance and Investment Division of the Department of the Treasury, which provides executive services to the Board. As each foreign investment proposal is unique, the guidelines the FIRB uses to determine the acceptability of the project are expressed in general terms.

Any foreign corporation considering investing in a SOE being privatised must satisfy this foreign investment policy. The criteria upon which the Treasurer is to determine if a proposal is against the national interest are not written into the Act nor indeed are they written into any legislation, but there have been references in the explanatory memorandum to the Act. Clearly the 'national interest' of a country is an ambulatory concept, and thus the Treasurer is given substantial room to move in considering a proposal for foreign investment in Australia.

When parties propose to enter into transactions that are subject to the provisions of the Act, including underwriting arrangements, the exercise of pre-emptive rights or transactions entered into by way of bids at auction or by tender, they should ensure that the contract includes a provision that the foreign investor's obligations under it are subject to approval under the Act and the Government's foreign investment policy. Failure to provide for such a condition may, in some cases, result in the contractual arrangements being in contravention of the provisions of the Act and expose the acquiring party to divestiture.

3.11 Share Structure

A major step in any privatisation is to decide the most appropriate capital structure, and the appropriate debt to equity ratio, and to prepare for the creation of the necessary new shares to be issued to the Government. A further decision needs to be made whether the shares should be issued for cash or whether they should be issued in consideration for the transfer of the assets and liabilities (with necessary consents) to the company.

Golden Shares

The UK Government developed the concept of the Golden Share. This is a special share issued to the relevant Minister on behalf of the Government which gives the Minister the right to veto a range of matters, such as sale of the company's core business or a takeover of the company.

The concept of a golden share raises interesting issues. There are a number of commercial aspects of golden shares to be considered. They include:

Pricing: What discount will the market demand in relation to the privatisation of a company in which the Government holds a reserve right which may allow the Government in the future to impose its will on management? The UK example seems to suggest that there is no discount, but no empirical research has been undertaken in the UK on this issue, and in any event many of the UK share issues have been at a discount to meet broader Government social objectives.

Rights: What rights are to attach to the golden shares? How many are to be issued and to whom? Are there to be different rights attaching to different golden shares? It should not be assumed that all golden shares are the same. They must be constructed to suit particular Government requirements and the commercial environment in which the privatised entity is to operate.

Takeover immunity: Companies with golden shares are usually regarded as immune from takeover, and therefore the management has latitude to manage the company for longer-term gains (consistent with stock price support).

What does the Government do if a takeover is, in fact, launched? By what criteria do advisers to the Minister determine what the Government's response will be? What time will be taken in making the decision and what effect will that have on the offer and the management while the decision is awaited? Coupled with these questions is the question of when and to whom the premium for control is paid. Is it on acquisition of sufficient shares to control the Board subject to golden share approval, or is it to the Government for that approval?

It is often said that golden shares are put in place to stop foreign takeovers, but we already have an established mechanism for dealing with acquisitions by overseas interests in the form of the *Foreign Acquisitions and Takeovers Act* (Cwlth). It does not seem sensible to insert another layer of approval for that purpose.

There are no definitive answers to the other questions. It should be questioned whether Governments really need this ultimate control, even where strategic assets are involved. The consequences of holding a golden share need to be carefully thought through. So far the only example of a golden share in Australia is AMECON which acquired Williamstown Dockyard in Victoria.

3.12 Preparing a Prospectus

It has been usual practice worldwide for Governments engaging in privatisation to offer shares through the medium of a registered prospectus.

Since the commencement of the *Corporations Law* the requirements for prospectuses have changed considerably. Pre-vetting of all

prospectuses by the regulatory authorities has been abandoned with the result that prospectus issuers have no assurance prior to issuance that the Australian Securities Commission (ASC) considers a prospectus to comply with the law. Post vetting may lead to an ASC stop order, so issuers have to take great care to 'get it right' before registration. Certain excluded offers or invitations do not require a prospectus.

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As a result of changes announced by the ASC on 17 February 1992 to advertising rules governing prospectuses relating to privatisations, Governments will be permitted to advertise before the release of a prospectus. Potential investors will also be able to register their interest after receiving a 'preliminary prospectus'. The ASC stated: 'The conflict between allowing maximum time for investors to examine a prospectus and the commercial pressures and uncertainties that shorten the time in which a prospectus for an underwritten offer can be allowed to remain open has been overcome by allowing the circulation of a preliminary prospectus which excludes the issue price.

The *Corporations Law 1992* (Cwlth) is not specific as to what exactly should be contained in a prospectus. A prospectus must contain all such information as investors and their professional advisers would reasonably require and reasonably expect to find in the prospectus for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the SOE. In this respect an investigating accountant's report will be required, and this may pose technical difficulties for many GBEs, as their accounts may not have been prepared in such a way as to lend themselves to these reports.

The *Corporations Law* also sets out a number of requirements regarding profit forecasts or projections, and the ASC has set out details regarding asset valuations.

A review of prospectus legislation is continuing after a period of consultation with professional and regulatory bodies. Final recommendations will be re-examined by the Companies and Securities Advisory Committee.

3.13 Methods of Privatisation

A decision by Government to privatise will carry with it a number of subsidiary decisions which will need to be made about whether to sell the GBE or SOE by float, public or private tender, private placement, (or less likely) by way of management buy out. These decisions will involve a mixture of commercial and political considerations.

Whichever method is chosen (as mentioned previously) there will need to be an information memorandum (prospectus or tender) which

must contain precise details of the enterprise, its past performance, and views about the way in which the business can operate in the future.

4. CONCLUSION

The concepts of 'Corporatisation' and 'Privatisation' are well established as processes by which any Government may effect a programme of microeconomic reform. This makes for interesting times for legal practitioners in the corporate/commercial field, particularly given the current programme of reform in place both in Victoria and Federally. An understanding of the basic legal principles is essential to the efficient provision of legal services throughout this period of reform.