

Investment Guidelines  
for  
Government Owned Corporations



**Queensland  
Government**

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## **EXECUTIVE SUMMARY**

Government Owned Corporations (GOCs) consider and commit to investment opportunities in an increasingly competitive Queensland and national market environment. To perform effectively, it is important GOCs are commercially focussed, have the flexibility to respond to competition, and pursue investment opportunities that enhance shareholder value.

These guidelines define the involvement of the shareholder in GOC investment matters and identify a set of principles that underpin this involvement. In particular, the guidelines set boundaries on the geographical location, nature and scope of GOC activities. These guidelines also define a process that enables the shareholder to be satisfied that a corporation is adequately maintaining/increasing its productive assets for the long term by putting in place commercial investments.

The guidelines cover all non-financial investments, including for example:

- asset refurbishment and replacement;
- new capital expenditure;
- acquisitions; and
- major contracts, excluding short to medium term energy contracts or derivatives.

Financial investments are covered by the corporation's own financial policies and the requirements outlined in the *Code of Practice for GOCs' Financial Arrangements*.

Activities characterised by an absence of direct equity investment, other than for minor current inventory stock typically associated with export of services, are expected to be covered by the *Guidelines for Export of Services by Government Owned Corporations*. This includes for example consultancy services, operating and management contracting services and licensing or sale of intellectual property.

Where GOCs are unsure whether their proposal is covered by the Investment Guidelines, they should write to the Executive Director, Office of Government Owned Corporations for clarification.

The key objectives of the Investment Guidelines are to:

- clearly set out the expectations, priorities and risk concerns of shareholding Ministers, without compromising the responsibility and accountability of board directors;
- ensure GOCs put in place commercial investments and to hold boards accountable for their investment decisions;
- replicate, as far as possible, private sector market disciplines in order to control the Government's risk exposure from the investment activities of GOCs; and
- provide confidence to industry that market type disciplines are being applied to GOCs.

The guidelines reflect a shareholder perspective. Broader policy objectives that require a different perspective are defined elsewhere, in energy policy statements for example. This approach improves the clarity of objectives and clearly separates the Government's role as a shareholder from its other, potentially conflicting roles.

The guidelines define ten investment principles. The principles replicate, as closely as possible, private sector market disciplines and shareholder management solutions that are not readily available within a public sector environment. The guidelines' principles are as follows:

1. GOC investments are subject to shareholding Minister notification and approval requirements;
2. the decision-making process used by a GOC in developing a significant investment proposal will be reviewed by shareholding Ministers or via an external independent party acting on behalf of shareholding Ministers. Provision has been made for regulated investments to be reviewed and endorsed by shareholding Ministers prior to GOCs proceeding with projects. Provision has also been made for contracts, which exceed the investment thresholds shown in Tables 1 and 2, excluding short to medium term energy contracts or derivatives, to be notified to shareholding Ministers to provide for their input or approval.;
3. significant investment proposals will be assessed and approved by shareholding Ministers based upon the commercial merit of the proposal and the ability of the investment to contribute to the long-term strategic objectives of the entity;
4. QTC will conduct a credit review of each GOC on an annual basis and in cases of new funding applications that would have credit rating implications;
5. the State does not guarantee any obligation arising from the investment activities of a GOC, entities controlled by a GOC or entities in which the GOC has an investment stake;
6. a GOC should ensure risk sharing arrangements are commensurate with their own financial contribution to a joint venture relationship established with third parties;
7. Investments undertaken at the direction of Government will be dealt with and financially supported via commercially based Community Service Obligation arrangements;
8. investments are to be restricted to a GOC's core business activities;
9. interstate and overseas investments will continue to be strictly limited and assessed on a case by case basis, with shareholding Ministers' approval required for all such investments regardless of the value of the investment. Investments will need to be proved to be commercially sound, of strategic advantage to the corporation and consistent with its core operations within Queensland, to be considered.; and
10. post-approval monitoring will apply for significant investment projects and will form the basis of determining future GOC investment approval thresholds.

## **1.0 Introduction**

Government Owned Corporations (GOCs) are required to consider and commit to investment opportunities in an increasingly competitive Queensland and national market environment. To perform effectively, GOCs must be commercially focussed and have the flexibility to respond to competition by pursuing investment opportunities that enhance shareholder value.

It is therefore important for the Government to transparently set out its GOC investment requirements.<sup>1</sup> Ten key principles have been identified, many of which are already implied in the existing relationship between GOCs and shareholding Ministers. The principles address shareholding Minister interests, whilst allowing GOCs to act commercially and compete effectively against both the private sector and other GOCs.

The principles incorporate mechanisms that replicate, as closely as possible, private sector market disciplines. This assists in ensuring that each GOC competes on equal terms with the private sector and that any special advantages or disadvantages that the GOC may have because of its public ownership are removed, minimised or made transparent.

## **2.0 Involvement of the Shareholder**

Exchange-listed companies generally have an “open” investment policy that allows all investment opportunities to be considered, including overseas, interstate and in non-core business areas. Commercial decision making is driven by the need to generate a risk-adjusted rate of return that is at least as good as the market benchmark.

Board directors determine the investment policy of exchange listed companies, with shareholders having an indirect influence via the share price. Bad investment decisions lead shareholders to seek value elsewhere, which, apart from contributing to a falling share price, may also expose the corporation to the threat of takeover.

Government ownership however assumes a greater financial risk than private investors. The discipline of the stock market and the risk management options available to private sector shareholders do not directly apply in the public sector. For example, the Government faces significant barriers to exit for its GOC investments and the Government cannot diversify its investments to the degree that private sector investors are able.

A more relevant system of governance arrangements applicable to the public sector is those that apply to unlisted companies that are closely held by either a single owner or a small number of owners. The absence of market signals and the more fixed nature of the investment, leads the owners of unlisted companies to become more directly involved in investment decisions that can significantly influence their risk/return exposure. The implications of GOC investment activities for the State’s credit rating also leads the shareholder to become involved in such matters.

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<sup>1</sup> A moratorium on GOC investments overseas and interstate came into effect in late 1998. This followed concerns by shareholding Ministers about the risk exposure for investment opportunities pursued by some GOCs. These Guidelines formalise the outcome of a review of the moratorium and its various implications.

It is on this basis, together with the lack of share market discipline upon GOCs, that the Government has developed these guidelines. In particular, it is considered appropriate for the shareholder to become involved in GOC investment matters by:

- setting boundaries on the geographical location, nature and scope of GOC activities; and
- satisfying itself that a corporation is adequately maintaining/increasing its productive assets for the long term by putting in place commercial investments. Investments that fail to generate market rates of return reduce the government's flexibility to improve community welfare by redirecting resources away from the community sector.

Competitive neutrality requires shareholding Ministers to keep their involvement in investment matters on an expeditious and commercial basis.

### **3.0 Key Objectives**

The key objectives of the Queensland Government's Investment Guidelines for Government Owned Corporations are to:

- clearly set out the expectations, priorities and risk concerns of shareholding Ministers, without compromising the responsibility and accountability of board directors;
- ensure GOCs put in place commercial investments and to hold boards accountable for their investment decisions;
- replicate, as far as possible, private sector market disciplines in order to control the Government's risk exposure from the investment activities of GOCs; and
- provide confidence to industry that market type disciplines are being applied to GOCs.

### **4.0 Application**

The guidelines apply to all GOCs declared under the *Government Corporations Act 1993* (Qld). The parent company Board and CEO are accountable to ensure the guidelines are applied and followed by all controlled entities of the parent GOC.

The Code is to be applied through the following acknowledgment and reference in the parent GOC's SCI:

“The Board and CEO take full responsibility to ensure that {*insert parent GOC name*} and any entities controlled by {*parent GOC*} will comply with the *Investment Guidelines for Government Owned Corporations (2003)* as issued by the Queensland Government.

This responsibility does not limit the obligations imposed on the Board and the CEO by the *GOC Act* and where applicable, the *Corporations Law*.”

For the purposes of these guidelines, an entity is defined to include:

“any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives.”<sup>2</sup>

For the purposes of these guidelines, a GOC’s control of an entity refers to:

- the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity<sup>3</sup>, or
- where a number of GOCs together own greater than 50% of an entity, or together are able to cast a majority of votes at a meeting of the board of directors or governing board of the entity, or at a general meeting of the entity.

Note that in the situation referred to in the second point above, none of the GOCs satisfy the requirements for control in AASB 1024. However, such an entity will be required to comply with the requirements of these guidelines as if it was subject to GOC control.

## **5.0 Principles and Parameters**

For the purposes of these guidelines ‘investments’ are defined to include all non-financial investments and incorporate, for example:

- asset refurbishment and replacement;
- new capital expenditure;
- acquisitions; and
- major contracts excluding short to medium term energy contracts or derivatives.

Where GOCs are unsure whether their proposal is covered by the Investment Guidelines, they should write to the Executive Director, Office of Government Owned Corporations for clarification.

Financial investments are covered by the corporation’s own financial policies and the requirements outlined in *the Code of Practice for GOCs’ Financial Arrangements*.

Activities characterised by an absence of direct equity investment, other than for minor current inventory stock typically associated with export of services, are subject to the *Guidelines for Export of Services by Government Owned Corporations*. Activities would include, for example, consultancy services, operating and management contracting services, licensing or sale of intellectual property.

Ten principles underpin the Government’s Investment Guidelines for GOCs. These are summarised in Table 3 at the end of this paper and are elaborated upon as follows.

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<sup>2</sup> This is an Australian Accounting Standard AAS 24 definition.

<sup>3</sup> As defined in Australian Accounting Standard 1024. Refer to Appendix 1 for further detail of the Standard.

***Principle 1: GOC investments are subject to shareholding Minister notification and approval requirements.***

Given the different ownership arrangements, GOCs may never face all the same commercial pressures and disciplines as the private sector, and it is therefore incumbent on the Government to ensure appropriate mechanisms are put in place in an attempt to replicate the market disciplines existing in the private sector.

With this in mind, GOC investments are subject to various shareholding Minister approval and notification requirements:

**Investment approval requirements**

The requirement for prior shareholding Minister approval is determined by whether an investment or major contract, excluding short to medium term energy contracts or derivatives, exceeds the investment approval thresholds as defined in Table 1. Details are as follows:

***Investment approval thresholds***

Key features of the investment approval thresholds include:

- the investment approval thresholds defined in Table 1 are based upon the total value of a project, including both debt and equity. The thresholds are also defined to include any future capital cost obligations associated with the initial investment (for example, an asset acquisition that requires substantial refurbishment or any other attendant future commitments). The thresholds apply to both parent GOCs and to GOC controlled entities;
- multi-staged investment proposals that require board approval at each stage of the process will also require separate approvals by shareholding Ministers. It is not acceptable for a corporation to break a single large investment into smaller component parts in an attempt to circumvent the investment approval thresholds.
- in relation to more complex investment proposals or, proposals that may be less well defined or structured, GOCs are encouraged to seek early consultation with the Executive Director, Office of Government Owned Corporations on any issues requiring clarification;
- uncommercial investments funded via Community Service Obligation (CSO) arrangements are subject to a separate process that is typically instigated by shareholding Ministers. The negotiation and finalisation of the CSO arrangements, which require significant involvement by shareholding Ministers, effectively represent the approval process for such investments;
- major contracts are entered into by GOCs from time to time. Major contracts include revenue and coal supply contracts but exclude operating expense contracts and short to medium term energy contracts or derivatives. Although these may not generally be viewed as investments, their significance warrants them being included in the definition of investments for the purposes of these guidelines. Where such contracts, are contemplated and they exceed the investment thresholds shown in Table 1, they are to be notified to shareholding Ministers at an early stage, to provide for shareholder input and consideration; and

- past investment performance and/or changing business circumstances as a basis for determining the thresholds. In the future, shareholding Ministers may assign a higher or lower investment approval threshold to a GOC, based upon its overall performance and as part of a rewards and sanctions system.

### ***Regulated investments***

Monopoly GOC investments are subject to economic regulation by a regulatory authority. The regulatory authority allows for the corporation's asset base in the determination of a regulated rate of return. This allows the monopoly to determine the level of "regulated investment" it can make in its asset base to ensure the assets remain productive and to provide for growth.

In making this determination, the regulator endeavours to ensure that gold plating and cross subsidisation do not occur and that as far as possible, assets do not become stranded. The regulator also endeavours to ensure that prices are cost reflective. In addition, regulated electricity investments are subject to the scrutiny of all market participants under the consultative provisions of the National Electricity Code.

These arrangements for regulated investments currently apply to the electricity network businesses (transmission and distribution), to parts of Queensland Rail's network and Sunwater's assets.

Shareholder concerns relate to the potential scale of investments involved and the fact that where a requirement for open access has been determined, the regulator's decision effectively only provides a cap on overall capital expenditure on the respective network. In these circumstances, provision has been made for investments contemplated within decisions by the regulators on monopoly rates of return, to be reviewed and endorsed by shareholding Ministers prior to GOCs proceeding with projects. Shareholding Ministers may require GOCs to take specific steps in relation to such projects, whilst having regard to the GOCs commercial imperatives e.g. in relation to prioritisation, financing arrangements or how a project is undertaken.

### **Investment notification requirements**

Where the value of an investment is below the approval thresholds outlined in Table 1, but exceeds the notification threshold corporations will be required to keep shareholding Ministers informed by notifying them of the investments they have undertaken. Notifications are to be provided in a GOC's quarterly report and are to consist of investments that:

- have a total value in excess of the notification thresholds defined in Table 1;
- have public policy implications;<sup>4</sup> or
- involve third parties. Specific requirements in this regard are detailed in Principle six.

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4 Public policy implications include for example, effects that result in significant distributional shifts in costs and benefits between and within Queensland communities, thus provoking appreciable community concern. Where uncertainty exists as to the significance of the public policy implications of an investment, corporations are requested to seek clarification from shareholding Ministers.

**Pre-emptive rights**

GOCs are required to consult with shareholding Ministers prior to entering into a legally binding contract that contains clauses pertaining to pre-emptive rights. A pre-emptive right provides a third party, that has an ownership interest in a venture with a GOC, a first right to acquire the GOC's interests in the venture. As pre-emptive rights contain commitments regarding the potential sale of GOC assets, they are a particularly sensitive issue for the Government and will need to be determined on a case-by-case basis. This includes such provisions as put option arrangements, whereby the assets of a GOC can be sold to a third party.

**Table 1 - GOC Investment Approval and Notification Requirements**

Industry/ Corporation	Investment approval threshold <sup>a</sup>		Notification threshold <sup>a</sup>	Are interstate investments permitted? <sup>b</sup>
	Regulated (\$m)	Non-regulated (\$m)	All investments (\$m)	
<b>Electricity</b>				
CS Energy	n.a.	75.0	20.0	Yes
Stanwell	n.a.	75.0	20.0	Yes
Tarong	n.a.	75.0	20.0	Yes
Powerlink	100.0	60.0	20.0	Yes
Energex	75.0	60.0	20.0	Yes
Ergon	75.0	60.0	20.0	Yes
<b>Rail</b>				
QR <sup>c</sup>	150.0	100.0	20.0	Yes
<b>Ports</b>				
North Queensland Bulk	n.a.	7.5	2.0	No
Brisbane	n.a.	40.0	10.0	No
Cairns	n.a.	7.5	2.0	No
Townsville	n.a.	7.5	2.0	No
Gladstone	n.a.	40.0	10.0	No
<b>Other</b>				
SunWater	25.0	25.0	10.0	Yes

(a) the above thresholds are based upon the total value of a project (debt plus equity) and also include any future financial obligations associated with the initial investment. The thresholds apply to both parent GOCs and to GOC controlled entities.

(b) subject to shareholding Ministers' approval, regardless of the value of the investment.

(c) Separate interstate investment approval thresholds apply to QR.

***Principle 2: The decision-making process used by a GOC in developing a significant investment proposal will be reviewed by shareholding Ministers or via an external, independent party acting on behalf of shareholding Ministers.***

Board members are responsible and accountable for the investment decisions made by the corporation which they govern. Consequently, investment proposals requiring shareholder approval, must previously have been approved by a corporation's board before they are submitted to shareholding Ministers.

Shareholding Ministers will require a review of the decision-making process used by the board and senior management in developing the proposal. The review will not duplicate the processes undertaken by the GOC board and management. Rather, the purpose of a review will be to:

- establish that the investment project has been formulated in a commercially sound manner;
- confirm that an appropriately qualified and experienced team has been assembled to prepare the proposal;
- advise on any implications for shareholder value arising from the proposed project; and
- advise if the proposed investment gives rise to any broader public policy issues for Government.

In order to facilitate the review, corporations are required to submit to shareholding Ministers, all documentation received by the board in their due diligence of the investment, together with copies of relevant board minutes.

Apart from using shareholding Minister representatives to conduct the review, Ministers may engage an appropriately qualified adviser(s) to review critical or more complex investment proposals. The adviser would report directly to shareholding Ministers.<sup>5</sup>

The cost of these independent reviews will be borne by the GOC. This is similar to private sector practice whereby project proponents incur advisory costs in order to secure equity provider support. GOCs will be consulted and advised about the cost of the independent review and kept fully informed as the consultancy continues.

The Office of Government Owned Corporations will put in place appropriate arrangements to ensure the strict confidentiality of market sensitive information made available by GOCs for the purpose of any independent reviews that may be required by shareholding Ministers.

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<sup>5</sup> The adviser(s) will be selected from a pool of consultants following consultation with the affected GOC. A basis of selection will be that the adviser does not have a conflict of interest in relation to the investment proposal. The adviser will be required to carry out the review in a strictly confidential manner.

GOCs should incorporate sufficient time into their project development schedules to allow shareholding Ministers to conduct a rigorous review of the decision making process used to develop the project proposal. The need for GOCs to rapidly respond to commercial opportunities in a competitive environment is recognised by shareholding Ministers.

In this regard, proposed investments will be reviewed by shareholding Ministers in an expeditious manner, with commercial realities recognised and GOCs kept informed about the review progress.

***Principle 3: Significant investment proposals will be assessed and approved by shareholding Ministers based upon the commercial merit of the proposal and the ability of the investment to contribute to the long-term strategic objectives of the entity.***

The Queensland Government is a unique shareholder in so far as it owns a number of separate corporations that compete in the same industry sectors. Examples include generators and retailers in the electricity industry, and Queensland Rail that competes with road infrastructure. This presents the Government with a threshold decision - should each GOC investment be independently assessed on the basis of commercial merit or should the broader implications of the investment be centrally taken into account?

A centralised model would require shareholding Ministers to decide whether a project should proceed based upon various trade-offs. A trade-off might include for example, the effect the project has on other GOCs and private sector participants in the same sector. This approach is considered to be detrimental given that it:

- is inconsistent with the Government's initial decision to promote greater competition between all industry participants and may have *Trade Practices Act* implications;
- is not competitively neutral in that it imposes a constraint on GOCs that does not apply to their private sector competitors; and
- may introduce a conflict between shareholding Ministers and a GOC board's fiduciary responsibility to independently promote the commercial interests of their respective corporations.

The outcomes of a centralised model potentially include an inefficient allocation of resources from an economy wide perspective. This will arise to the extent that, on portfolio grounds, uncommercial projects are approved, or alternatively, commercial investments are rejected. These outcomes would not have arisen in a competitive market environment.

A more appropriate model by which investments should be assessed requires shareholding Ministers to focus on the commercial viability and investment merits of each proposed project. Such an approach is intended to foster competition, innovation, and improved performance and decision-making by GOCs. It also acknowledges shareholder value as a prime objective of GOC conduct and operations.

Retaining a shareholder perspective within these investment guidelines, does not deny the Government scope to pursue its broader policy objectives where an investment will contribute to the strategic goals of the State Government. These objectives will generally be pursued and defined through:

- other, more generic policy statements (ie energy policies, community service obligations policies, employment policies); and
- strategic reviews of the risks associated with the Government's exposure to the GOC sector or a particular industry classification in which a number of GOCs reside. The reviews would be conducted as required, from both an equity and debt perspective.

This model of investment approval improves the clarity of objectives and clearly separates the Government's role as a shareholder from its other, potentially conflicting roles.

A corollary to this approach is a commitment by shareholding Ministers to encourage GOCs in their commercial pursuit of opportunities. In a competitive market, GOCs are faced with challenges from private sector participants and other GOCs. To face these challenges and compete effectively in a competitive market, GOCs will increasingly need to develop strategies and identify opportunities that will increase their competitiveness. This may involve GOCs entering into joint ventures or strategic alliances with private sector parties. Such arrangements will enable both parties to take advantage of economies of scale and the pooled resources available to them. The Government, as sole shareholder, will support GOCs developing strategies to compete effectively and succeed commercially in competitive markets.

***Principle 4: QTC will conduct a credit review of each GOC on an annual basis and in cases of new funding applications that would have credit rating implications.***

QTC will conduct an annual credit review of each GOC's capacity to maintain existing and planned levels of debt. A credit review will also be undertaken for new funding applications that would materially affect the capacity of the GOC to meet its obligations.

Reviews undertaken in this manner and irrespective of whether QTC is the financier, will be conducted as part of QTC's responsibility for the credit review function that was identified for implementation in the *Code of Practice for GOCs' Financial Arrangements*.

Private sector commercial lending practice typically involves credit approval costs being absorbed by the lending institution and recovered from the loan applicant via the interest margin. Similarly, where QTC incurs costs associated with the annual credit review and during the assessment of new funding applications, these costs will be recovered from customers as part of QTC's administration fee arrangements. Any costs associated with the need to engage advisers to review more significant or complex investment proposals may also be recovered.

**Principle 5: The State does not guarantee any obligation arising from the investment activities of a GOC, entities controlled by a GOC or entities in which the GOC has an investment stake.**

The State **does not** guarantee any obligation incurred by a GOC (including any associated subsidiaries or entities in which the GOC has an investment stake) **unless** the liability is expressly undertaken or provided for on behalf of the State. This is consistent with the Government position taken within the *Code of Practice for GOCs' Financial Arrangements*.

To assist in communicating these arrangements, all future loan documents and business/constitutional agreements prepared by a GOC are required to acknowledge section 158 of the *GOC Act*.<sup>6</sup> This section disclaims any recourse to the State Government or its assets in respect of the liabilities and other obligations of a GOC. Furthermore, GOC officers are prohibited from:

- providing any written note or oral representation that could imply government assistance would be forthcoming in support of difficulties associated with a financial arrangement in which the GOC has a stake; and/or
- entering into contractual arrangements or undertakings that would produce the effect of an actual or contingent obligation on Government to support a GOC.

**Principle 6: A GOC should ensure risk sharing arrangements are commensurate with their own contribution to a joint venture relationship established with third parties.**

GOCs are encouraged to be innovative when identifying a corporate structure that will protect the Government's investment in a joint venture project with third parties. In this regard, the following matters should be taken into account:

- the due diligence performed by a GOC's board and senior management should ensure that no contractual arrangements are entered into (including by way of guarantees, undertakings, indemnities or any other assumption of risk) that would increase the exposure of the GOC beyond the level of its equity share in the venture. Neither the Government nor the GOC should be exposed to joint and several liability risks associated with a third party;
- special project financing vehicles may be used to ensure that a GOC's financial exposure is limited to its own equity contribution. In doing so, reference should be made to the *Code of Practice for GOCs' Financial Arrangements*;
- prior to entering into any legally binding arrangements involving joint ventures, limited recourse structures, or other investment arrangements with third parties, a GOC board should obtain comprehensive transaction documentation summaries and risk matrices that outline the effect of the documentation and the key risks to be borne by transaction participants;

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<sup>6</sup> Section 158 states that: "the State is liable for the debts and other liabilities of a GOC or its subsidiaries **only if**, and to the extent that, the liability is expressly and lawfully undertaken on behalf of the State." In this regard, it should be noted that GOCs do not represent the Crown and consequently, the *Crown Proceedings Act 1980* is not applicable to GOCs.

- corporate structures involving third parties should ensure that tax payments payable on the GOC's portion of the investment accrue to the State under the Queensland Tax Equivalents Regime (TER) to the greatest extent practical.

Formal verification that a GOC is not carrying a disproportionate share of risk associated with an investment involving a third party and that TER payments will accrue to the State Government is required to be provided by a GOC to shareholding Ministers. In this regard, shareholding Ministers require copies of:

- risk matrices that were received by the board in its due diligence of the investment and which identify the key risks borne by transaction participants;
- documentation confirming that tax payments on the GOCs portion of the investment will accrue to the State Government under the Queensland TER; and
- relevant board minutes leading to the approval of the investment.

These requirements apply to investments involving third parties, regardless of whether the investment falls within the approval threshold or the notification threshold (refer Principle 1).

GOCs are also required to consult with shareholding Ministers prior to entering into legally binding contracts with a third party that contain clauses pertaining to pre-emptive rights (refer Principle 1). Pre-emptive rights are a particularly sensitive issue for the Government and will need to be determined on a case by case basis.

***Principle 7: Uncommercial investments undertaken at the direction of Government will be dealt with and financially supported via commercially based Community Service Obligation (CSO) arrangements***

The major means of ensuring that GOCs compete effectively with the private sector and other Government owned businesses is for GOCs to have a commercial focus not constrained by the broader objectives of Government. Government intervention in the operations of GOCs, without appropriate mechanisms to ensure transparency, mixes commercial and non-commercial objectives, disadvantages GOCs and blurs accountabilities.

This does not constrain the Government's ability to deliver its social and regional development objectives through the Corporatisation framework. Rather, these objectives are generally more effectively delivered through the implementation of industry wide policy or regulation rather than shareholding Ministers intervening solely in GOC decision-making.

Where an uncommercial investment is required to meet a social or regional development objective of government, this will be financed via CSO arrangements that will not commercially disadvantage the service provider (ie GOC financing combined with CSO arrangements would achieve a commercial return on investment).

***Principle 8: Investments are to be restricted to a GOC's core business activities.***

It is vital that GOCs concentrate on their respective areas of expertise by investing in the industry sector they normally operate within. It is acknowledged however, that what constitutes a GOC's "core activities" will obviously alter over time reflecting the evolving nature of industry. These dynamics should form part of the SCI negotiation process and will require careful consideration by the shareholder of diversification risk.

Without an assessment of diversification risk, shareholding Ministers require GOC investment activities to be confined to their core business as defined in their SCI.

It is not acceptable for a GOC to make investments in non-core business activities. In this regard, financial investments should only be made as a by-product of a GOC's core business activity.

***Principle 9: Interstate and overseas investments may be permitted in particular limited circumstances on a case by case basis, with shareholding Ministers' approval required for all such investments regardless of the value of the investment.***

GOCs are increasingly adopting a national focus and are looking to invest outside of the Queensland market. However it is deemed appropriate that interstate investments continue to be strictly limited, in recognition of the numerous risks such investments pose and the preference by shareholding Ministers that GOCs concentrate their business activities within Queensland.

**Interstate Investments**

As some GOCs are automatically operating in a national market by virtue of their core business activities, confining all GOC investment activity solely to Queensland may, at times, be impractical. It could:

- restrict a GOC's risk mitigation options;
- lead to a reduction in or sub-optimisation of shareholder value;
- place GOCs at a competitive disadvantage vis-a-vis interstate GOCs and private sector entities; and
- limit some GOCs as profit making, commercial enterprises.

On this basis, GOCs that operate in a developed or competitive national market may be able to pursue particular interstate investment opportunities in line with the GOC Investment Guidelines with shareholding Ministers' approval required regardless of the value of the investment.. An interstate investment proposal may receive shareholding Minister approval providing the commercial merit of the investment proposal can be readily and strongly demonstrated. Such investments will need to be proved to be commercially sound, of strategic advantage to the corporation and consistent with its core operations within Queensland, to be considered. The corporations to which this allowance applies are identified in Tables 1 and 2.

## **Overseas Investments**

The risks and opportunity costs associated with overseas investment are deemed to be very high. In particular:

- the risks associated with overseas investments are likely to be far greater than those pertaining to Australian locations. Opportunities in nations with developing and even unstable political and economic systems present notable financial and sovereign risks. Likewise, investment opportunities in developed economies, such as those in North America and Western Europe, may be severely limited, given the developed nature of industries and the balance sheet capacity and sophistication of the entities already operating there; and
- many GOCs are securing their position and competing in an increasingly national market. The need to invest overseas in the short to medium term is not readily justifiable.

Consequently, overseas investments may be permitted only in very limited circumstances and on a case by case basis. Unless shareholding Ministers have approved otherwise, investments may only be considered where:

- investments are commercially sound;
- clear competitive advantage can be demonstrated;
- sovereign risk is broadly equivalent to Australia; and
- investments are within the South-East Asia/South-West Pacific Regions.

Consulting services are not covered by these Guidelines. The Guidelines for Export of Services by GOCs covers consultancy services, operating and management contracting services, and licensing or sale of intellectual property. These activities are characterised by an absence of direct equity investment, other than for minor current inventory stock typically associated with export of services. In the situation where the export of a service is accompanied by a direct equity investment, the GOC will also need to comply with these investment Guidelines.

Where GOCs are unsure whether their investment proposal complies with these requirements, they should contact the Office of Government Owned Corporations for clarification in the first instance.

### ***Principle 10: Post-approval monitoring will apply for significant investment projects and will form the basis of determining future GOC investment approval thresholds.***

Post implementation monitoring will apply for significant GOC investments given approval by shareholding Ministers. To assist this process, shareholding Ministers require information on the commercial effectiveness and financial viability of investment projects to be provided as part of the GOC's quarterly reports.

It is not envisaged that reporting of investment performance will be a necessary component of every quarterly report to shareholding Ministers. Rather, it is expected that investment performance will be covered in the quarterly report at appropriate intervals as agreed with the GOC (for example, on the basis of completed project milestones and half-yearly thereafter).

Should it become evident to a particular GOC that its investment is performing poorly or well below expectations, or has produced risks originally not foreseen, shareholding Ministers are to be informed immediately, along with proposals for remedial action to mitigate these circumstances.

Post implementation monitoring of investments will comprise a key aspect of the shareholder's overall assessment of a GOC's performance. More generally, the assessment will also consider the nature and type of business activities undertaken by the GOC and the risk profile associated with these. Shareholding Ministers may assign a higher or lower investment approval threshold to a GOC based upon this assessment. This initiative may form part of a rewards and sanctions regime that is aimed at aligning the interests of corporation boards and shareholders.

## **6.0 Future Developments**

For immediate purposes, the investment principles outlined above represent an optimal set of rules to guide GOC investment decision making. In the future, further work may be considered and undertaken in relation to GOC investment activity. Such work may include:

- assessing the risk inherent in the Queensland Government's ownership of all GOCs;
- investigating options for the financing of GOC investment strategies that transfer both the risks and returns to the private sector. In this manner, scarce Government funds will be freed up for alternative uses; and
- developing an improved GOC performance monitoring regime which, at a minimum, utilises shareholder value based indicators and sophisticated benchmarking techniques.

**Table 3 - Summary of GOC Investment Guidelines Principles and Requirements**

**1. *GOC investments are subject to shareholding Minister notification and approval requirements.***

- Shareholding Ministers must be notified of investments made by a GOC that have public policy implications or which exceed the corporation's notification threshold.
- Projects above a corporation's investment approval threshold require shareholding Minister approval. Major contracts, (including revenue and coal supply contracts but excluding operating expense contracts and short to medium term energy contracts or derivatives), with values exceeding the investment thresholds shown in Tables 1 and 2 are to be notified to shareholding Ministers at an early stage, for their input and consideration.
- Regulated investments available as a result of favourable regulatory decisions regarding a corporation's regulated asset and revenue bases, are to receive shareholding Minister approval when they exceed the investment thresholds shown in Tables 1 and 2.
- The investment notification and approval thresholds are based upon the total value of the investment (debt plus equity).
- Multi-staged investment proposals require separate approvals by shareholding Ministers.
- A GOC is required to consult with shareholding Ministers prior to entering into a legally binding contract that contains clauses pertaining to pre-emptive rights.

**2. *The decision-making process used by a GOC in developing a significant investment proposal will be reviewed by shareholding Ministers or via an external, independent party acting on behalf of shareholding Ministers.***

- Investment proposals requiring shareholder approval, must previously have been approved by a corporation's board before they are submitted to shareholding Ministers.
- A shareholding Minister review will not duplicate the processes undertaken by the GOC board and management in developing their investment proposal. All external review costs will be borne by the GOC.
- To facilitate the review, GOCs will need to submit to shareholding Ministers all documentation received by the board in the due diligence of their investment proposal, together with relevant copies of board minutes.
- GOCs will incorporate into their project development schedules sufficient time to allow shareholding Ministers to conduct the external review process.

**3. *Significant investment proposals will be assessed and approved by shareholding Ministers based predominantly upon individual commercial merit.***

- Shareholding Minister approval for an investment proposal will be based principally on the project's commercial and financial merit and capacity to enhance shareholder value.
- The Government, as shareholder, will support GOCs developing strategies to compete effectively and succeed commercially in competitive markets.

**4. *QTC will conduct a credit review of each GOC on an annual basis and in cases of new funding applications that would have credit rating implications.***

- Reviews undertaken in this manner and irrespective of whether QTC is the financier, will be conducted as part of QTC's responsibility for the credit review function.
- Where QTC incurs costs associated with the annual credit review and during the assessment of new credit applications, these costs will be recovered from customers as part of QTC's administration fee arrangements.

**5. *The State does not guarantee any obligation arising from the investment activities of a GOC, entities controlled by a GOC or entities in which the GOC has an investment stake.***

- All future loan documents, business/constitutional agreements and contractual arrangements entered into by a GOC are required to disclaim any recourse to the State Government or its assets in respect of the liabilities and other obligations of a GOC.
- GOC officers are prohibited from providing any written note or oral representation that could imply government assistance would be forthcoming in support of GOC liabilities.

**6. *A GOC should ensure risk sharing arrangements are commensurate with their own financial contribution to a joint venture relationship established with third parties.***

- A GOC is prohibited from entering into a partnership or any other legal entity in which the GOC is required to bear joint and several liability.
- Special project financing vehicles may be used to ensure a GOC's financial exposure is limited to its own equity contribution.
- Formal verification that a GOC is not carrying a disproportionate share of risk associated with an investment involving a third party is required to be provided by a GOC to shareholding Ministers.
- GOCs are required to consult with shareholding Ministers prior to entering into legally binding contracts with a third party that contain clauses pertaining to pre-emptive rights.
- Corporate structures involving third parties should ensure that tax payments payable on the GOC's portion of the investment accrue to the State under the Queensland Tax Equivalents Regime (TER).

**7. *Uncommercial investments undertaken at the direction of Government will be dealt with and financially supported via commercially-based Community Service Obligation (CSO) arrangements.***

- GOCs must have a commercial focus.
- Where an uncommercial investment is required to meet a social or regional development objective, this will be financially supported via commercially based CSO arrangements.

**8. *Investments are to be restricted to a GOC's core business activities.***

- GOCs must concentrate on investment proposals that are directly related to their "core business" as defined in their Statement of Corporate Intent (SCI).
- It is not acceptable for GOCs to make investments in "non-core" business activities.

**9. *Interstate and overseas investments may be permitted in particular limited circumstances on a case by case basis with shareholding Ministers' approval required for all such investments regardless of the value of the investment.***

- GOCs that operate in competitive national markets may be granted approval to pursue certain interstate investment opportunities provided particular circumstances are met and commercial merit can be demonstrated. Such GOCs are identified in Tables 1 and 2.
- The risks and opportunity costs associated with overseas investments or activities exposing the State to financial risk are judged to be very high by shareholding Ministers and so overseas investments will only be considered in very limited instances and on a case by case basis. Although Consulting services are generally covered by other guidelines, if they involve a direct equity investment, they will also need to comply with these investment Guidelines. Criteria are outlined in the body of the guidelines.
- Shareholding Ministers' approval shall be required for all interstate and overseas investments.

***10. Post-approval monitoring will apply for significant investment projects and will form the basis of determining future GOC investment approval thresholds.***

- GOCs must include information on the commercial effectiveness and financial viability of significant investment projects in their quarterly and annual reports. Where an investment is performing below expectations, shareholding Ministers must be informed immediately along with proposals for remedial action.
- A GOC's performance will determine the future level of investment approval threshold.

## **Appendix 1 - Definition of Control (Australian Accounting Standard Board 1024)**

Under Australian Accounting Standard 1024, the following factors indicate the existence of control by one entity over another:

- the capacity to dominate the composition of the board of directors or governing board of another entity;
- the capacity to appoint or remove all or a majority of the directors or governing board of another entity;
- the capacity to control the casting of a majority of the votes cast at a meeting of the board of directors or governing board of another entity;
- the capacity to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of another entity, irrespective of whether the capacity is held through shares or options; and
- the existence of a statute, agreement, or trust deed, or any other scheme, arrangement or device, which, in substance, gives an entity the capacity to enjoy the majority of the benefits and to be exposed to the majority of the risks of that entity, notwithstanding that control may appear to be vested in another party.