



Queensland
Government

Government Owned Corporations

Investment Guidelines for Government Owned Corporations

Version 5.0

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Version History

Version	Date	Contact	Changes
1.0	April 2003	Office of Government Owned Corporations (OGOC)	Initial release.
2.0	September 2008	OGOC	Revised investment approval thresholds; operating expense contracts excluded from the application of the Guidelines.
2.1	July 2009	OGOC	Revised investment approval thresholds for ports review.
3.0	February 2010	OGOC	Consultation Draft – initial review by shareholding departments.
3.1	January 2011	OGOC	Consultation Draft – for GOC comment, excluding thresholds.
4.0	November 2011	OGOC	Final revised Guidelines, including revised investment approval thresholds.
5.0	April 2013	Commercial Monitoring	Investment approval thresholds and minor references

1 Introduction

The Investment Guidelines for Government Owned Corporations (the guidelines) set out the key principles for Government Owned Corporations (GOCs) to adopt when undertaking investment and other such related activities within the scope outlined below, ensuring that shareholding Ministers' requirements are met while still enabling GOCs to pursue commercial effectiveness in their business activities and enhance shareholder value.

2 Application and Scope of Guidelines

The guidelines apply to all GOCs, with the exception of QIC Limited. The parent company board is accountable to ensure the guidelines are followed by all the GOC's controlled entities¹ with the guidelines to be applied through a statement of compliance in the parent GOC's Statement of Corporate Intent (SCI) for the relevant financial year.

The guidelines are intended to complement each GOC's SCI and internal governance arrangements, without diminishing the board's responsibility for its investment decisions and the corporation's performance.

The guidelines cover all non-financial investments, including asset refurbishment and replacement, new capital expenditure, acquisitions, and certain major, long-term or multi-stage projects.

The guidelines exclude purely financial investments which are covered by the corporation's own financial policies and the requirements outlined in the *Code of Practice for GOCs' Financial Arrangements*. They also exclude activities characterised by an absence of direct equity investment, such as consultancy services.

The State does not guarantee any obligation arising from the investment activities of a GOC or its controlled entities or entities in which the GOC has an investment stake and as such all loan documents and business agreements prepared by a GOC are required to acknowledge section 130 of the *Government Owned Corporations Act 1993 (Qld)* (GOC Act)². GOC officers are also 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.

Where GOCs are unsure whether their investment proposal is covered by or complies with the guidelines they should contact the Assistant Under Treasurer, Commercial Monitoring for clarification.

1 An entity is a controlled entity if it is subject to the control of another entity. Control means 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.

2 Section 130 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.

3 Key Objectives

The key objectives of the guidelines are to:

- clearly set out the expectations, priorities and risk concerns of shareholding Ministers, without compromising the responsibility and accountability of GOC boards;
- ensure GOCs put in place commercial investments and create a framework that holds the board accountable for their investment decisions;
- replicate, as far as possible, private sector market disciplines in order to manage 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, for example, in energy policy statements. This approach improves the clarity of objectives and clearly separates the Government's role as a shareholder from its other, potentially conflicting roles.

4 Other Relevant Guidelines

These guidelines need to be read in conjunction with the *Government Owned Corporations Guidelines for Joint Venture Agreements* (the JV Guidelines) where applicable.

The JV Guidelines will also be of assistance to GOCs in clarifying the expectation of shareholding Ministers in respect of contractual obligations involved in projects which are not technically joint ventures. It is recommended that GOCs should have regard to the JV Guidelines when negotiating appropriate terms and conditions in respect of major, long-term or multi-stage projects as well as joint ventures.

5 Investment Principles

Principle 1: Investments are to be restricted to commercially viable projects within GOCs' core business activities.

Consistent with the objectives of the GOC Act, only those projects which are capable of generating a commercial return should be undertaken by GOCs. Shareholding Ministers will consider investment proposals primarily on their commercial viability and investment merits.

GOCs are to undertake investments strictly within areas of their "core business" activities as agreed by shareholding Ministers as part of the annual SCI negotiation process.

In assessing the investment proposals, GOCs should seek to earn a rate of return at least equal to the appropriate risk-adjusted Weighted Average Cost of Capital (WACC) as calculated consistent with the *GOC Cost of Capital Principles*.

Shareholding Ministers retain the discretion to pursue their broader policy objectives where an investment will contribute to the strategic goals of the Government. These objectives will generally be pursued and defined through other mechanisms, for instance community service obligations as provided for under the GOC Act.

Principle 2: GOC investments are subject to shareholding Minister approval and notification requirements.

GOC investments are subject to shareholding Minister approval and notification requirements as outlined below. However, shareholding Ministers retain the discretion to request projects below threshold levels to be submitted for approval. The board should also provide early advice to shareholding Ministers of any planned projects involving potentially sensitive investments or contracts, including those with longer term and strategic implications.

Investment approval thresholds

Investments or major contracts exceeding the investment approval thresholds require prior shareholding Ministers' approval. The thresholds apply to GOCs and their controlled entities, except where otherwise agreed by shareholding Ministers.

Thresholds are based on the total value of a project and 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).

Investment approvals are separate to financing arrangements. GOCs should refer to the *Code of Practice for Government Owned Corporations' Financial Arrangements* when considering financing arrangements.

Although major contracts are not generally viewed as investments, their significance warrants them being included in the definition of investments for the purposes of these guidelines. Major contracts include revenue contracts as well as coal and gas supply contracts for generator GOCs, but exclude operating expense contracts, short to medium term energy contracts or derivatives and regulated network support agreements. Investment approvals may also be required for other contracts as agreed by shareholding Ministers, including those with long term risk exposures to the State.

The value of a contract (or series of related contracts in a project) should be calculated using the present value (PV) of all revenue or expense flows over the life of the contract or contracts using an appropriate risk-adjusted WACC calculated consistent with the *GOC Cost of Capital Principles*. Shareholding Minister approval should be sought for any negative PV revenue contract.

Multi-staged investment proposals that require board approval at each stage of the process will also require separate approvals by shareholding Ministers. However, most importantly, approval must be obtained prior to the first framework agreement for the proposal, which maps out the proposed overall structure of the project and the GOC's future commitments. It is not acceptable for a GOC to break a single large investment into smaller component parts in an attempt to circumvent the investment approval thresholds.

Regulated investments

GOC investments in monopoly environments are subject to economic regulation by a regulatory authority. The regulatory authority allows for the GOC's asset base in the determination of a regulated rate of return. This allows the GOC 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.

Arrangements for regulated investments currently apply to the electricity network businesses (transmission and distribution) and to parts of Queensland Rail Limited's network.

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 revenue. 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, subject to the regulated investment approval thresholds. Shareholding Ministers may require a GOC to take specific steps in relation to such projects, whilst having regard to the GOC's commercial imperatives, for example, in relation to prioritisation, financing arrangements or how a project is undertaken.

Investment notification requirements

Notification thresholds and investment approval thresholds are individually advised to each GOC by shareholding Ministers. Where the value of an investment is below the approval threshold, but exceeds the notification threshold, GOCs are required to keep shareholding Ministers informed by notifying them of the investments. Notifications are to be provided in a GOC's quarterly report and by other agreed arrangements, and consist of investments that:

- have a total value in excess of the notification thresholds as advised by the shareholding Ministers;
- have public policy implications³; or
- involve third parties (associated with joint venture or similar such agreements).

³ Public policy implications include for example, effects that result in significant distributional shifts in costs and benefits between and within Queensland communities, thus raising appreciable community concern. Where uncertainty exists as to the significance of the public policy implications of an investment, GOCs are requested to seek clarification from shareholding Ministers.

Principle 3: Information relating to GOCs' investment decisions is to be provided to shareholding Ministers

GOC boards are accountable for their investment decisions. As such, investment proposals requiring shareholding Ministers' approval must be approved by a GOC board before being submitted to shareholding Ministers for their consideration. Informal and early consultation with Commercial Monitoring, Queensland Treasury and Trade is encouraged to assist in facilitating the shareholder approval process.

Early consultation with Commercial Monitoring, Queensland Treasury and Trade is also required for expressions of interest, memorandum of understanding, framework agreements and unsolicited approaches for significant projects to determine whether approvals are required.

In order to appropriately assess and approve investment proposals, shareholding Ministers are to be provided with the necessary information to determine whether the project is commercially sound, enhances shareholder value and whether it gives rise to any broader public policy issues for Government. Information is also required for shareholding Ministers to confirm that all appropriate probity processes have been followed by the board and senior management in developing the proposal.

To enable shareholding Ministers to assess the project's commerciality, GOCs are required to submit a full business case, including analysis using a cost of capital based on the *GOC Cost of Capital Principles*.

The board is to also provide a summary of the process and findings used by the board in its due diligence review of the investment.

Shareholding Ministers may engage appropriately qualified advisers to review critical or more complex investment proposals.⁴ The adviser will report directly to shareholding Ministers. The cost of these independent reviews will be borne by the GOC. GOCs will be consulted and advised about the cost of the independent review and kept fully informed as the consultancy continues.

Independent advisers will be required to adhere to appropriate arrangements to ensure the strict confidentiality of information made available by GOCs.

GOCs should incorporate sufficient time into their project development schedules to allow for shareholding Ministers' consideration. Proposed investments will be assessed by shareholding Ministers in an expeditious manner, with commercial realities recognised, and GOCs kept informed of progress.

⁴ The adviser will be selected from a pool of consultants following consultation with the 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.

Principle 4: GOCs must give appropriate consideration to the risks associated with their investment arrangements

GOCs are expected to undertake risk assessments of their investment proposals and implement appropriate risk mitigation strategies. This undertaking should also be confirmed to shareholding Ministers. The risks that will be considered will vary with the investment being undertaken. The purpose of any risk review is to manage risks in a way that will deliver the optimum outcome to the GOC. Some specific risks GOCs should consider include:

Construction Risk

GOCs' investment activities are often focused on construction projects, including capital maintenance. Construction projects are generally complex and are characterised by continuous decision-making due to the many sources of risk and uncertainty. Project risks in achieving deadlines and cost targets are significant and therefore it is essential that a GOC identifies risk sources and monitors these risks actively.

Examples of the risks a GOC is expected to address in its business case include:

- Economic: the risk that the project's output will not be saleable at a price that will cover the project's operating and maintenance costs and its debt service payments.
- Supply: the risk that the GOC is unable to access a competitive group of suppliers for various inputs or only a limited group of suppliers exist, placing upward pressure on prices.
- Completion: the capacity to complete within given timeframes will be very dependent on the management of other risks, including the ability of the construction company to deliver.
- Environmental: the risk that a proposed project may not receive environmental approvals or there are environmental issues resulting from the project due to poor management.
- Technological: inherent risks exist where there is use of new or unproven technologies.
- Force Majeure: the impact of uncontrollable events, including weather and industrial disputations.

Counterparty Credit Risk

Credit assessments are to be undertaken for contractual counterparties in accordance with each GOC's approved credit risk policy as outlined in the *Code of Practice for GOCs' Financial Arrangements*.

Consideration of the counterparty's credit risk profile should enable appropriate risk mitigation strategies to be determined and clearly specified in tender contracts, for example, the requirement for bank guarantees.

The aim of any risk mitigation strategy is to attempt to ensure that the GOC is not financially disadvantaged due to non-performance of a counterparty under a contract. Mitigation strategies could include the requirement for:

- a parent company guarantee as long as the parent has an appropriate credit rating from an international rating agency; or
- a bank guarantee from an appropriately rated bank.

Careful consideration needs to be given to accepting insurance bonds given a GOC is unable to access the notional value of the bond on demand.

Counterparties in joint ventures or similar such projects are typically characterised by low levels of equity, with financier-secured assets. As such there is no capacity to take security and consideration of contracted off-take is essential, as well as profitability, potential parent guarantees and/or third party guarantees.

Contractual Risk

GOCs should not enter into a contract, framework agreement or memorandum of understanding that may bind a GOC to advance an investment proposal irrespective of shareholding Ministers' approval being obtained.

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 arrangement and the key risks to be borne by transaction participants.

Joint Ventures (or similar arrangements)

Joint venture (JV) or similar arrangements should be entered into only where such arrangements are considered to be the most appropriate vehicle for achieving a GOC's financial and strategic objectives. When considering alternative investment arrangements, GOCs are encouraged to identify a corporate structure that will protect their investment when undertaking a project with third parties and should ensure risk sharing arrangements are commensurate with their own contribution to a joint venture relationship established with third parties. Arrangements should be structured to best balance commercial arrangements, returns, risk, flexibility and protection, in consultation with shareholding Ministers.

GOCs are expected to comply with the JV Guidelines as appropriate and confirm to shareholding Ministers that the GOC is not carrying a disproportionate share of risk associated with an investment involving a third party.

GOCs should only announce or commence construction of a project where the prior approval of shareholding Ministers for JV arrangements and agreements has been granted.

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.

Guarantees

A GOC should not provide guarantees to its controlled entities or assume any liability of their controlled entities, unless specifically approved by shareholding Ministers. Guarantees should not be provided to non-controlled entities.

IT Project Risk

Given their size and the nature of their businesses, GOCs typically make large investments from time to time in upgrading IT software and infrastructure. Investments of this nature require particular attention to be given to people or cultural risk. Despite providing a great technological solution, many software projects fail as businesses fall short of 'selling' the benefits of the solution to the people who are going to use it. GOCs should consider and plan for cultural risk in these projects as well as the necessity for exhaustive testing and parallel runs.

Governing Law and Jurisdiction

Investment documentation should preferably stipulate the laws of Queensland as the governing law regardless of whether the investment is predominately based in Queensland or outside of Queensland.

Principle 5: Interstate and overseas investments may be permitted in particular limited circumstances

Adopting a national focus or investing outside of the Queensland market should only be considered if the investment aligns with a GOC's core business and strategic direction as detailed in the GOC's approved SCI. As a general rule, interstate and overseas investment continues to be strictly limited, in recognition of the numerous risks such investments pose and the preference of shareholding Ministers that GOCs concentrate their business activities within Queensland.

Interstate Investments

GOCs that operate in a developed or competitive national market may be able to pursue particular interstate investment opportunities, only with prior shareholding Ministers' approval, regardless of the value of the investment. Such investments will need to be commercially sound, of strategic advantage to the GOC and consistent with its core operations within Queensland.

Asset purchases from other States that do not constitute a continuous investment or presence in that State are not considered interstate investments and are subject to approval and notification thresholds.

Overseas Investments

Overseas investments may be permitted only in very limited circumstances and on a case by case basis as approved by shareholding Ministers. Some of the considerations include:

- investments are consistent with, and complementary to, the GOC's core business;
- investments are commercially sound;
- clear competitive advantage can be demonstrated; and
- sovereign risk is broadly equivalent to Australia.

Overseas asset purchases that do not constitute a continuous investment or presence in an overseas market are not considered overseas investments and are subject to approval and notification thresholds.

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 guidelines.

Principle 6: *Post-approval monitoring will apply for significant investment projects and will form the basis of determining future GOC investment approval thresholds.*

Post-approval monitoring will apply for significant GOC investments, with GOCs to provide shareholding Ministers with information on the staged progress and investment performance of the project at agreed intervals, for example, on the basis of completed project milestones, and half-yearly thereafter.

Should it become evident to a GOC that its investment is progressing or 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.

GOCs will also be expected to undertake post-implementation reviews of the project including assessment of performance against key objectives such as planning and risk management, commercial performance and project management. Shareholding Ministers may request GOCs to provide this review for their consideration and may undertake independent reviews from time to time.

Post implementation monitoring and review of investments will constitute a key aspect of shareholding Ministers' overall assessment of a GOC's performance. Shareholding Ministers may assign a higher or lower investment approval threshold to a GOC based upon this assessment. This initiative may also form part of a rewards and sanctions regime that is aimed at aligning the interests of GOC boards and shareholders.