THE GOVERNMENT AS A VENDOR — CAVEAT EMPTOR

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INTRODUCTION

As both Federal and State government initiatives to privatise certain assets and businesses move forward, there will be increasing opportunities for the private sector to purchase those assets and businesses. The purpose of this paper is to highlight the major issues likely to arise in any transaction to which an Australian government is a party as a vendor, as a direct consequence of government involvement. As I intend to demonstrate, there are a number of considerations that need to be addressed by a private sector purchaser from government that would not arise if the vendor were a private company.

It is not possible to deal here with all of the issues that can arise when dealing with a government vendor. This paper does not purport to be an exhaustive survey of these issues. The format I have adopted for this paper is to address a number of significant issues which I have encountered when dealing with government and provide examples of how matters have been dealt with in practice wherever possible. Clearly, the issues with which I will deal are relevant whatever the government, including foreign governments. However, I have restricted the scope of this paper to issues arising in the Australian context.

In summary, the main issues to be considered fall into the following categories:

(a) assessing the objectives of a purchaser and a government vendor and identifying where countervailing interests may exist, including the "wild card" effect of political interests and pressures on a transaction;

(b) the sovereign risk of dealing with a government or a government-owned body;

(c) complexities introduced through dealings with more than one level of government;

(d) the authority of governments to enter into contracts for the disposal of assets and factors relevant to the enforceability of those contracts against the vendor;

(e) the desirability or otherwise of having arrangements with government specifically authorised by or enshrined in legislation, or both, including examining the effect of the doctrine of executive necessity;

(f) where specific agreements with government are concluded, deciding upon what those agreements should include by way of ongoing protection of the asset or business or concessions for the purchaser;

(g) risk allocation; who should bear the risk and what particular obstacles are there in due diligence procedures where the government is involved? and

(h) where government plans to dispose of an asset by public float, what are the obligations of the government vendor in the listing procedures?

While the matters I address are quite varied, a common theme is clear: dealing with a government vendor requires the purchaser to be aware of a myriad of issues that do not arise where a vendor is a private entity.

THE TRANSACTION PARTIES' OBJECTIVES

The Purchaser

Any purchaser, whether it be an individual buying a house or a car, or a company or group of companies buying a power station, an insurance company or some form of resource supply, has essentially the same objectives. The purchaser needs to be certain of a number of basic facts including that:

(a) the purchaser will acquire good title to the asset;

(b) the vendor has capacity to dispose of the asset;

(c) the vendor has capacity to enter into and perform the sale agreement and any other incidental agreements;

(d) the asset is designed and otherwise fit for the purpose for which it is being purchased; and

(e) the purchaser will receive a rate of return on its investment which will at least be sufficient to cover interest and other expenses on the purchase, as well as providing a reasonable return on equity.

The achievement of these aims must be analysed and assessed against the objectives of the government vendor, some of which may be (to a greater or lesser extent) inconsistent with the purchaser's preferred view.

The Government Vendor

Governments sell assets both to reduce debt and, for the politically more acceptable and longer term reason of improving business efficiency and providing economic incentives. There is, however, an inherent contradiction in these objectives. The government must balance its desire to achieve the highest possible price for the asset in order to maximise the return for its public owners against the public interest concerns such as economic efficiency and competition.

Tensions exist between the vendor wishing to sell at the best possible price and the purchaser's required rate of return. This tension is exacerbated where the purchaser intends to obtain credit to fund its purchase. This is because to persuade financiers that the acquisition is "bankable", the purchaser must show reasonable certainty of an economic rate of return on investment. All this generally means that the higher the price which the purchaser pays for the asset, the more likely it is that the purchaser will seek to cover its acquisition costs by increasing the cost of the product or service provided by the business. Where the business provides a public service (such as power or other infrastructure), increased prices to consumers will be an issue to factor into the political equation as governments will be keen to avoid any allegations that privatisation equates with more expense for consumers — particularly for the same level of service.

The Political Interests "Wild Card"

Governments' objectives and how they go about meeting them can be changeable, largely because of political influences. Sale negotiations may be quite protracted and may not be completed within the term of the incumbent government. It is important therefore to keep the opposition informed, to the extent possible, in case there is a change in government. If there is a change in government, it would usually mean adapting the transaction to meet the (different) political objectives of the incumbent party or, in the worst case, a scrapping of the transaction because it has no place in the policy framework of the new government.

Where negotiations are carried on with the same government, a purchaser still has to remain alert to changes in the political landscape. Given that a primary objective of governments is to retain the support of its constituents, any opinions which are expressed about a proposed project can be influential on the type of deal ultimately concluded. If the opinions are expressed with sufficient volume by a sufficient number of people, a government may seek to placate the voters concerned by changing the deal.

The Wesley Vale Pulp Mill proposed to be developed in northern Tasmania by North Broken Hill Peko and a joint venture partner in 1988 is an example of how critical the political situation is in dealings with government. Negotiations with the Tasmanian government were at a very advanced stage, despite strong lobbying of that government by conservationists. However, conservation issues gained such momentum that in March 1989 the Federal government effectively brought a halt to the project, on environmental grounds.

While it is always easy to be wise in hindsight, this project may have proceeded had the politics and public relations been more vigorously managed. Wesley Vale showed that it is not enough to have a technically and financially viable project when dealing with government. You also have to build up relationships with people on both sides of politics, keeping them fully informed about a project so that they see the project as a worthwhile venture which they are willing to support. As important as monitoring the political situation is keeping the public informed. While you cannot be sure that an informed public will endorse a project, there should be less likelihood of the project becoming politically unsustainable because of the dissemination of false information and scare-mongering in that case.

My advice to any purchaser proposing to deal with government, whether in a privatisation or otherwise, is to get the media on side at an early stage in the transaction, talk to politicians and members of the public and to try to keep well abreast of political agendas — express or hidden. If a purchaser can consistently show how the public will benefit from the proposed project and secure the public's endorsement (or at least acceptance) of the project, the pressure on the politicians to abandon or modify the transaction should be lessened.

Example — Australian Loan Council

The guidelines relating to the Australian Loan Council are a good example of political matters which can impact upon the substance of a privatisation by a State. Governments have historically been keen to ensure that privatisation projects are not assessed as involving financial exposure for the vendor, such that the cost of projects forms part of that vendor's Loan Council Allowance ("LCA").

Until recently, either the total value of a project was considered part of a State's LCA, or none of it was. However, changes to the guidelines foreshadowed at the Premier's Conference held on 25 March 1994 mean that when the new guidelines are effective, it will be possible to attribute **part** of the value of a project to a State's LCA. The changes have been made to reflect the commercial reality that projects will rarely be entirely at a government's risk or risk-free.

From 1 July 1994 (when the new guidelines will be effective), a purchaser from government will have to be aware of the vendor's desire to minimise the extent to which the particular

project is considered to be within the State's global borrowing limits.[1] This is likely to be evidenced by a pronounced reticence to provide government credit enhancements for projects.

Deregulation

A further tension between the interests of a government vendor and the objectives of the purchaser exists in relation to the degree of regulation of the enterprise to be sold and the certainty of the applicable regulatory regime. A purchaser will want to ensure that many of the concessions available to the government controlled business remain available after it acquires the asset concerned and also that its ongoing legal obligations are clear. In contrast, a government may see privatisation as an opportunity to make significant changes and to give effect to new policies.

Government enterprises often operate in a natural monopoly, for example railways, postal services, electricity supply and urban public transport. Privatisation may necessarily result in the removal or reduction of regulations governing entry to the sector, the types of products or services offered and restrictions on the right to engage in some activity monopolised by the enterprise, so that a further process of deregulation will ensue.

It is essential to the process of privatisation that the same level of services will continue to be provided to the public, or will be provided to much the same extent. In order to ensure this, it is likely that privatisation will result in a whole new body of regulations. The original aim of deregulation may well give way to re-regulation.

It has been a fundamental problem in major privatisations in Australia such as Loy Yang B, Qantas, Australian National Line, the Housing Loans Insurance Corporation and the Moomba-to-Sydney Pipeline that the regulatory environment has not been settled prior to the sale, giving rise to major ongoing uncertainty for the purchaser and its financiers in dealing with the asset acquired or to be acquired.

SOVEREIGN RISK

"Sovereign risk" or "country risk" is an issue for a party dealing with a government or a government owned or controlled entity. Generally, these terms refer to the risk that arrangements will not be performed as contemplated because of situations that develop within a government or country. Sovereign or country risk includes any impediment to the conclusion of a transaction or the ongoing operation of a business because a government reneges on a previously held position, or a change in circumstance occurs (for example in resource projects, the denial of an export licence) which effectively frustrates the agreement reached.

A number of very good articles have been written about the types of sovereign risk, how to address it and the comparative risk rankings of different governments.[2] I do not propose to deal with these risk issues in detail here, but for present purposes, it is sufficient to note that

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1 In assessing a State's financial exposure on a project under the new guidelines, the Loan Council Secretariat ("LCS") will take into account asset value, the amount of debt funding, a volatility factor (which varies depending upon the nature of the project) and the term of the project. The LCS's review will result in a project risk weighting which, when multiplied by the government's liability upon default by the owner or operator, yields the LCA.

2 See L Warnick, "State Agreements" (1988) 62 *Australian Law Journal*, page 878; D Frecker, "Coping with Political Risk" [1991] *AMPLA Yearbook*, page 507; J Williams, "Commentary on Coping with Political Risk" [1991] *AMPLA Yearbook*, page 536; P J Turner, "Some Aspects of Sovereign Risk" [1993] *AMPLA Yearbook*, page 135; "United States Back on Top", *Euromoney*, September 1993, page 363.

arrangements with government will generally be sustainable only as long as there is the political will to keep them on foot. This very much ties in to my earlier point about the "wild card" effect of politics and is of serious concern to a purchaser dealing with government, particularly where the business being sold requires ongoing dealings with that government.

Sovereign risk is particularly real in the context of privatisations where arrangements are entered into with a government or government controlled entity. Government policy for the overall privatisation of the industry may well involve transferring the relevant functions away from the government entity and possibly to a new company which has few or none of the solid credit and other attributes which the purchaser relied upon in entering into arrangements with the government directly. In these circumstances, a purchaser will seek assurances from the government (in the form of letters of comfort or performance guarantees) that it effectively stands behind the new entity, although a government will usually resist providing clear credit support of this nature.

In the sale of a majority interest in the Loy Yang B Power Station to Mission Energy, for example, sovereign risk was an important consideration because entities controlled by the State government are both long term purchasers of product from the project and long term suppliers of fuel. The continued performance of agreements by the government-controlled parties is therefore critical to both the successful operation of the project and to revenue stream generation.

THE MANY LEVELS OF GOVERNMENT

While I do not propose to examine in detail all the different ways in which more than one level of government can become involved in a transaction, I think that it is worth noting that when government is a vendor, a purchaser should be aware of the many levels of government.

In general, a purchaser should be aware that just because it has concluded a deal with one level of government, that another level will not see the transaction as presenting an opportunity to raise revenue, score points with its constituents, or both. As an example, even though Mission Energy concluded a deal in relation to Loy Yang B with the State government (after long and often arduous negotiations), it found that it still had to negotiate with the relevant municipalities in relation to various matters, including rating of the property. Similarly, in the Wesley Vale project, the participants had almost completely negotiated a deal with the Tasmanian government when the Federal government intervened to require compliance with additional environmental standards.

AUTHORITY AND CAPACITY OF GOVERNMENT TO CONTRACT

It is likely that the sale of a significant asset or business unit by government will involve a whole series of inter-related agreements with one or more levels of government. Not only will there be the sale agreement, but there will also be agreements for the supply of raw materials (such as coal in the case of Loy Yang B), for the provision of other essential services (for instance water, power and access to transport infrastructure) and, most importantly, the agreements for the sale of the product or service produced by that business unit. These agreements are all likely to be long term agreements appropriate for the life of the project.

In negotiating these contracts, it is necessary to consider the capacity of government to enter into those agreements.

Local Governments

It is generally agreed that local governments are not sovereign — their authority to act and contract derives from the particular statutes under which they are established. Section 8(3) of

the *Local Government Act* (Vic) provides, for example, that a Council can do anything which is necessary or convenient to be done in carrying out its functions and meeting its obligations.

State Governments

The power of the individual States to contract is theoretically unlimited, because they do not have any enumerated set of legislative powers by which they are bound. Most likely, the vendor of a State-owned asset will be a Statutory Authority whose authority to contract and dispose of assets will be provided by the specific legislation under which it is established.

Federal Government

Federal power of the Commonwealth to enter into a contract is more complex because Federal legislative competence is limited to the specific matters listed in the Constitution.

(a) The Capacity of the Commonwealth Government to Dispose of Assets

The executive power of the Commonwealth is vested in the Queen and is exercisable by the Governor-General by section 61 of the *Commonwealth Constitution.*

There is no doubt that it is within the inherent executive capacity of the Commonwealth as an owner of assets to dispose of assets in accordance with the general law governing the disposal of such assets.[3]

(b) The Capacity of the Commonwealth to Enter into Agreements

There are two possible (relevant) limitations on the capacity of the Commonwealth executive to enter into agreements for the disposal of Commonwealth assets including agreements incidental to the sale agreements:

First, the High Court has established that the inherent capacity of the Commonwealth executive to engage in any activities is limited to the areas corresponding to areas for which the Commonwealth can make laws under the Constitution.[4]

Secondly, the High Court has held that the inherent power of the executive to enter into contracts without express authority to do so is limited to contracts within the ordinary course of administration of government.[5]

Each of these possible limitations can be sufficiently answered as follows:

The inherent executive power of the Commonwealth extends to the disposal of assets in accordance with the law governing the disposal of such assets which, if it chose to do so, the Commonwealth could make under section 51(xxxix) of the Constitution (the power to make laws with respect to matters incidental to the exercise of powers, including executive powers).

The disposal of assets is within the ordinary course of administration of government.

So far as any incidental agreements are concerned it is within the inherent power of the Commonwealth executive and it is a matter of the ordinary course of administration for

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3 *In Re KL Tractors Limited* (1961) 106 CLR 318.

4 *Victoria v Commonwealth* (1975) 134 CLR 338, 396.

5 *New South Wales v Bardolph* (1934) 52 CLR 455, 474, 496, 507.

the Commonwealth executive to procure services to assist it to carry out matters within Commonwealth executive power.

Assuming the agreements are incidental to the disposal of Commonwealth assets then it is within the Commonwealth executive power to enter into them.

(c) **Ability of Purchaser to Obtain Damages Against the Commonwealth Generally Under Contracts and Specifically for Breach of Warranties Given by the Commonwealth to the Purchaser**

In relation to all levels of government, it will be important for a purchaser to know that if the government fails to perform an obligation, the purchaser will be able to specifically enforce that obligation or obtain damages for non-performance. While the issues of enforcement are relevant at all levels of government, I have confined myself to an examination of the situation at the Federal level.[6]

Any common law immunity of the Commonwealth from action on a contract has been waived by sections 56 and 64 of the *Judiciary Act* 1903 (Cth). Consequently, in a suit against the Commonwealth (based on agreements) the rights of the parties would as nearly as possible be the same as in a suit between private citizens.

Under sections 81 and 83 of the Constitution, no moneys can be paid out of consolidated revenue other than in accordance with a valid appropriation made by a law of the Commonwealth Parliament. Accordingly, realisation of any judgment debt against the Commonwealth is conditional on the appropriation by Parliament of funds to meet the debt. Parliament routinely makes such appropriations and I am not aware of any instance of Parliament ever having declined to appropriate funds to meet a judgment debt.

The principle that Parliament's authority in the form of an appropriation must be obtained before funds can be paid out of consolidated revenue cannot be evaded by obtaining a writ of execution against Commonwealth property.[7] This constitutional principle is reflected in section 65 of the *Judiciary Act* which expressly prohibits execution against Commonwealth property but provides for the issue of a certificate of a judgment.

Such certificates can be presented to the Commonwealth Treasurer who is obliged under section 66 to meet judgment debts so certified out of funds "legally available" — that is, out of funds which have been made available by an appropriation.

STATUTORY APPROVAL OF CONTRACTS

While, as noted above, contracts with the Crown — at least the Crown in right of the States — are valid, it may nonetheless be desirable for contracts to have statutory support. Dixon J in the leading judgment in *Bardolph*[8] stated the rule as:

> "No statutory power to make a contract in the ordinary course of administering a recognised part of the government of the State appears to me to be necessary in order that, if made by the appropriate servant of the Crown, it should become

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6 Each State and Territory has Crown proceedings Acts, but it should be noted that not all of them contain a permanent appropriation of funds to satisfy judgment debts obtained against the Crown.

7 *NSW v Commonwealth (No 1) (Garnishee Case)* (1932) 46 CLR 155.

8 *Op cit* at page 508.

the contract of the Crown, and, subject to the provision of funds to answer it, binding upon the Crown."

What constitutes a recognised role or function of government is a question of fact which may change as the role of government changes. The relevant current statutory provisions and general activities of government must therefore be considered at the time of negotiations with government.

It is no easy task to determine just what functions of government fulfil the general criteria as stated in *Bardolph*. How can you be confident that the vast range of issues that must be addressed in a complex transaction such as the sale and ongoing operation of the Gladstone or Loy Yang B Power Stations fall within the "ordinary course of administering a recognised part of government"? The cautious and prudent solution therefore is to obtain legislative endorsement for the agreements to effect such a transaction. Legislative support will place beyond doubt the power of the government to make the agreement and the authority of the persons signing on behalf of the Crown.

Form of Legislation

Legislative sanction can take a number of forms and has been discussed in detail in a number of excellent articles.[9] I set out below some examples of the possible form such legislation may take.

(a) The legislation can provide that the agreement be given the form of law as if enacted by the ratifying Act. This approach was taken in the recent *Victorian Casino (Management Agreement) Act* 1993 (Vic) which ratified and implemented the Management Agreement for the Melbourne Casino which was scheduled to the Act. It provided by section 6:

> "(i) The Agreement is ratified and takes effect as if it had been enacted in this Act.
>
> (ii) The Minister and the Victorian Casino Control Authority are authorised and required to do all things necessary or expedient to implement and give full effect to the Agreement."

This formulation effectively gives the agreement the force of law which can be an advantage, but can also lead to difficulties. It means that the agreement can no longer simply be amended by agreement of the parties to it and the obligations of the parties are turned into statutory duties. It also raises the possibility that third parties could sue the parties to the agreement for breach of statutory duty.

(b) In the *Loy Yang B Act* 1992 (Vic), the Minister was specifically authorised to enter into the Loy Yang B Agreement in the form set out in the schedule, the agreement was ratified and approved and its implementation was authorised.

The *Loy Yang B Act* then, by section 7(1), authorised the implementation of the State Agreement and by section 7(2) directed that its terms be implemented.

> "(2) The Government of Victoria, the Ministers, instrumentalities of the State and all bodies created by or under an Act for a public purpose, including municipal councils, are authorised, empowered **and required** to do all things necessary or expedient to carry out and give full effect to, the State Agreement." (emphasis added)

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9 See L Warnick *op cit*, P J Turner *op cit*, footnote 2.

A similar technique was employed in the *Roxby Downs (Indenture Ratification) Act* 1982 (SA). The High Court has recognised that these types of provisions effectively elevate the terms of an agreement to statutory rights and obligations.[10]

To emphasise the fact that the obligations in the Loy Yang B agreement are given statutory force and are enforceable against third parties, section 7(3) of the Act provides:

> "(3) A person must not do anything that interferes with the operation or implementation of the State Agreement or the ability of the parties to the State Agreement to exercise rights, or discharge duties or obligations, under the State Agreement."

Executive Necessity

The effect of the doctrine of executive necessity should be borne in mind by a purchaser entering into long term arrangements with government. This doctrine is usually attributed to the judgment of Rowlatt J in the *Amphitrite* case[11] in which he stated:

> "...it is not competent for the Government to fetter its future executive action, which must necessarily be determined by the needs of the community when the question arises. It cannot by contract hamper its freedom of action in matters which concern the welfare of the State."

This statement has been criticised by numerous text writers and by Mason J in *Ansett Transport Industries (Operations) Pty Ltd v The Commonwealth*[12] on the grounds that it is expressed too generally.

Mason J stated the rule more narrowly:

> "The public interest requires that neither the government nor a public authority can by a contract disable itself or its officer from performing a statutory duty or from exercising a discretionary power conferred by or under a statute by binding itself or its officer not to perform the duty or to exercise the discretion in a particular way in the future."

Statutory authorisation of an agreement with the government will avoid any risk that an undertaking by the government (contained in the agreement) will not be binding on the government on the basis that the undertaking purports to fetter the government's future executive action.

At page 77, Mason J stated:

> "Where statutory approval for the making of the contract exists and the contract contains an undertaking that the statutory power will be exercised in a particular way, there is no room for the notion that the undertaking is invalid on the ground that it is an anticipatory fetter on the exercise of a statutory discretion. The contract, assuming it to be within constitutional power, is valid and the undertaking is free from attack."

The effect of the statutory approval, however, is worth considering. According to Mason J such a statute can do one of two things:

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10 *Sankey v Whitlam* (1978) 142 CLR 1.

11 *Rederiaktiebolaget Amphitrite v R* [1921] 3 KB 500 at page 503.

12 (1977) 139 CLR 54 at page 74.

(i) "The statute may impose on the repository of the discretion a duty to exercise it in conformity with the undertaking..." (in which case) "...the contracting party may be able to compel the government and the person in whom the discretion is vested, though it has been relevantly converted into a duty, to comply with the undertaking;" or

(ii) "(I)t may leave him with a discretion to arrive at some other result..." (in which case) "...the undertaking if it is enforceable will be enforceable by an action for damages only."

Special-Purpose Legislation as Protection Against Changes in Policy

It must be remembered that even where commercial arrangements are authorised by and given the force of statute, there are usually no guarantees that a government will not change its policy and abrogate previous legislation.

A review of procedures available to entrench legislation on the one hand and the policy that a government should not fetter the future exercise of its discretion on the other is beyond the scope of this paper. However, a purchaser should be aware that political imperatives may one day be such as to motivate government to attempt to unilaterally change the ongoing deal. While there is no "sure-fire" legal protection against such action, as a practical matter, a purchaser and project operator may do well to include a significant level of public ownership in the project. If this is done, a government may be less willing to interfere with the project, as a number of its constituents (and not just the project sponsor) will be affected.

Case Study — Restructuring the Electricity Industry

I mentioned earlier that it is a fundamental problem in privatisations that the regulatory environment has not been settled prior to the sale. This was a constant problem throughout the Loy Yang B transaction and similar concerns are recognised in the Gladstone Power Station transaction. In the case of Loy Yang B, the government, both Labor with whom the negotiation process started and the Kennett Liberal opposition which became the government with whom it concluded, made it very clear that the transaction must not interfere in any way with their determination to restructure the electricity generation and distribution industries. The difficulty was that at the time the contracts were being negotiated, neither party had decided what form the restructuring of the electricity industry would take; and both parties had different views.

To ensure that the exercise by the government of its future executive action with respect to the restructure of the electricity industry was totally uninhibited by a provision such as section 7(3) of the *Loy Yang B Act*, the Act contains the following most unusual and extremely broad provision:

"33. Act not to affect restructuring of electricity industry

(1) Nothing in this Act or the State Agreement prevents or restricts the State, an agency or instrumentality of the State, the Commission, another statutory body or a municipal council taking any action that constitutes or is connected with a restructuring of the Commission or the electricity industry.

(2) A provision of an agreement that is inconsistent with sub-section (1) is void and unenforceable to the extent of the inconsistency.

(3) Despite sub-section (2), a provision of a project agreement is not void and unenforceable by reason only of a provision that is inconsistent with sub-section (1) but which accords with principles in the contractual documents.

(4) In this section -

'contractual documents' means the copy of the documents in 4 volumes held by the Commission entitled 'Investment in Loy Yang B Project: Contracts Initialled by Mission: State Electricity Commission of Victoria Mission Energy Company: 28 May 1992' as added to, altered or amended by an addition, alteration or amendment signed by a person authorised so to do in writing signed by the Leader of the Parliamentary Liberal Party;

'Loy Yang Property' has the same meaning as in section 35;

'restructuring' includes —

(a) any sale, lease or other disposal of all or part of any interest in the Loy Yang property held by the Commission or another statutory body;

(b) any sale, lease or other disposal of any interest of the Commission or any other entity in any property within the Victorian electricity industry other than the Loy Yang property;

(c) any agreement relating to the supply of products, by-products, materials or services used or produced by, in or through the operation of any electricity generating asset other than the power station;

(d) any agreement relating to the supply, purchase or sale of electricity from any electricity generating asset other than the power station;

(e) the issue of a permit within the meaning of the State Agreement in respect of any electricity generating asset other than the power station;

(f) any restructuring of the Commission including the incorporation of any part of the Commission."

Because of the uncertainty that was created by section 33, and in particular sub-sections (2) and (3), it was subsequently repealed after the various Loy Yang B agreements were completed as the government was by then (apparently) satisfied that they were either not inconsistent with sub-section (1), or more likely, that they accorded with the principles in the contractual documents.

Again to ensure that the government's future executive discretion was totally uninhibited, the sentiment of section 33 of the *Loy Yang B Act*, re-emerged in *Electricity Industry Act* 1993 (Vic) which provided by section 76:

"76. Validity of things done under this Act

(1) Nothing effected by this Act or done or suffered by SEC, the State, a Minister, an electricity corporation or SEC company under this Act —

(a) is to be regarded as placing SEC, the State, a Minister, the corporation or company in breach of contract or confidence or as otherwise making any of them guilty of a civil wrong; or

(b) is to be regarded as placing any of them in breach of or as constituting a default under any Act or other law or any provision in any agreement, arrangement or understanding including, without limiting the generality of the foregoing, any provision prohibiting, restricting or regulating the assignment or transfer or any property or the disclosure of any information; or

(c) is to be regarded as fulfilling any condition which allows a person to exercise a right or remedy in respect of or to terminate any agreement or obligation; or

(d) releases any surety or other obligee wholly or in part from any obligation.

(2) The validity of any act or transaction of SEC or the Administrator must not be called in question in any proceedings on the ground that any provision of this Act or the *State Electricity Commission Act* 1958 had not been complied with."

This section on its face would raise for any lawyer acting for a party contracting with the government all the concerns about sovereign risk referred to above, as it seems to give the SEC or the State virtually unlimited scope to breach contractual arrangements so long as the action of the SEC, the State or the Minister is done or suffered under the *Electricity Industry Act*.

Section 86 of the *Electricity Industry Act*, however, gives some comfort as, despite anything to the contrary, it authorises the Minister or the State, or with the consent of the Minister, SEC, an electricity corporation or an SEC company to enter into agreements about certain matters and by sub-section (2) "any such agreement takes effect according to its terms".

Thus it is possible under section 86 of the *Electricity Industry Act* to negotiate an agreement to protect a private party from the very wide-ranging powers that the government has given itself under section 76. It should be recognised, however, that in negotiating any agreement under section 86, the government always has the upper hand. One is left to wonder why a government which is seeking to encourage investment and development feels it is necessary to give itself the power to walk away from agreements which private parties have made in good faith with it.

ISSUES TO BE ADDRESSED IN STATE AGREEMENTS

Many other issues arise when purchasing from a government which are addressed in State agreements. I have tried to identify the principal matters of this type below.

Exemption from Certain Laws

As the legislative sanction of the Loy Yang B agreement in the *Loy Yang B Act* did not give the agreement itself the force of law, it did not override inconvenient or inconsistent existing laws. It was necessary therefore to deal specifically with any necessary modifications to pre-existing law by specific provisions in the Act. Section 8 of the *Loy Yang B Act* provided:

> "If a provision of the State Agreement is inconsistent with a provision of the law of Victoria, the provision of the State Agreement prevails and the provision of the law of Victoria is, to the extent of the inconsistency, modified accordingly."

The Act also dealt specifically in Part V with necessary amendments to the *State Electricity Commission Act* 1958 (Vic) to ensure that the SEC could perform all of its obligations under the various project agreements.

Sovereign immunity often applies to exempt government instrumentalities and authorities from certain laws and regulations. Even if it does not actually do so, certain laws are sometimes not strictly enforced against such instrumentalities which, accordingly, conveniently ignore them.

In the Loy Yang B transaction, Mission Energy as purchaser was concerned to ensure that any exemptions that SEC had from complying, or any excuses for failing to comply, with certain laws were extended to Mission Energy. A general power was therefore included in the Act, giving the Governor-in-Council, on the motion of the particular Minister, power to exempt Mission Energy from having to comply with nominated laws.[13]

A number of matters were identified in the course of our due diligence where it seemed that the SEC or Mission Energy, in its turn, required valid permits under certain laws. We were concerned that, at the date of signature, either the licences would need to have been obtained by SEC; SEC would be required to give warranties about the obtaining of those licences; or Mission would need to be exempted from regulatory requirements by the Act.

For example, there was a major difficulty over building regulations as the *Building Control Act* 1987 (Vic) had not previously been applied to the Loy Yang land. Mission Energy was not prepared to accept the risk of having to remedy deficiencies in building construction or design, which might have arisen. The eventual solution was that section 22 of the *Loy Yang B Act* was included to give the Director of Building Control, unqualified discretion to exempt the Loy Yang land from the provisions of the *Building Control Act*, subject to such conditions (if any) as he may specify. It was agreed that Mission Energy would not finalise the purchase of the land until the necessary certificates, in a form acceptable to the participants, were received from the Director of Building Control.

Different Levels of Government

The issue discussed above about different levels of government attempting to secure benefits from a project is often specifically addressed in State agreements, notwithstanding that State governments are sometimes reluctant to intervene with the legitimate revenue raising powers of local government. For example, in the case of Loy Yang B, after a great deal of negotiation, a provision was included in the *Loy Yang B Act* which allowed the Governor-in-Council to fix an amount in lieu of municipal rates if the parties could not agree.[14]

Disposal of Interest in Crown Land

It is well established that an agreement unauthorised by statute on the part of a Minister for the grant of an interest in Crown lands is invalid.[15]

Sections 14 to 18 (inclusive) of the *Loy Yang B Act* provide for the surrender to the Crown by the SEC of the Loy Yang B land, the subsequent regrant by the Crown of that land to SEC and then an authorisation of SEC to dispose of its interest in the land. These provisions were necessary because our due diligence established that the title to the land extended some 15 metres below the surface, while the power station's excavations had already gone more than 20 metres below the surface.

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13 *Loy Yang B Act* — section 23.

14 *Loy Yang B Act* — section 27.

15 *Cudgen Rutile (No 2) Pty Ltd v Chalk* [1975] AC 520.

Trade Practices Act

As already mentioned, projects such as the sale of the Loy Yang B Power Station require long term contracts commensurate with the life of the project for the supply of raw materials, the provision of other services and the purchase of the product of the power station. These contracts can contravene the restrictive trade practices provisions of the *Trade Practices Act* 1974 (Cth) since the whole purpose of these contracts is to ensure certainty of both supply and price.

Section 51 of the *Trade Practices Act* contains general exemptions which apply to the restrictive trade practices provisions of the Act and, in particular by section 51(1)(b), exempts things done in a State which are specifically authorised or approved by an Act of the State, unless regulations are made under the *Trade Practices Act* to the contrary.

Section 29 of the *Loy Yang B Act* was included to authorise and approve the entering into, or the giving of effect to a provision of a State Agreement, a project agreement or any other agreement authorised by the State Agreement, including the engaging in exclusive dealing or other conduct or the doing of any other act or thing that relates to the supply or acquisition of goods or services by or to the SEC or a participant. In this manner, the application of the *Trade Practices Act* to the Loy Yang B project was avoided.

Non-Discrimination

While it is recognised that a government has the ability to change its policy direction in a way that impacts upon an existing project, a purchaser and operator of an ongoing project frequently seeks the assurance of the government that it will not introduce discriminatory provisions. "Non-discrimination" clauses are designed to restrict the government (on the strength of its undertaking) from introducing laws (for example, levying taxes or imposing fees or duties) which, while expressed to operate broadly, in fact single out particular projects.

Confidentiality — Freedom of Information

Confidentiality is important, to a greater or lesser degree, in most commercial arrangements. When contracting with government, it is vital to consider the impact of relevant public disclosure statutes, including Freedom of Information ("FOI") laws and, I suspect, "whistle blowers" legislation. If the parties agree that certain information concerning their contract must be kept confidential and the applicable FOI Act does not have provision for excluding certain information from disclosure under that Act, it will be necessary to amend the Act.

The *Loy Yang B Act*, for example, did not amend *the Freedom of Information Act* 1982 (Vic), but listed information to which the FOI did not apply. As a government-owned company was one of the joint venturers which purchased the power station, the *Loy Yang B Act* also provided in section 34(2) that:

> "A participant in the joint venture...must not, under the *Freedom of Information Act* 1982, disclose any information which may entail commercial confidentiality except with the agreement of all other participants."

A difficulty for any prospective purchaser is to achieve this level of protection from disclosure during the preliminary tender phase of a project. In practice, a separate confidentiality agreement is often necessary until all agreements are in place and conditions precedent cease to apply. It is, of course, feasible to make the confidentiality provisions of an agreement effective from execution and not subject to conditions precedent. The position of a tenderer, however, may not be protected under FOI legislation unless the relevant Act expressly provides for information disclosed in a bid to remain confidential or for the relevant Minister to exclude such information from the operation of the FOI Act.

RISK ALLOCATION — ISSUES FOR DUE DILIGENCE

Risk Averseness of Governments

In the present context of the corporatisation and privatisation of government business and assets, the government as vendor seeks to minimise its risks associated with the asset sale to a much greater extent than would a private sector vendor. The government will typically refuse to give warranties other than the standard warranties, such as to title, power and authority and validity of the agreements.

One would expect that the greater the number of risks that are taken by the purchaser, the higher the return it will demand from its investment. Similarly, the purchaser's financiers will require a higher return, assuming of course they are prepared to accept the risk in the first place, thereby increasing the purchaser's capital cost. The purchaser will seek to protect its return by either reducing the price that it pays for the asset or demanding a higher price for the service it is to provide to the public. Either way, it seems to me, that the public, as the original owners of the assets and the ultimate consumers of the service, will be disadvantaged by the risk averseness of the government.

Importance of Due Diligence

Another consequence of the government risk averseness has been to place a greater reliance on due diligence enquiries from the perspective of the purchaser.

The government will usually give "full" disclosure of all material by placing it in a "data room" for the purchaser and its advisers to examine. Presumably in order to avoid any liability for misleading the purchaser, most questions asked by the purchaser are given the helpful answer: "It is in the data room"!

It is necessary for the purchaser to devise a due diligence enquiry which will enable it to:

(a) determine precisely the assets which it needs to purchase to comprise an economically feasible business unit;

(b) determine the value of those assets; and

(c) assess the sustainability of revenues which those assets are capable of generating when owned and operated by a private sector operator.

When an asset or business unit, such as a power station, has been owned and operated by a government utility, it has most likely been supported by other infrastructure provided by integrated business units of the utility. In those circumstances, it is necessary to determine which businesses of the integrated utility should be sold with the power station and which retained by the utility. A strategic decision is required by each of the government, the utility and the private sector purchaser as to which assets in fact comprise those necessary to be bundled and sold in order to be a complete business unit for sale at prices which match all parties' expectations. For example, the power station at Loy Yang could not operate without a waste management facility. The question was whether this would be sold as part of the power station, and therefore provide the private sector participants with strategic security, or whether the government would be prepared to assume an obligation in the nature of a trade waste agreement where all the waste produced at the power station would be removed under a contractual obligation by them.

Other issues which must be considered in a due diligence enquiry include:

(a) the need for permits and licences, most of which have never been obtained prior to the corporatisation process;

(b) the enforceability of contracts of maintenance and warranties of performance when the assets are sold;

(c) the rights (if any) of the purchaser to key industrial and intellectual property; and

(d) industrial relations policies when an asset or business is privatised.

ADDITIONAL ISSUES THAT MAY ARISE IF THE SALE IS BY WAY OF A PUBLIC FLOAT

Who Takes Responsibility for the Prospectus?

Parties named in a prospectus, as lead manager or professional advisers, are potentially liable both civilly and criminally under the *Corporations Law* should the issue of the prospectus be shown to have involved conduct which was misleading or deceptive, or the prospectus itself is shown to contain false or misleading statements or material omissions.

In most cases, the vendor of the securities the subject of the prospectus would also be exposed to potential liability, and could be joined as a defendant in an action under the *Corporations Law*. However, the Crown is not bound by the prospectus provisions of the *Corporations Law*. A lead manager would not, therefore, be able to join the government vendor as a co-defendant, or take action in its own right against the government vendor under the *Corporations Law*.

In our experience, both Commonwealth and State governments refuse to represent or warrant that prospectuses do not contain any misleading or deceptive statements or material omissions or that the information provided to the lead managers is complete, true and accurate.

This raises then the worrying question of who takes responsibility for the prospectus when the vendor is the government? The prospectus for the second tranche of the CBA shares made it abundantly clear who does **not** take responsibility. On page 2, it is stated:

> "The Commonwealth Bank of Australia has not authorised or caused the issue or participated in the preparation of any part of this Prospectus.
>
> The shares offered by this Prospectus are owned by the Commonwealth of Australia. In preparing this prospectus, the Government has taken reasonable steps to ensure that the information in the Prospectus is accurate and not misleading. In doing so, the Government has had regard to the prospectus requirements of the *Corporations Law*. The Commonwealth of Australia is, however, not bound by the prospectus requirements of the *Corporations Law*."

And then on page 4 to make doubly sure that the CBA is not responsible:

> "The Commonwealth Bank has advised the Government that it will not accept responsibility for the information contained in this Prospectus.
>
> The Commonwealth Bank has declined to provide any non-publicly available information to the Government for the purpose of this Offer in relation to the assets and liabilities, financial position, profits and losses and prospects of the Commonwealth Bank, except as required by statute and detailed below."

The prospectus then refers its readers to the bank's corporate plan which has been supplied to the government and to the bank's 1993 annual report and tells investors to conduct their own investigation.

What Defences are Available?

A defence is available to the lead manager if it is prosecuted or sued under the *Corporations Law* if it is able to demonstrate:

(a) in the case of a prosecution under the *Corporations Law* — that it made such enquiries as were reasonable, and had reasonable grounds to believe (and did so believe) that the statement was true and not misleading or the omission was not material (section 996);

(b) in the case of a civil action — that the false or misleading statement or the omission was due to:

(i) a reasonable mistake;

(ii) reasonable reliance on information supplied by another;

(iii) an act or default of another person, an accident or some other cause beyond the defendant's control;

and in the case of (iii), that it took reasonable precautions and exercised due diligence to ensure that the contents of the Prospectus were true and not misleading and that the Prospectus contained no material omissions (section 1011).

Significance of Sign-Off Letter

It has become common practice in due diligence procedures for sign-off letters to be provided by the issuer's lawyer, responsible management and the issuer's accountants. The lead manager will be assisted in establishing these defences by the due diligence report and sign-off letters on the basis that the report indicates reliance by the lead manager on the enquiries of others for the purposes of the section 1011 defence. It would, of course, be necessary also to establish that such reliance was reasonable in all the circumstances. If the lead manager were unable to successfully mount a defence to an action under the *Corporations Law*, it may wish to take action against the government to recover any amounts it has been held liable to pay, on the basis that the opinions expressed in the sign-off letters were misleading.

The sign-off letter could also provide the basis for a cause of action by the lead manager against a government in tort for negligent misstatement. This was recognised in the recent CSL Limited prospectus which stated that:

> "The Commonwealth is liable for the contents of the Prospectus under normal common law principles."

The Commonwealth Government, however, is probably not liable under section 52 of the *Trade Practices Act*.

The difficulty with the *Trade Practices Act* is that it expressly provides by section 2A that the Crown in right of the Commonwealth is bound by the Act in so far as the Crown in right of the Commonwealth "carries on a business". Otherwise, the Commonwealth is able to claim immunity from the provisions of the Act. Although it might be argued that the sale by the Commonwealth of the shares in a corporatised business unit constitutes the carrying on of a business by the Commonwealth (that is, the business of privatisation), I think it more probable that the sale of the shares would be characterised as the "one off" implementation of policy by the government.

CONCLUSION

In this paper I have attempted to flag a selection of issues which are peculiar to purchasing assets or a business from government. The particular issues that arise are so numerous and diverse that it is difficult in the present forum to do more than alert you to the relevant considerations.

In summing up: in my view, when the government is a vendor, there is reason to conclude that the buyer should indeed beware. However, in canvassing the main areas of concern today, I hope that we can go some way to ensuring that the buyer is forewarned, and so to some extent, forearmed.