

# Commercial Issues

## Overview

This section outlines the commercial policies affecting the way in which Territory Government businesses operate and the way in which the Territory Government deals with the private sector.

It provides an overview of:

- the Government Business Divisions and Government Owned Corporations frameworks which recognise that business activities of Government must operate on a more commercial basis than general government agencies;
- *Territory Partnerships*, which outlines the framework for dealings between the Territory Government and the private sector in relation to public private partnerships; and
- the risks faced by the Territory, in particular those under contingent liabilities arising from guarantees and indemnities that the Territory has issued when dealing with the private sector and other governments.

## Commercial Frameworks

Government has established legislative and administrative frameworks governing the operation of Government owned businesses. The intent of such frameworks is to provide greater incentives to manage costs, increase efficiency and improve the quality of the goods and services delivered. Typically, Government owned businesses are managed according to best commercial practices in recognition that:

- their operations are similar to those of private sector businesses; and/or
- they operate in a commercial environment or in competition with private sector businesses.

Government businesses that are considered suitable to operate commercially can be declared a government business division (GBD) or a government owned corporation (GOC). These businesses do not receive direct output appropriations for their commercial activities. Instead, operating revenue is primarily generated from sales of goods and services to other Government agencies, the private sector or a combination of both. Budget appropriation is provided to Government agencies to enable them to purchase goods and services from GBDs or GOCs.

GBDs are subject to the Territory's financial management framework contained in the *Financial Management Act*, with the chief executive officer of a GBD accountable to the responsible Minister for financial performance.

GOCs are subject to the *Government Owned Corporations Act*, which seeks to replicate as far as possible the shareholder model of corporate governance. This structure essentially creates an 'arm's length' relationship between the GOC Board (or management) and the Government as owner or shareholder.

The Territory Insurance Office, another Government business, operates under its own legislative framework consisting of the *Territory Insurance Office Act* and the Territory Insurance Office Regulations. It also has a Board that is accountable for its performance. The Territory Insurance Office is subject to a prudential regulatory regime, similar to that applying to competitors in insurance and financial services, but administered by Treasury.

## Government Business Divisions

The Territory has established GBDs in order to improve operating efficiency and to reduce Government and business costs, thereby freeing up Government resources for other expenditure priorities.

The following commercial practices have been implemented for GBDs:

- full attribution of costs (including tax equivalents);
- efficient pricing based on costs;
- commercial accounting, operation under a charter of operation and establishment of an audit committee;
- identification and budget funding of community service obligation (CSO) payments, to compensate GBDs for undertaking non-commercial activities at the direction of Government; and
- performance monitoring.

GBDs are required to comply with competitive neutrality principles which seek to ensure a level playing field with private sector counterparts and that resources controlled by GBDs are determined by relative efficiency, rather than advantages accruing as a result of Government ownership.

Competitive neutrality complaints may arise where GBDs provide services in competition with private sector businesses. Northern Territory Treasury has been charged with investigating any such complaints and advising the Treasurer and the responsible Minister of the results of such investigations. Should a complaint be upheld, the Government decides, on a case by case basis, the appropriate action to be taken in order to overcome any net competitive advantage identified by the complainant.

The current emphasis of GBD reform is to build on initiatives to date by encouraging a greater commercial focus, improved management practices, additional efficiency and productivity gains, ensuring value for money from expenditure on CSOs and more rigorous performance monitoring. Charters of operation have been reviewed to ensure that operational and commercial boundaries are appropriate in the light of market developments that have occurred since GBDs were established in the mid 1990s.

During 2004-05, as part of the GBD reform process, amendments were made to the *Darwin Port Corporation Act* in order to align the governance arrangements with those in place for other government businesses and statutory authorities and to clarify the roles and responsibilities of Government, the corporation and the board.

## Government Owned Corporations

The *Government Owned Corporations Act* adopts the shareholder model of corporate governance. The objective of the Act is to impose capital market-type disciplines on government owned businesses and to replicate the corporate governance structures of private companies incorporated under the *Corporations Act 2001*.

Power and Water Corporation (PWC) became the Territory's first GOC on 1 July 2002.

Key elements of the Territory GOC model are:

- corporations established under their own legislation but governed by an overarching legislative framework based on the Australian Government's *Corporations Act 2001* principles;
- a commercial board of directors that is responsible for the operation of the business and accountable to the shareholding Minister for financial performance;

- a shareholding Minister (usually the Treasurer) who monitors the financial performance of the corporation;
- a portfolio Minister (the Minister for Essential Services in the case of PWC) who monitors the service performance of the corporation and has broad industry policy responsibilities; and
- a Statement of Corporate Intent, which is essentially a performance agreement between the shareholding Minister and the board of the GOC.

The shareholding Minister concept represents a significant change from governance arrangements for general government agencies and for GBDs under the *Financial Management Act*. Under the *Financial Management Act*, the chief executive officer of a GBD is directly accountable to Government for the performance of the business. GBD Boards generally have an advisory role, with Ministers responsible for business decisions, which may or may not be taken on the advice of the Board.

Conversely, under the GOC framework, the commercial Board of Directors is the decision-making body and is accountable for its decisions. The Board is accountable to the shareholding Minister for financial performance and to the portfolio Minister for the service quality aspects of a GOC's business.

GOCs are not subject to the *Financial Management Act*, reflecting the policy intent of operational autonomy.

At this time, PWC is the Territory's only GOC. The PWC Board is accountable for the performance of the corporation. In most of PWC's business lines, PWC is subject to a regulatory regime administered by an independent economic regulator, the Utilities Commission. This regime is applicable to any party that may operate in these areas of business in the Territory.

Like GBDs, PWC does not receive direct budget appropriation. However, through Government agencies, it receives CSO payments for non-commercial services that it provides at the direction of Government.

## Community Service Obligations

A community service obligation (CSO) arises when the Government requires a GBD or GOC to carry out activities which it would not elect to do on a commercial basis or would only do so at higher commercial prices. CSOs allow the Government to achieve identifiable community or social objectives which would not be achieved if left to commercial outcomes.

Government CSO policy is aimed at clearly identifying the non-commercial functions performed by GBDs and GOCs, making the functions transparent and their delivery accountable to the community. To ensure that non-commercial functions do not affect the financial performance of the GBD or GOC, the policy provides compensation for the provision of the CSO.

The provision of CSOs through budget funding or acceptance of a lower shareholder return has two important implications:

- it enables GBDs and GOCs to manage commercial activities without having to cross subsidise non-commercial activities, promoting the development of a commercial culture within GBDs and GOCs; and
- it provides opportunity for an annual review of those activities funded as CSOs.

CSOs are provided to the GBD or GOC by the 'purchasing' agency. Territory Government CSO-related initiatives, listed by 'purchasing' agency for 2005-06 are

presented in Table 7.1, with the following discussion on CSOs provided by the 'purchasing agency' outlining the key components.

### **Northern Territory Treasury**

Treasury allocates CSO funding to PWC in accordance with Government policy regarding:

- the provision of electricity supply services to domestic customers and small businesses and other organisations across the Territory at uniform tariffs (\$38.0 million in 2005-06);
- the provision of electricity supply services to Tranche 4 electricity customers (primarily medium size businesses and other organisations) at a subsidised tariff (\$7.4 million in 2005-06); and
- the provision of water and sewerage services to all customers at a uniform tariff (\$5.0 million in 2005-06).

A variation in estimated 2005-06 funding for uniform tariff and Tranche 4 electricity customers has been applied in response to the Utilities Commission's final determination on the regulated asset value of the PWC's electricity networks, released on 30 March 2005.

The Utilities Commission has determined that the regulated asset value used to calculate electricity network prices in 2004 required adjustment due to revised asset valuations. Consequently, the Commission has reduced the regulated asset value of electricity networks, in place as at 1 July 2002, from \$431 million to \$350 million.

As network costs are a component of the total costs of electricity supply, the Commission's decision serves to reduce the value of both the uniform tariff (approximately \$9 million) and Tranche 4 (approximately \$1.3 million) electricity CSOs compared to payments in 2004-05.

The uniform tariff CSO is not currently fully funded from the Budget. The unfunded component is met through PWC earning lower profits, and Government as owner accepting lower dividends, than would otherwise be the case. Conversely, the Tranche 4 CSO is fully funded as this class of customer can choose their electricity supplier under the current electricity supply industry regulatory framework.

Consequently, 2005-06 CSO estimates for PWC reflect a transfer of \$1.3 million from the Tranche 4 customer CSO to the uniform tariff CSO. This has the affect of reducing the unfunded component of the uniform tariff electricity CSO while maintaining the fully funded nature of the Tranche 4 CSO.

### **Northern Territory Tourist Commission**

Northern Territory Tourist Commission provides Territory Discoveries, the Territory Government-owned tourism product wholesaler, with CSO payments to fund net costs incurred by the Northern Territory Holiday Centre in Alice Springs, specific shoulder season campaigns which assist in promoting the Territory as a year round destination, and the inclusion of small tourism operators in its reservation system (\$0.4 million in 2005-06).

### **Department of Community Development, Sport and Cultural Affairs**

Territory Housing receives CSO payments from the Department of Community Development, Sport and Cultural Affairs for non-commercial activities such as:

- rental rebates for low-income families to enable them to access secure, safe and affordable accommodation (additional \$1.9 million in 2004-05 and 2005-06);
- providing incentives for people with medium to low incomes to increase the level of home ownership within the Northern Territory;

- rental subsidies for Northern Territory police personnel; and
- reducing up front costs for public housing tenants purchasing their homes through the provision of a stamp duty grant.

It is estimated that a total of \$20.6 million in CSOs will be paid to Territory Housing in 2005-06.

### **Department of Health and Community Services**

PWC receives CSO payments to fund subsidised electricity, water and sewerage tariffs for pensioners under the Department of Health and Community Service's Pensioner Concession Scheme (\$3.4 million in 2005-06).

### **Department of Infrastructure, Planning and Environment**

There are four non-commercial functions carried out by Territory Wildlife Parks for which CSO funding from the Department of Infrastructure, Planning and Environment (totalling \$7.8 million in 2005-06) is provided. These functions relate to:

- maintaining the Parks' assets to a high standard to assist the growth and development of the Territory's tourism industry;
- supporting the Territory's biodiversity through captive breeding of endangered, rare and threatened species;
- enhancing the education of school children by teaching them the benefits of the natural environment; and
- management of the Botanic Gardens at the Alice Springs Desert Park.

Darwin Port Corporation (DPC) also receives CSO funding from the Department of Infrastructure, Planning and Environment for non-commercial activities related to the development, operation and maintenance of wharf facilities that support the cruise ship and naval presence in the Northern Territory, the Darwin fishing and tourism industry and international trade through the port of Darwin.

It is estimated that a total of \$2.3 million in CSOs will be paid to DPC in 2005-06.

The full range and quantum of CSOs funded by the Territory Government are detailed in Table 7.1.

Table 7.1: Community Service Obligation Payments

PURCHASING AGENCY/Provider/Description	2004-05 Estimate	2005-06 Budget
	\$000	\$000
<b>NORTHERN TERRITORY TREASURY</b>	<b>48 939</b>	<b>50 437</b>
<b>Power and Water Corporation</b>		
Uniform Tariffs	40 385	43 022
Tranche 4 Customers	8 554	7 415
<b>NORTHERN TERRITORY TOURIST COMMISSION</b>	<b>448</b>	<b>448</b>
<b>Territory Discoveries</b>		
Tourism Marketing	448	448
<b>DEPARTMENT OF COMMUNITY DEVELOPMENT, SPORT AND CULTURAL AFFAIRS</b>	<b>15 730</b>	<b>20 560</b>
<b>Territory Housing</b>		
Rent Subsidies	13 404	13 404
Low Interest Home Loans	647	647
Early Start - Deposit Assistance Scheme	60	
Fringe Benefits Tax on Employee Loans	48	48
Interest Subsidy	400	290
Stamp Duty Differential	84	84
Police Rent Forgone	1 087	1 087
Government Employee Housing		5 000
<b>DEPARTMENT OF HEALTH AND COMMUNITY SERVICES</b>	<b>3 421</b>	<b>3 421</b>
<b>Power and Water Corporation</b>		
Pensioner Concession Scheme	3 421	3 421
<b>DEPARTMENT OF INFRASTRUCTURE, PLANNING AND ENVIRONMENT</b>	<b>10 542</b>	<b>10 101</b>
<b>Territory Wildlife Parks</b>	<b>7 445</b>	<b>7 817</b>
Territory Wildlife Park - Tourism	3 725	3 975
Territory Wildlife Park - Threatened Species	475	475
Territory Wildlife Park - Education	222	222
Alice Springs Desert Park - Tourism	1 985	2 107
Alice Springs Desert Park - Threatened Species	118	118
Alice Springs Desert Park - Education	277	277
Alice Springs Desert Park - Botanic Gardens	643	643
<b>Darwin Port Corporation</b>	<b>3 097</b>	<b>2 284</b>
Small Craft Services (Marine Industry Support)	280	274
Swires Shipping (NT Express)	256	
Cruise and Defence (Wharf Precinct)	1 549	1 507
Tourism and Real Estate (Wharf Precinct)	480	473
Security - City Wharves Infrastructure	502	
Hai Win Shipping Service (MV Ursula)	30	30
<b>TOTAL</b>	<b>79 080</b>	<b>84 967</b>

## Tax Equivalents Regime

GBDs incur similar tax liabilities to privately owned organisations. This measure ensures greater parity between the cost structure of GBDs and the private sector, aiding in the achievement of competitive neutrality. For example, PWC and DPC pay local government rates equivalents to the Central Holding Authority.

Additionally, although PWC has not had to pay income taxes prior to 2004-05 due to significant carry forward tax losses, it is estimated that PWC will pay \$15.5 million in income tax equivalents for 2004-05 and \$12.9 million for 2005-06. The forecast decrease in income tax equivalents for 2005-06 is due to lower profitability forecast associated with higher costs and restricted price growth for 2005-06 in comparison to 2004-05.

**Table 7.2: Tax Equivalents**

	2004-05 Estimate	2005-06 Budget
	\$000	\$000
<b>Income Tax Equivalents from GBDs</b>		
Government Printing Office		115
NT Fleet	2 474	2 678
Data Centre Services	513	481
Darwin Bus Service	30	46
Northern Territory Treasury Corporation	7 152	6 974
<b>Total Tax Equivalents from GBDs</b>	<b>10 169</b>	<b>10 294</b>
<b>Income Tax Equivalents from GOCs</b>		
Power and Water Corporation	15 497	12 941
<b>Local Government Rates Equivalents from GBDs</b>		
Darwin Port Corporation	147	149
<b>Local Government Rates Equivalents from GOCs</b>		
Power and Water Corporation	148	151
<b>Total Tax Equivalents</b>	<b>25 961</b>	<b>23 535</b>

Note: GBDs not shown paid no tax in 2004-05 and are not expected to in 2005-06.

## Dividend Policy

If the Treasurer is satisfied that a GBD or GOC has sufficient resources, it may be determined that the GBD or GOC is to pay a dividend to the Government. Generally, the Territory Government's primary benchmark is an ordinary dividend of 50 per cent of after-tax profit. However, a dividend payout ratio of 50 per cent may not always be appropriate, particularly where:

- a GBD's or GOC's debt levels are unsustainable in the medium to long term;
- where a GBD or GOC has significant future capital expenditure needs; or
- the Government elects to receive a lesser amount due to CSO obligations.

The Board of a GOC is to declare the amount of a dividend on the shares of a GOC, but the shareholding Minister may direct the Board of a GOC to declare a special dividend.

Special dividends can be declared where there are sufficient resources to pay an extra amount. An example is the Northern Territory Treasury Corporation, which operates as the Government's Central Financing Authority. The corporation generates its revenue from the positive margin between lending and borrowing activities. As the corporation does not need to retain profits to meet capital costs it is appropriate for it to pay a dividend of 100 per cent of after-tax profit.

Dividends payable by GBDs are projected at \$35.3 million in 2005-06, representing a decrease of \$3.2 million from 2004-05.

PWC's projected dividend in 2005-06 is \$15.1 million which is 50 per cent of its net profit after tax. This profit level is reached after the payment by the Territory of the \$53.9 million CSO to be paid in 2005-06, and a further \$6 million provided by Government in the form of assets that will be owned by PWC.

**Table 7.3: Dividends Payable to Government**

	2004-05 Estimate	2005-06 Budget
	\$000	\$000
<b>Dividends from GBDs</b>		
Data Centre Services	599	561
Government Printing Office	269	227
NT Fleet	2 886	3 125
Darwin Bus Service	35	54
Northern Territory Treasury Corporation	16 688	16 271
<b>Total Dividends from GBDs</b>	<b>20 477</b>	<b>20 238</b>
<b>Dividend from GOC</b>		
Power and Water Corporation	18 080	15 097
<b>Total Dividends to Government</b>	<b>38 557</b>	<b>35 335</b>

## Public Private Partnerships

Public private partnerships (PPP) is a term used to describe a method of procuring Government infrastructure and associated services. PPPs create opportunities with the private sector for increasing investment in social and economic infrastructure and the Territory's PPP policy framework, *Territory Partnerships*, defines the protocol for such commercial dealings between the public and private sectors.

Generally projects considered for PPP arrangements are those with significant whole of life costs (generally greater than \$50 million in today's dollars) and which are long term in nature (20 to 30 years). Usually a PPP project will be attractive to the private sector, where it presents a viable commercial business opportunity. A commercial opportunity is more likely to be created where third party revenues are available (such as from road tolls on a roadway) or where economies of scale can be achieved in construction and ongoing maintenance (such as with a group of schools).

From the Government's perspective, value for money will be achieved where private sector experience and expertise in delivery of the project exists and there is an environment of competitive tension to deliver the best outcome for Government. To achieve this, a PPP requires a rigorous and structured project development and evaluation process which assists in allocation of risks to the party best able to manage them. With these elements present, the bidding process will help ensure that efficient and optimal risk transfer occurs at realistic cost and that service delivery and innovation is maximised.

The Territory formally released its *Territory Partnerships* framework in April 2004. In line with a move by all governments in Australia towards uniform policy in this area, the policy is largely based on the policies of both the Victorian and New South Wales governments. The *Territory Partnerships* framework is premised on:

- the primary decision-making criteria as to whether to pursue a PPP being value for money and whether the project is considered to be in the public interest;

- all potential PPP projects require development of a public sector cost benchmark or comparator;
- projects of sufficient scale (\$50 million net present value whole of life costs would normally be the minimum size) and duration;
- projects with capacity for optimal risk allocation between the public and private sectors;
- projects which allow scope for innovative solutions from the private sector;
- projects which provide a genuine business opportunity for the private sector; and
- projects which foster a competitive bidding environment.

In progressing a uniform Australia-wide approach to PPPs, the Territory is represented on a National Ministerial Forum which focuses on fostering and promoting a national PPP market.

The Territory's first project under the *Territory Partnerships* framework is the Darwin City Waterfront Redevelopment project. This project involves the redevelopment of some 25 hectares of waterfront land in Darwin and the construction and long-term operation of the Darwin Convention and Exhibition Centre, as well as residential and commercial components.

## Darwin City Waterfront Redevelopment Project

The Darwin City Waterfront Redevelopment project is a significant initiative developed by the Northern Territory Government under its *Territory Partnerships* policy for public private partnerships. This project will combine substantial community infrastructure, the Darwin Convention and Exhibition Centre (DCEC), a serviced hotel and residential accommodation. It will be linked to Darwin's central business district via the Avenue of Honour and will provide economic opportunities as well as recreational and social opportunities for Territorians and visitors to the Top End. The Territory Government's financial contribution for the community infrastructure and the DCEC through a public private partnership has resulted in a \$1.1 billion project that will deliver long term economic and social benefits to the Northern Territory.

The Northern Territory Government called for expressions of interest for the redevelopment of the Darwin City Waterfront site owned by the Territory in September 2003. Eleven expressions of interest were received and three consortia were short-listed to respond to a call for detailed proposals document that sought the redevelopment of the site, with the construction and operation of the DCEC as the centerpiece of Stage 1 of the redevelopment. Public Infrastructure and commercial and residential developments were also expected as part of the redevelopment.

The Darwin Cove Consortium was selected as the preferred proponent for the redevelopment in September 2004. The Territory is currently finalising negotiations for the associated commercial relationship with the consortium. Given that the commercial relationship is still being finalised at the time of printing of these budget papers, the explanation of the proposed transaction is necessarily high level as many matters are commercial-in-confidence. The Consortium comprises ABN AMRO Australia Limited, the Sitzler Bros Barclay Mowlem joint venture, MacMahons NT, and Toga Pty Ltd.

The transaction is expected to involve the following key elements:

**(1) Darwin Convention and Exhibition Centre**

- The DCEC will be constructed during Stage 1 of the redevelopment and be completed by April 2008 although an earlier construction completion is being targeted. The DCEC will be delivered through a public private partnership arrangement.
- The consortium will finance, design, construct, provide ongoing maintenance and operate the DCEC for 25 years with the Sitzler Bros Barclay Mowlem joint venture constructing the DCEC and taking design and construction risk. Honeywell Inc is proposed to maintain the DCEC for 25 years and Ogden Australia Pty Ltd is proposed as the convention centre operator.
- The transaction is structured such that the consortium owns the convention centre with ownership of the DCEC transferring back to the Territory after 25 years. The owners and operators of the DCEC will be incentivised to attract international and national delegates.
- The Territory will make payments over 25 years for the DCEC that include capital, maintenance, operating cost and incentive based components. The operating arrangements will be reviewed on an annual basis to take into account actual performance. In particular, incentives are built into payments so that both the DCEC owner and operator are incentivised to maximize the growth in convention delegate numbers. As such, annual payments will be adjusted accordingly.
- Payments can be abated or suspended if the DCEC is not maintained to appropriate standards or the consortium is in breach of its obligations.

**(2) Community Infrastructure**

- The community infrastructure includes a seawall, extensive boardwalks, children's playground, swimming facilities, wave pool, a new cruise ship terminal at Fort Hill Wharf and an Avenue of Honour that connects Darwin's Central Business District to the Darwin Cove facilities.
- The community infrastructure will be delivered by MacMahons NT and is anticipated to be commenced soon after financial close is reached and be completed around April 2007.
- The Consortium will design and construct the community infrastructure with the MacMahons NT joint venture taking on design and construction risk. The Territory's payments will be staged, in line with the planning and construction timetable. Ownership of the community infrastructure will transfer to the Territory on completion.
- The Territory will establish an authority to manage the overall site including the community infrastructure.

**(3) Property Development**

- The Consortium will develop the commercial aspects of the site over time and in accordance with market demand. The arrangements will ensure that Stage 1 of the property development will be delivered shortly after the Convention Centre is complete, and include an apartment hotel to complement the DCEC and approximately 138 residential units and commercial and retail space.
- The remaining property development stages (total of approximately 1400 apartments for both stages) will be delivered over time in accordance with market demand. It is expected that the full development of the site will occur over 15 years.

- The Consortium will also be responsible for providing community infrastructure to the remaining property development stages.

## Financial Implications

The redevelopment of the 25 hectare site has an estimated value upon completion of \$1.1 billion. The majority of the construction costs will be invested by the Darwin Cove Consortium.

The Territory has responsibility for making operational payments for the DCEC over 25 years and the stage 1 community infrastructure. The Territory will share in the property returns from the development of all stages as they occur. The Territory decided to share in the increasing uplift in the value of its land over time as the property is developed rather than selling the unimproved land to the consortium.

As set out in the *Territory Partnerships* policy, before proceeding with these arrangements with the private sector, the Territory undertook a detailed appraisal of the project including an estimate of those elements of the project for which it would assume financial responsibility. This is known as the establishment of a “public sector comparator”. This analysis showed that a significantly better financial outcome would be achieved for the Territory through an arrangement with the private sector. This comparison does not take into account the related economic benefits that the project will deliver through direct investment by the Consortium, over and above the benefits associated with the Territory’s own financial investment.

The Territory is likely to make some payments at the completion of the construction of the DCEC and will then make payments over 25 years to the consortium. These payments are for the DCEC’s capital cost and its maintenance and operation. Payments can be withheld should the DCEC not be maintained to appropriate standards.

The Territory will also make payments during the 25 years of DCEC operations to reward the DCEC owners and operators for attracting national and international delegates.

The Territory will also receive revenue as the site is developed by the consortium. The Territory will share in the gross sale proceeds of the residential and associated commercial elements of the redevelopment which means that the Territory will share in the ongoing increase in land values at the site as it is developed.

There are some risks in relation to the Darwin City Waterfront Redevelopment project that may result in payments being made by the Territory. These risks relate to discriminatory changes in law, native title and environmental clean-up costs. The amount of these risks is unable to be estimated accurately but provision has been made in the forward estimates for environmental clean up costs and it is within the Territory’s discretion whether to make a discriminatory change in law. In addition, the Territory will undertake works to improve the road system to the site through the Territory’s capital works program.

The Territory’s contribution to this project is best described in net present cost terms (today’s dollars) that takes account of the contributions to be made by the Territory during the construction of the community infrastructure and after the completion of the DCEC, as well as taking account of the future revenue streams expected to be received by the Territory as the consortium fully develops the Darwin City Waterfront site. The revenues to be received from sharing in the property development gross sale proceeds will partly offset the Territory’s

contribution to the development of the community infrastructure and the construction, operation and maintenance of the DCEC.

As at the time of printing of these budget papers some of the contractual arrangements are yet to be finalised, and the forecasts contained in the budget are based on the best estimate able to be made of the arrangements that may be agreed. At a minimum, the financial forecasts will differ due to interest rates that will be applied at financial close and the final outcome of negotiations. At the time of printing these budget papers, it is not expected that these differences will be material in the context of the overall size of the project.

## **Commercial Risks in Relation to the Budget**

This section outlines risk issues that relate to formulation of the Budget and the performance of the public sector against the Budget. All forecasts are subject to a degree of risk and therefore some risk attaches to the Budget and forward estimates.

The Budget and forward estimates have been developed based on a range of factors about which consensus exists at the time the Budget is framed. However, events occurring after the Budget has been tabled may affect actual budget outcomes in current and future years.

In addition to changes in economic or other parameters, such as inflation rates, interest rates and exchange rates, factors which may affect the Budget outcome result from the commercial relationships and dealings between the Territory Government and other governments or the private sector. These encompass matters such as the exclusion of certain items from forecasts because of uncertainty about timing, and possible crystallisation of contingent liabilities.

In any discussion about the Budget, it is important to consider that the largest source of revenue for the Territory Government is Goods and Services Tax (GST) revenue paid by the Australian Government. While it is expected that national GST collections will grow over time, the revenue base is subject to significant volatility. Additionally, the recommendations of the Commonwealth Grants Commission are of greater importance to the Territory than to other jurisdictions because of the Territory's greater reliance on GST revenue, and they therefore pose greater risks to the Territory than to other jurisdictions. Further discussion on the risks to GST revenue estimates is provided in Chapter 5 of this Budget Paper.

## **Contingent Liabilities**

A contingent liability is a liability that the Government may be called on to meet at some future date if a specified event should occur. Contingent liabilities of the Territory may arise out of a range of circumstances, the most common of which are indemnities and guarantees contained in agreements executed by the Territory. Contingent liabilities may also arise as a result of undertakings made by the Territory or as a result of legislation containing a guarantee or indemnity.

Details of estimated amounts of material contingent liabilities at 30 June 2004 resulting from guarantees or indemnities granted by the Territory are presented in Table 7.4.

Table 7.4: Material Quantifiable Contingent Liabilities

	Estimated Quantifiable Contingent Liability at 30 June 2004
	\$M NPV <sup>1</sup>
Amadeus Basin to Darwin Gas Pipeline	261
Pine Creek/McArthur River Electricity Purchase Agreements	101
Public Trustee Common Fund	26

<sup>1</sup> Future values discounted at a nominal 7 per cent discount rate.

Material contingent liabilities of the Territory cover guarantees and indemnities of the Territory and are disclosed in annual financial statements of the Territory in accordance with Australian Accounting Standards requirements. Quantifiable and unquantifiable contingent liabilities of the Territory are outlined briefly below.

## Quantifiable Contingent Liabilities

### Electricity, Gas and Water Supply

These contingent liabilities result from arrangements for the purchase and transportation of gas, and the purchase and sale of electricity by and for PWC. Material contingent liabilities relating to these arrangements are reported below.

PWC has been a government owned corporation (GOC) since 1 July 2002. Under the *Government Owned Corporations Act*, a GOC is not within the shield of the Crown and the obligations of a GOC are not guaranteed by the Territory except where the Treasurer specifically agrees to this. The following Territory commitments were given prior to PWC (formerly Power and Water Authority) becoming a GOC and will remain in place until the relevant contractual arrangements cease.

### Amadeus Basin to Darwin Gas Pipeline

The Territory indemnified the company which constructed the natural gas pipeline from the Amadeus Basin to Darwin in support of obligations of PWC to the company. The Territory also supported the corporation's financing obligations to the pipeline company and its financiers. Should this facility be terminated prior to the end of the contract term, the Territory undertook to stand behind and, if necessary, underwrite the refinancing of the outstanding facility amount including a lease residual due to be paid at the end of the facility term. The lease residual at the end of the contract term is a direct contingent liability of the Territory unrelated to any obligation of PWC.

The Territory guaranteed gas producers in support of the obligations of a subsidiary company of PWC under gas purchase contracts and provided a letter in support of a loan to the corporation's subsidiary company used to meet the company's development obligations under a gas purchase agreement.

In the event that PWC experienced a significant decline in its sales of electricity, there is a risk that the corporation may have a lesser requirement for natural gas to be delivered through the Amadeus Basin to Darwin gas pipeline. In circumstances where the decline was severe, both gas purchase contracts and the pipeline financing arrangements could present a risk to the corporation and the Territory, as there would be ongoing payments made despite reduced need for delivered gas. This situation is considered highly improbable.

On the other hand, there is a risk that contracted supplies of gas will prove inadequate to meet the fuel needs for a public electricity supply. Although most installed capacity that generates electricity for public supply can use alternative liquid fuels, there is presently a very significant price differential between gas and

liquid fuels at all locations where gas can be delivered through existing infrastructure.

PWC has advised that it expects to be able to meet its needs and those of the public electricity market for at least the next five years. Within this timeframe, the corporation is planning to contract for additional gas supplies, most likely from one of the gas fields located in waters adjacent to the Top End of the Territory. Risks related to gas supply shortfall are not associated with guarantees or indemnities in contracts, as they relate to situations where existing contracts cannot meet PWC's needs.

### **Electricity and Gas Supply to Pine Creek and McArthur River**

PWC has entered into agreements for the provision of gas and wholesale supply of electricity for the supply of power to the Pine Creek region and McArthur River Mine. The agreement for the supply of gas contains three indemnities relating to PWC supplying non-conforming gas. PWC's contingent liability is unquantifiable. However, a major portion of the value of the contingent liability is the cost of overhauling turbine machinery owned by the electricity producers, where damage has been caused by the provision of non-conforming gas. Since 5 March 2003, no gas has been supplied to the power stations, significantly reducing, but not entirely removing, the risk exposure.

Under PWC's current operating practices, the contingent events relating to each of the above indemnities are within the corporation's control and are expected to be easily avoidable.

In relation to the electricity purchase agreements, the Territory has provided an indemnity against possible actions of the Territory in relation to the structure or operations of PWC. The Territory's maximum exposure is equivalent to the net present value of lease and operating charges under the purchase agreements. This risk is within the Territory's control.

### **Transport**

Contingent liabilities in this category relate to indemnities and guarantees that have been provided in support of the Adelaide to Darwin railway project.

The AustralAsia Railway Corporation (AARC) and the Northern Territory and South Australian governments have entered into a concession arrangement for the Adelaide to Darwin railway on a build, own, operate and transfer-back basis.

Quantifiable contingent liabilities of the Territory identified in previous years in relation to the project arose from commitments to provide a capped amount of \$25 million in contingent equity, of which 50 per cent will be provided by the Commonwealth. The equity will be fully called and paid before 30 June 2005.

## **Unquantifiable Contingent Liabilities**

Unquantifiable contingent liabilities exist which could pose a risk to the Government's financial projections.

### **Transport**

Unquantifiable contingent liabilities of the Territory in relation to the Adelaide to Darwin railway project relate to the following:

- joint guarantee of the obligations of the AARC;
- indemnities granted in relation to title over the railway corridor (title is secure but the indemnity continues);

- agreement to compensate in the case of early termination of the project (where a termination event is caused by the Territory); and
- indemnities in favour of the Commonwealth for the Commonwealth's financial contribution.

The Darwin Port Corporation has leased to Asia Pacific Transport Pty Ltd facilities at the East Arm port, interfacing the port and the railway. There are contingent liabilities which arise out of the performance of the facilities.

Although the majority of contingent liabilities arising from the above guarantees and indemnities are unquantifiable, AARC and the governments have comprehensive risk management procedures in place for all events that would give rise to liabilities.

The Northern Territory Government has entered into agreements for the relocation of fuel terminals currently located near the Darwin CBD. The agreements provide for certain unquantifiable contingent liabilities to be provided to the developer of the new fuel terminal and an oil company. Government has put in place comprehensive risk management processes to address potential exposure.

### **Health and Community Services**

The Territory has granted a series of health-related indemnities for various purposes including indemnities to specialist medical practitioners employed or undertaking work in public hospitals and indemnities provided to medical professionals requested to give expert advice on inquiries before the Medical Board. Indemnities have also previously been granted to midwives.

Although the risks associated with health indemnities are potentially high, the beneficiaries of the indemnities are highly trained and qualified professionals. The indemnities generally cannot be called upon where there is wilful or gross misconduct on the part of the beneficiary.

### **Government Administration**

Where the Territory has invited the participation of private sector persons and Government officers on Boards of government owned or funded companies or corporations, the Territory may grant an indemnity to board members, which covers them for any losses that may result from good faith actions. This indemnity is generally consistent with the cover available through directors' and officers' insurance and the policy of issuing an indemnity rather than purchasing commercial insurance is in line with the Government's policy of self insurance.

The resulting contingent liabilities are considered low risk as Board members are professionals selected on the basis of their expertise and knowledge. Further, the indemnities are restricted to good faith actions only.

Indemnities are granted to the Australian Government and other entities involved in funding or sponsoring activities and programs initiated or undertaken by the Territory. Under the indemnities, the Government generally accepts liability for damage or losses occurring as a result of the activities or programs and acknowledges that, while the Australian Government or another party has contributed financially or provided in-kind support, the Territory is ultimately liable for the consequences of the activity or program.

Although the resulting contingent liability may not always be low risk, depending on the activity undertaken, the Territory's financial exposure is no greater than would have been the case without funding or sponsorship assistance.

The Government has indemnified private sector insurers who provide workers' compensation insurance in the Territory. The indemnity covers insurers for losses which may arise as a result of acts of terrorism. It is considered unlikely that the indemnity will be called, notwithstanding that the consequence in terms of financial exposure, should the indemnity be called, is potentially significant.

The Territory Government also generally self insures its insurable risk. The size of the Government budget, coupled with the spread of risk, the small size and high degree of centralisation of Government activities, have been considerations in determining that self insurance is appropriate. Government's primary exposure is to natural disaster risks that are outside Government control, for example, cyclones. In previous years, where catastrophic natural disasters result in major loss, the Australian Government has provided assistance, even beyond the terms of the Natural Disaster Relief Arrangements. Given recent cyclones that have affected parts of the Territory, the Territory has already applied to the Australian Government for assistance under the Natural Disaster Relief Arrangements.

### **Finance**

The Territory's financial management framework is underpinned by centralised banking arrangements. The sole provider of banking-related services has been granted indemnities under the whole of government banking contract. These indemnities are considered not to involve significant risk.

### **Property and Business Services**

Agreements for leases or licences of property, plant or equipment generally contain standard indemnity provisions covering the lessor or licensor for any losses suffered as a result of the lease or licence arrangement. These indemnities are considered not to involve significant risk.

Potential contingent liabilities arising from the Darwin City Waterfront Redevelopment project are covered above.

## **Statutory Contingent Liabilities**

A number of statutory contingent liabilities also exist, however, the prospect of these contingent liabilities being called upon is considered negligible.

### ***Public Trustee Act***

Under section 97 of the *Public Trustee Act*, the Treasurer indemnifies the Common Funds against any deficiencies in money available to meet claims on it. The Common Funds are a repository for all moneys received by the Public Trustee on behalf of estates, trusts or persons, and earns interest. Money to the credit of the Common Funds is invested according to the directions issued by an Investment Board.

### ***Territory Insurance Office Act***

In previous years, a contingent liability related to the Government's potential exposure under section 30(1) of the *Territory Insurance Office Act* has been reported. Section 30(1) provides that the Territory guarantees every policy or contract of insurance or indemnity, and the repayment of, and the interest payable on, each deposit with the Territory Insurance Office in pursuance of a contract or other agreement. Government support is in respect of actual liabilities of the Territory Insurance Office. As this entity is a controlled entity of the Territory Government, the actual liabilities are included in the relevant Uniform Presentation Framework consolidated sectoral financial statements (see Chapter 9 in this Budget Paper) and a contingent liability is no longer separately reported.

### **Negotiations Not Yet Finalised**

Negotiations not yet finalised have the capacity to influence the achievement of budget projections and have the potential to affect both revenue and expenses, as well as the Statement of Financial Position.

However, as indicated above, the Budget and forward estimates have been developed based on a range of factors about which consensus exists at the time the Budget is framed.

### **Legal Proceedings**

Like negotiations not yet finalised, the outcome of legal proceedings brought by and against the Government also have the potential to affect actual Budget outcomes in current and future years. The Budget and forward estimates have been developed based on consensus existing at the time the Budget is framed.