New Corporations Unit (NewCo)

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Submission to Public Accounts Committee

April 2014

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1. Introduction

On 26 March 2014, the Public Accounts Committee (PAC) resolved to inquire into and report on the Northern Territory Government's decision to split the Power and Water Corporation into three separate entities.

The purpose of this submission by the New Corporations Unit (NewCo) based within the Department of the Chief Minister (DCM) is to put on the public record:

- the role of NewCo in implementing the Government's structural separation decision,
- certain background information relating to NewCo's establishment, and
- certain details regarding the progress to date in implementing the structural separation.

2. PWC structural separation[1]

In September 2013, in its capacity as owner of the Power and Water Corporation (PWC), the Northern Territory Government decided to divest PWC of two businesses operating in the electricity supply industry, namely Power Generation and Power Retail, and to establish those businesses as two separate new Government Owned Corporations (GOCs). Power Networks and Power System Control are both to remain with the ongoing PWC (also referred to as the Monopoly GOC).

Structural separation involves both:

- *legal separation*, through the establishment of separate government owned corporations, and
- *governance separation*, with each corporation being subject to its own Board and executive management team.

The sole aim of PWC's structural separation is to strengthen the Government's ability to:

- put a lid on power prices, and
- put downward pressure on power costs.

This will be achieved by structural separation:

- significantly improving the financial transparency of PWC's various lines of business,
- empowering more focussed and specialised Boards and management, and
- removing certain deterrents to competition.

The Government has also instructed that implementation of PWC's structural separation be achieved in accordance with *the Government's implementation objectives*, namely that the separation be achieved:

- on schedule, with the two new corporations commencing operations on 1 July 2014,
- at no inconvenience or disruption to end users,

[1] This section draws on the Department of Treasury and Finance, *Northern Territory Electricity Market Reform: Information Paper* (February 2014) (http://www.treasury.nt.gov.au/Pages/Northern-Territory-Electricity-Market-Reforms.aspx)

- on the basis of fair and equitable treatment of employees,
- within a total budget approved by the Treasurer,
- in ways that involve no net cost to Territory power consumers, and
- in a manner supportive of improving competition and efficiency through regulatory reform.

Among other things, these implementation objectives have served to constrain the extent to which the new corporations will be *operationally* separate on Day 1 (1 July 2014). While the separation of core/front-line operations is targeted from Day 1, there will continue to be a significant amount of shared operations at the back-office level where this does not jeopardise the commercial independence of the new corporations. This means that duplication of a range of back office functions and systems can be avoided, but with the advantage that the associated terms and conditions of supply of such shared services will be made transparent by use of transitional or ongoing service agreements.

3. Establishment and role of the New Corporations Unit (NewCo)

On 9 December 2013, PWC's Shareholding Minister (the Treasurer) wrote to the PWC Board advising that he had "…asked Alan Tregilgas to take responsibility for establishment of the two new GOCs and I would ask that the Board do whatever needs to be done to allow him to complete this task consistent with the Government's stated objectives…" This letter is provided in full at Attachment A.

Subsequently, Alan Tregilgas agreed to plan and manage all matters in relation to establishing the two new corporations as Executive Director, New Corporations Unit, based within the Department of the Chief Minister, commencing on 1 January 2014. The creation of NewCo within DCM was approved by the Chief Executive on 17 December 2013.

NewCo formally commenced on 1 January 2014, at which time Alan Tregilgas took on the role of Executive Director of NewCo under an Executive Contract of Employment with DCM for 6 months through to 30 June 2014. The Executive Director is supported by a Program Coordinator employed by DCM. The Executive Director has a line reporting relationship with the Shareholding Minister, with DCM providing administrative support for the Unit

NewCo's basic role is to represent the interests of the Boards (and executive management) of the two new corporations prior to the legal establishment of these corporations. Until such time as the Boards of the new Corporations are in place, NewCo is responsible for the making of all management decisions on behalf of the two new corporations that are essential to their separation and establishment.

The bulk of the work necessary to achieve the structural separation is being undertaken by PWC officers, both at the (internal) project coordination level and through the various workstreams tackling the associated operational, legal, IT systems, financial and HR requirements of structural separation. As not all the expertise and experience required to support an effective structural separation is accessible from within NT government agencies, NewCo and PWC are being assisted by specialist advisers/consultants engaged for this purpose by PWC and by the Department of Treasury and Finance (DTF).

The Shareholding Minister requires that all structural separation decisions be based on an assessment as to which option, on balance, best achieves the Government's implementation objectives. Key decisions are only taken:

- after consultation with the Monopoly GOC about the costs and consequences (for the Monopoly GOC) of the main alternative courses of action, and
- taking into account an assessment of the relative costs as well as the relative benefits of the main options to the respective new corporation.

The purpose of the above process is:

- to obtain *timely* decisions, and
- to ensure that separation decisions with respect to individual GOCs, whether the two new corporations or the Monopoly GOC, are made on a *whole-of-industry* basis and in accordance with the *shareholder's requirements*.

As a result, the respective responsibilities of NewCo and the PWC Board are as follows. NewCo:

- plans and manages all matters in relation to the creation of the two new corporations prior to their legal establishment,
- makes all key management decisions in relation to the creation of the two new corporations, within the policy framework set by the Government and subject to appropriate consultation,
- ensures key risks have been identified and appropriate mitigation controls are in place,
- negotiates all necessary contracts and service level agreements on behalf of the two new corporations with business units of the ongoing PWC or third party generators/retailers,
- coordinates information flows to the Shareholding Minister as well as to the PWC Board and CEO, and
- ensures external advisers are engaged as necessary.

By contrast, the PWC Board:

- oversees all associated organisational changes within the Monopoly GOC, in time for separation on 1 July 2014,
- through negotiations with NewCo, establishes shared services arrangements – whether transitional or ongoing in nature – and enters into the associated services level agreements or contracts with the new corporations,
- develops commercial contracts for the sale of network connection and access services and wholesale gas supplies to the two new corporations or third party generators/retailers, and
- ensures continued delivery of PWC's responsibilities for all aspects of the supply of electricity in the Territory until 30 June 2014.

4. Key achievements to date and key next steps

After a design phase in January 2014 which developed the implementation project management and governance arrangements and detailed the design of the Day 1 and Day X operating models for the two new corporations, those involved in the structural separation project have focused on implementing all necessary activities to achieve the respective Day 1 operating models and the associated legal and financial separation of the three GOCs.

4.1. Organisational structure and transition of employees

Key achievements to date in this area include:

- organisational structures for GenCorp and RetailCorp have both been finalised and approved by NewCo and PWC.

Key next steps in this area include:

- consultation with unions in regards to the proposed organisational structures,
- organisational structures communicated to impacted staff,
- job descriptions finalised for new or changed roles,
- employee transfer mechanism being clarified, and
- commencement of recruitment of employees to any newly created positions.

4.2. Brand and communications

Key achievements to date in this area include:

- brands and trading names have been determined for the new corporations, and
- legal checks have been conducted on these names.

Key next steps in this area include:

- registration of the trading name, trademark and internet domains for the approved names, and
- development of logos and brand supporting materials.

4.3. Transitional services and service agreements

Key achievements to date in this area include:

- work being well advanced in determining transitional and on-going service agreements requirements.

Key next steps in this area include:

- agreement on pricing principles to be used as a basis for the transitional service agreements (TSAs) and ongoing service level agreements (SLAs),
- SLAs between the Shared Services unit of the ongoing PWC and the new corporations being drafted, negotiated and agreed to, and
- TSAs between units of the ongoing PWC and the new corporations being drafted, negotiated and agreed to.

4.4. Key system and process changes

Key achievements to date in this area include:

- a significant program of work is underway in regards to delivering Day 1 IT and system requirements to the new corporations, and
- a workable solution for Day 1 retail billing has been determined and is currently being validated.

Key next steps in this area include:

- execution of the Financial Management System (FMS) reimplementation program that is required to enable financial separation,
- execution of the 'non-core' separation program that is required to deliver separation of non-core systems and infrastructure,
- validation and implementation of the Day 1 retail billing solution, and
- establishment of the 'residual' retail business in PWC.

4.5. Key external contracts

Key achievements to date in this area include:

- terms sheet exchanged or under development in relation to: the Gas Sales Agreement between PWC's Gas Sales unit and GenCorp, the power purchase agreement between GenCorp and RetailCorp, the network access agreement between PWC Networks and RetailCorp and the network connection agreement between PWC Networks and GenCorp, and
- dialogue commenced between GenCorp and all active third-party retailers, and between RetailCorp and potential third-party generators.

Key next steps in this area include:

- all terms sheets need to be agreed, and
- these agreed terms sheets need to be incorporated into finalised agreements or contracts capable of being signed off by the new Boards once they are constituted.

4.6. Legal and financial due diligence

Key achievements to date in this area include:

- a comprehensive legal due diligence review has been drafted and is currently in review, and
- work has commenced on the financial carve-out and associated financial due diligence.

Key next steps in this area include:

- developing sets of actions to address legal due diligence findings,
- finalising the methodology for the separation of the balance sheet accounts between the three GOCs,
- developing 5 year Statement of Corporate Intent (SCI) financial models for the new corporations and completing operating statement forecasts, and
- drafting a comprehensive financial due diligence report for consideration by the new Boards.

4.7. Establishment of new entities

Key achievements to date in this area include:

- a Board and executive recruitment search process is currently underway,

- interim governance arrangements to apply between the date of legal commencement of the new corporations and their date of commencement of operations have been developed, and
- likely Board meeting dates have been determined.

Key next steps in this area include:

- development of each new corporation's draft SCIs,
- passage and assent of the enabling legislation, and gazettal of the legal commencement date of the new corporations,
- finalisation of the job descriptions for the CEO positions of the new corporations and recruitment action commenced in earnest, and
- nomination of members of the new Boards, and appointment of acting CEOs until substantive appointments are made.

5. Separation costs[2]

A structural separation budget has been developed according to a number of principles.

- The budget is to include only the incremental (or additional) costs directly arising as a result of planning for and implementing PWC's structural separation. These costs are not to count the use of existing staff or resources except where backfilling is necessary, nor the costs of regulatory reform or business improvement.
- The budget has been developed top down, initially for 2013-14 only.
    - Structural separation operating budgets for 2014-15 and onwards for the two new corporations (as well as any capital budgets) will be negotiated in the context of the relevant SCI, and
    - Structural separation-related operating costs incurred by the ongoing PWC in 2014-15 and annually thereafter and any capital costs/investments are to be recovered in full by PWC from the two new corporations via service charges under SLAs and TSAs.
- Major capital spending (IT, systems) by or on behalf of the two new corporations is to be deferred until at least 2014-15.

NewCo is not responsible for all expenditure incurred by the Northern Territory Government on PWC's structural separation. Structural separation expenditure is also being borne by PWC itself and by DTF.

The Treasurer has approved expenditure totalling $2.8 million as the amount to be spent by the Northern Territory Government on PWC's structural separation in 2013-14 (see Attachment B). This remains NewCo's estimate of the total cost of structural separation in the current financial year. This estimate will be reviewed once the enabling legislation has been passed.

All but $400,000 of this approved budget amount for 2013-14 is once off and not recurrent in nature.

This budgeted spend of $2.8 million is little more than one-half of a percentage point (½%) of electricity revenue collected by PWC, which in 2013-14 is expected to be around $450 million.

[2] The costings in this section have been compiled in consultation with DTF and PWC.

For a project of this size and complexity, this is a modest budget.

With regard to the structural separation expenditure being borne by PWC itself, NewCo has agreed that:

- aside from the cost of legal advice which is to the direct benefit of the ongoing PWC, and consistent with their commercial objectives, all separation costs funded by PWC in accordance with the approved separation budget will be recovered from the two new corporations, either on their establishment or via future service charges, and
- NewCo (and not PWC) will be responsible for seeking the Treasurer's approval for any overspends against the approved budget.

Besides the amounts to be spent during 2013-14, PWC's structural separation will also involve the additional annual Board, management, staffing and operational costs of the two new corporations (GenCorp and RetailCorp) which would not be incurred by PWC in the absence of structural separation. Expenditure of this nature to be incurred in 2014-15 and beyond is a matter for discussion and agreement as part of negotiations of SCIs that are yet to take place with the two new corporations. NewCo's estimate is that the additional annual costs of the two new corporations are likely to total up to $4 million annually (see Attachment B). This is less than 1% of electricity sales revenue. These costs primarily involve internal resourcing. This amount includes an allowance for additional user charges that may be necessary to recover any additional spend by the ongoing PWC on IT systems essential to the efficient provision of shared services to the two new corporations.

These structural separation costs are to be recovered by the new corporations by the improved efficiency and operations made possible only by the financial transparency, focussed governance and increased competitive outcomes associated with effective structural separation. These costs are not to be passed onto electricity consumers.

Most of the annual ongoing costs of structural separation from 2014-15 involve internal resourcing. However, the bulk of the separation costs incurred in 2013-14 relate to the engagement of specialist external advisers (consultants). Not all the expertise and experience required to support an effective structural separation is accessible from within NT government agencies.

NewCo has no budget for the purpose of engaging advisers or consulting firms to work on the structural separation of PWC and the Executive Director does not have the appropriate financial delegations. Consultants working on PWC's structural separation are instead funded by PWC or by DTF.

Between them, PWC and DTF have to date engaged a total of nine advisers or consultancy firms to variously work on implementation of PWC's structural separation. These consultants are:

- Ernst & Young Australia – project management and financial separation advice,
- Clayton Utz – legal advice,
- Minter Ellison Lawyers – legal advice,
- Engage People Pty Ltd – Board and executive search,
- NERA Economic Consulting – financial modelling and pricing advice,
- Armature Pty Ltd (Jim Colvin) – legislative and policy advice,
- Australian Representation Services Pty Ltd (Deane Russell) – communications advice,
- Creative Territory – branding advice, and

- NADCO Advisory Services – taxation advice.

The legal advisers (Clayton Utz and Minter Ellison) were both engaged under PWC's existing legal tender panel.

The project management and commercial advisers (Ernst & Young, and NERA) were both engaged under an existing DTF economic advice tender panel.

The board and executive search adviser (Engage People) was contracted after a public select tender process.

The remaining advisers have been engaged in accordance with public sector procurement requirements.

Total expenditure on consultants/advisers working on PWC's structural separation that has actually been incurred amounts to $559,000 as at 31 March 2014. This comprises:

- nil by DCM (for NewCo),
- $435,000 by PWC, and
- $124,000 by DTF.

Attachment A

TREASURER

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Mr Ken Clarke
Chair
Power and Water Corporation Board

Dear Ken

The purpose of this letter is to advise the Board of the Power and Water Corporation (PWC) of some of my expectations for the new Board in light of recent Government decisions.

In its capacity as owner of PWC and with a view to improving the commercial performance of its investment in the Territory's electricity supply industry, the Government has decided to divest PWC of two businesses operating in that industry: Power Generation and Power Retail. As a result, two new Government Owned Corporations (GOCs) will be established on 1 July 2014. Power Networks and, until commencement of a wholesale electricity market in the Territory, Power System Control will both remain with PWC.

As the Shareholding Minister, I do not consider it appropriate that the PWC Board or executive management take direct responsibility for establishing the two new GOCs. This would give rise to a number of conflicts of interest on PWC's part. Besides, the Board already has significant challenges associated with its SCI efficiency improvement targets, which should continue to be the Board's primary focus along with ensuring effective and uninterrupted operations of all its business units through to 30 June 2014.

I therefore request that the Board take whatever action is necessary at the first meeting of the new Board on 11 December 2013 to facilitate implementing the Government's policy decisions in relation to the two new GOCs. The principal tasks will be to:

- plan and manage all matters in relation to the creation of the new GOCs prior to their legal establishment;
- develop and negotiate all necessary contracts and service level agreements between the new GOCs and PWC; and
- ensure the transition process is well communicated to stakeholders.

As you know, I have asked Alan Tregilgas to take responsibility for establishment of the two new GOCs and I would ask that the Board do whatever needs to be done to allow him to complete this task consistent with the Government's stated objectives, namely that implementation be achieved:

Northern Territory Government

- on schedule, with the two new GOCs commencing operations on 1 July 2014;
- at no inconvenience or disruption to end users;
- within a total budget approved by the Treasurer;
- in ways that involve no net cost to Territory power consumers; and
- in a manner supportive of improving competition and efficiency through regulatory reform.

I request that – prior to Christmas – agreement be reached between the Board and Alan on the necessary implementation arrangements, so that those arrangements can commence in earnest on 1 January 2014.

Should any conflicts arise with the Board's obligations under current legislation, I am willing to use my power of direction if the Board is of the view that to do so would assist in overcoming any such problems.

Yours sincerely

DAVID TOLLNER

- 9 DEC 2013

Attachment B

Table 1: Structural Separation Costs – Estimates – 2013-14

	Approved budget[(a)] ($000s)
Board	**150**
CEO, CFO and support	**250**
Specialist external advice	
legal	750
commercial advice & project management	750
legislation and executive search	300
technical advice & financial modelling	350
Total specialist external advice	**2,150**
Corporate costs (branding, comms, etc)	250
TOTAL	**2,800**

Source: New Corporations Unit, Department of the Chief Minister
(a) As approved by the Treasurer.

Table 2: Structural Separation Costs – Estimated Annual Costs (2014-15 $s)

	GenCorp (estimate)[(a)] ($000s pa)	RetailCorp (estimate)[(a)] ($000s pa)	Total (estimate)[(a)] ($000s pa)
Board	350	350	**700**
CEO, CFO and support	700	600	**1,300**
Additional staff	200	800	**1,000**
Other corporate costs	500	500	**1,000**
TOTAL	1,750	2,250	**4,000**

Source: New Corporations Unit, Department of the Chief Minister
(a) As estimated by the New Corporations Unit, and does not include the costs of regulatory reform or business improvement. Excludes any direct costs for the ongoing PWC, but includes an allowance for additional user charges yet to be negotiated that may be necessary to recover any additional spend by the ongoing PWC on IT systems essential to the efficient provision of shared services to the two new corporations.