



The Victorian Treasury and the Smelter Reduction Amount (B)

In July 2003, the case launched by The Australian Steel Company (Operations) Pty Limited (TASCO) against the State Electricity Commission of Victoria (SECV) was handed over to the Department of Treasury and Finance (DTF). That same month, Origin Energy served a cross-claim on the SECV which essentially sought reimbursement for any moneys that may be owed to TASCO as a result of the High Court action. Whether this cross-claim became effective or not depended on the High Court.

In his recollection of the project's early stages, Jeff Byrne, (Director of Revenue Policy) noted that a kind of "war room" mentality emerged, and one of the first challenges facing the department involved determining exactly what they were up against. "We get a lot of constitutional tax cases and what typically happens is that we'd hire the best gun we could find, defend our position and hope that we were right." But this wasn't a routine case as it encompassed legal, regulatory, taxation and accounting issues that cut across several DTF divisions and had broad-based implications for the State. Department Secretary Ian Little soon started seeing the number of potentially involved parties rise considerably: "You talk about the energy industry, it immediately brings in the ACCC [Australian Competition and Consumer Commission], you talk about the Constitution, it immediately it brings in the upper echelon of the legal profession, the Commonwealth Treasury and other state governments." According to Byrne, the attitude quickly became: "We need to get the best people together, and we need to approach it from a whole of DTF basis. We need to have people on it that have got expertise, or who can at least ask the right questions."

This case was written by Marinella Padula, Australia and New Zealand School of Government, for Professor John Alford as a basis for class discussion rather than to illustrate either effective or ineffective handling of a managerial situation. It is a sequel to case 2006-26.1 and precedes case 2006-26.3 and the case epilogue; as such its use is restricted to authorised persons for teaching purposes. The generous assistance and support of the Victorian Department of Treasury and Finance is gratefully acknowledged.

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Assembling a team

The Department soon came to the view that the project should be managed from within the Revenue Policy group in the Economic and Financial Policy Division. The reasoning behind this decision was based on this being a constitutional tax case and the litigation potentially raising Commonwealth-State and revenue policy issues: all issues that Revenue Policy typically managed. Senior leadership within the DTF also had to decide whether to leave the case with Sandra Denis, Assistant Director of Revenue Policy or hand over project management to someone else. Remarked Ian Little:

“[Sandra Denis] is a very talented person with a lot of technical skills. We also thought this would be a great learning experience for her. The only drawback was that she’d never managed something as big as this before. We went with our gut instinct [and chose her] which was a bit of a risk but we surrounded her with a couple of other experienced people... Usually in treasuries when the big juicy jobs come along, you either leave it to the trusted few who’ve done it before, or you throw it to a new person and let them sink or swim.”

Adrian Nye (a Director in the Economic and Financial Policy Division who was leaving the Department at the end of 2003) was assigned to the project as co-manager to provide Denis with support and ensure a smooth transition. Ian Little also set about marshalling resources to facilitate a successful outcome. Within a few weeks budgets were allocated, dedicated office space set up and the project managers were given the authority to decide how resources were distributed. To oversee the project, the Department established a project board comprising Ian Little and Helen Silver (then Deputy Secretary, Economic and Financial Policy). The project board was to ensure the project team had a clear sense of direction and assist in the evaluation and preparation of an appropriate government response. The project board also had more hands-on involvement, as Little explained:

“One important thing about projects like this is that everyone needs to play the role they’re set up to play, otherwise you get gaps. I would have loved to get more involved in the technical detail but that wasn’t my job. My main job was to ensure that the resources were available for the project team and at several instances it became obvious that there was more expertise we needed that we didn’t have. I would ring up other department heads or agencies and say, ‘I can’t tell you what this was about, but we need your best person for three months.’ My other tasks were to open doors at senior levels and to try and remove obstacles where there were instances of people or organisations that couldn’t see beyond their own interests.”

The internal project team was broadened and now comprised Ian Gibson (Solicitor to the Department), Jeff Byrne (Director, Revenue Policy) and Jesse Brooke (Senior Policy Analyst). The internal governance structure was also set up very quickly. Sandra Denis (with Ian Gibson, Adrian Nye and Jeff Byrne) reported to the project board on a regular basis (often fortnightly) which was time-intensive but something that was considered to be a necessary discipline on the process.

Denis recognised the need to recruit the necessary external expertise quickly. Her previous experience in the Energy and Security Division in the Department of Infrastructure helped her identify those with the best technical skills and industry knowledge, and Little’s willingness to personally enlist assistance from other

departments and agencies proved extremely valuable. But restrictions limiting how much she and Little could reveal about the case and to whom added an extra layer of difficulty. Denis also had to enlist sufficient people to effectively address the problem whilst knowing that, if anyone leaked information too soon, or the wrong details, the DTF could have an even bigger issue on its hands.

The industry experts called upon included senior officers from the Energy and Security Division (Department of Infrastructure), the SECV, electricity network administrator VENCORP, the State Revenue Office and legal advisers including the Victorian Government Solicitor's Office and Allens Arthur Robinson. While the parties would each lend their knowledge and experience, the DTF project board would ultimately decide on the direction taken and the recommendations to be put to the Treasurer. Some experts were to be enlisted on an ad hoc basis as specific questions arose; other specialists would be seconded to the DTF for as long as necessary. Different working groups would then be formed to tackle different aspects of the problem.

Approaching the problem

After some spirited internal debates and exploring a number of initial possibilities, it became increasingly apparent that there wasn't a straightforward, overnight solution. Towards the end of September 2003, the DTF decided that a two-pronged approach would be best: namely, to rescind the SRA and find a replacement whilst continuing to defend the case. Jeff Byrne explained the rationale thus:

“We pretty quickly decided that we needed to be both defensive and offensive. Within about a month we were looking at replacements because, given the amount of money involved, to take a chance that we would be successful was a pretty high-risk strategy, even if there was an 80-90 percent chance [of winning]. Constitutional cases typically take two to three to four to five years to resolve, so if you go down the road of defence and it turns out that you're unsuccessful then you've got four or five years of extra problems you have to unravel. We couldn't really take the punt.”

This added considerably to the complexity of the project – not only was there the litigation to manage, but now the DTF was also required to manage the State's assumed risk exposure and find an alternative, viable revenue source. Given the Government's commitment not to introduce any new taxes, this made the task an even greater challenge. In her communications with the Treasurer's office, Sandra Denis knew that the Government was eager for a quick and clear response: “It was the Treasurer's office preference very early on, ‘We want a simple, effective solution.’ And our reaction was, ‘We're not sure that's achievable – there's nothing actually sticking out as a complete solution to this.’ ” Added Byrne:

“The Treasurer in particular was very keen on one thing that could be done in one hit and was easily explained. Brumby was after a ‘clean cut’ from the old regime to the new one.... Giving the public the impression that nothing had changed was really important. What the Government did not want was a debate about impacts on electricity prices because if it got to that, then you've got a whole different debate going. If it's just an argument between some electricity retailers and some large public companies fighting legal cases, you can deal with that. It would make a half page in the back business section – it's not the front page of the *Herald Sun*.”

Although the State would continue to defend the court action, the project team knew that it had to find an alternative as soon as possible to minimise the potential for future problems. But even with such ready access to internal and external expertise, the task was still not a straightforward one. “One of the things I was mindful of was that you can fairly easily find a tax that gets money,” Byrne noted, “It was about trying to find something that didn’t have a major redistribution effect. If you do that, then it will essentially be portrayed out in the public as just a new tax. The aim was, if we could do it, was to find something that also closely matched the previous [regime],” he explained. At least now, the team was clear on the requirements of a good solution. These were outlined in a DTF briefing document:

“There are five main criteria that need to be satisfied if an option is to be practicable:

- that it can be implemented given the existing regulatory arrangements in the electricity industry;
- that it matches as closely as possible the existing distribution of the SRA (*i.e. the same economic “footprint”*);
- that it does not distort competition in the National Electricity Market;
- that it is capable of withstanding the scrutiny of the High Court, and
- that it is acceptable to the Government (*e.g. relatively simple and easy to communicate to the public*).”

Looking for answers

Intensive brainstorming sessions began in earnest. Sandra Denis rapidly assembled a working group to find an alternative source of revenue with the idea of keeping the group self-contained, whilst still allowing for a variety of perspectives. It was also important to Denis that members were co-located to foster cross-fertilisation of ideas and speed up the idea generation process.

“To the extent possible, we brought experts into the Department to work alongside the project team. I think this worked really well because the experts were readily available to discuss issues and provide advice. It also meant that they were taken out of their current work environment and could fully concentrate on the issues at hand. Had we not adopted this approach, I think we could’ve had serious issues relating to work/priority conflicts and consequently difficulties in meeting our tight timetable.”

Early project team meetings involved getting as many ideas on the table as possible and discussing their merits, which, observed Ian Little, is, “a tricky thing in a professional organisation because people want to criticise an option once it’s put forward. When someone suggests an option, it’s not going to be perfect but the tendency is that someone else will see all the things wrong with it, so it’s taken off the table too soon. We had to quell our natural desire to criticise our ideas before they were fully developed.” However, Denis found a readiness amongst the team to engage constructively:

“The significance of the project resulted in the project team being really focused on delivering results, but even more importantly team members were very supportive of each other – with people willing to help out on any matter or issue that required additional input or resources. Whilst the tight timelines placed a lot of pressure on the

project team, it also inspired some incredibly dynamic discussions, with lots of innovative thinking and strategic analysis.”

The team soon had more than 25 options to explore, refine and gradually eliminate. Although generating ideas had not posed a problem, discerning which options were truly viable proved more difficult. Each new idea involved consulting a slightly different set of experts and stakeholders to discern whether the idea would be accepted and ensure the DTF was operating under the correct set of assumptions. As Ian Little noted:

“It’s a real art to know how much work to put into a proposition. The best way is to have a range of experts around a table with people giving a rough probability of the option’s likelihood of success. If the general consensus was 70-80 percent plus, then we’d take that option further. The idea was to do just enough work to keep narrowing the options down. Ultimately we got down to a few that we decided we had to explore very intensely, but it just shows you that you can’t do that in a normal bureaucratic environment where you’re sending bits of paper from Department A to B to C.”

However, as Ian Gibson recalled, working with external consultants wasn’t always easy:

“The atmosphere within the core leadership group was superb. There were also some of those drawn into the project who were totally committed and energised by it all...[but] there were some other departments whose people seemed to bring some negativity. Sometimes this was just around personality, but it also seemed to come from an unwillingness or inability to change their working style, their resentment that they weren’t in charge, or an inability to have their work placed within the context and demands of the project as a whole. [And] just as there were multiple projects, so there were multiple working groups. Some people who could rightly claim to have worked on the TASC0 project never met others who could make the same claim.”

The team’s biggest frustration stemmed from the fact that it was extremely difficult to obtain answers to legal questions as rapidly as members would have liked. While the DTF’s own internal lawyers were prepared to engage with the team frequently and informally, some external counsel had a different way of working, as Jeff Byrne discovered:

“A big issue was that we were very interested in probabilities, whereas lawyers are traditionally interested in certainty and caution. Also, posing questions is not easy when you’re not exactly sure what the question should be. We’d often pose a question, get an answer and then realise that the question we asked wasn’t quite the right question; we should have asked another one. We were being asked to be fairly formal in the way we asked questions, such as in writing and so on, which became quite difficult because we wanted to iterate straight away.”

Realising the impact this was having on progress, the DTF attempted to improve the situation by a variety of means: “We tried developing personal relationships with the people who were most difficult,” recalled Ian Gibson, “We diversified the source of supply. We put quite direct pressure on others. And when we could see the way things were shaping, we redesigned and reallocated work in order to minimise their involvement, and to confine what they were asked to do to the type of contribution

they were able and willing to make.” But in some instances, they had few options but to live with circumstances as they were. Noted Sandra Denis:

“At the end of the day, lawyers advising Government on matters of significance are always going to want to take their time to think through the issues and discuss the matters amongst themselves, before finally making the advice available. We sought conferences with Counsel to try and get some quick answers but ultimately, I just had to factor into the project timetable the time it would take to obtain this advice. We also had to get smarter about the questions we were asking – the more you asked, the longer the time it might take to get a response, but the less likely follow-up questions were necessary. It was difficult to balance this at times.

One area not causing the DTF concern was the Government. Although keeping a keen eye on proceedings, Treasurer John Brumby was confident in the DTF’s ability to devise a workable solution. “It was a bit disturbing in a way,” recalled Ian Little, “because [the Government] had such absolute confidence that we would come up with a solution. I’m not sure all of them quite understood just how hard this task was.’ Historically, the states had not experienced much success in devising new taxes that could withstand a High Court challenge. Little could only name a handful that had, and to formulate a robust alternative to the SRA within six months or so was looking increasingly optimistic.

Meanwhile for Denis, hitting upon something that would raise a similar amount of revenue, but not produce differential effects in the marketplace, was one of the most important criteria to satisfy. But devising such a scheme and evaluating it was an enormous task. She was also acutely aware how tight their time frame really was. If their solution required the passage of any new legislation, then they would need to have legal clearance before the end of 2003, or early in 2004. This was to enable any legislative changes adequate time to pass through Parliament and be implemented by the start of the next financial year. Within the DTF there was a growing sense of urgency amid a great deal of uncertainty: time was running short.