

National Competition Policy: Applying the Principles to Local Government in Tasmania

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1. Introduction

The National Competition Policy (NCP) Agreements have been operational since 1996 and has implications for all levels of government. Local Government in Tasmania has made significant progress in applying the competition principles in relation to competitive neutrality, legislation review, and, in the case of the reform of water and sewerage services, prices oversight.

This Application Statement has been prepared to ensure that Tasmania continues to meet its obligations as a party to the NCP Agreements. It is intended to assist Local Government in the continued application of competition principles to its activities. It reaffirms Local Government responsibilities in relation to each of the competition principles as set out in the NCP Agreements.

Broad guidance on applying the competition principles to Local Government was initially provided in the former Government's policy statement of June 1996, titled *Application of National Competition Policy to Local Government* (1996 Statement). It included a requirement for review, which was undertaken in consultation with Local Government. The 2004 Statement was developed following that review and replaced the 1996 Statement. This revised Statement supersedes the 2004 Statement.

Tasmania has made excellent progress in meeting its obligations under the Agreements. This is due, in part, to the co-operation of Local Government in implementing NCP.

Further information on NCP and the NCP Agreements can be found at the website of the National Competition Council at: www.ncc.gov.au or ncc.ncc.gov.au.

2. Prices Oversight in Relation to Local Government

Clause 2 of the *Competition Principles Agreement* (CPA) requires state and territory governments to consider establishing independent sources of prices oversight advice where these do not exist.

Tasmania's *Economic Regulator Act 2009* (the Act), which replaces the *Government Prices Oversight Act 1995*, establishes the Tasmanian Economic Regulator as the independent body responsible for conducting investigations into, and reporting on, the pricing policies of government bodies that are monopoly, or near monopoly, providers of goods and services. The Act provides for investigations into complaints of breaches of the National Competition Policy competitive neutrality principles. The Act also provides for inquiries into matters relating to or affecting the pricing policies of certain State and Local Government bodies whether or not they are monopoly, or near monopoly, providers of services and goods.

3. Competitive Neutrality

Clause 3(1) of the CPA requires that government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. This is the principle of 'competitive neutrality'. The objective of competitive neutrality is the

elimination of resource allocation distortions arising out of the public ownership of entities engaged in Significant Business Activities (SBAs), so that ultimately all government businesses compete on fair and equal terms with private sector businesses.

The CPA provides two separate models of competitive neutrality. These are the corporatisation model (clause 3(4)) and the full cost attribution model (clause 3(5)). The CPA requires these models to be applied to the extent that it is in the public benefit. While the CPA sets out these models as alternatives, there is considerable merit in a staged approach to the introduction of competitive neutrality. On an ongoing basis councils must:

- identify all business activities within their operations;
- identify which of these are SBAs;
- apply full cost attribution to those SBAs, to the extent that it is in the public benefit;
- identify those SBAs which are potentially suitable for corporatisation;
- undertake public benefit assessments of the corporatisation of those business activities; and
- corporatise those business activities where a public benefit assessment indicates that the benefits outweigh the costs of doing so.

Councils should refer to the document, titled *Identification and Management of Significant Business Activities by Local Government in Tasmania to Comply with Competitive Neutrality Principles* (previously known as *Significant Business Activities and Local Government in Tasmania*), updated in 2013, which provides guidelines on identifying and reporting on Local Government SBAs. Amongst other things, this document provides that while, in the first instance, councils identify which business activities are significant, the ultimate decision as to what is a business activity and a SBA may need to be resolved by the Tasmanian Economic Regulator, in the event of a complaint under the Act.

The document *Corporatisation Principles for Local Government Business Activities*, December 1998, provides a detailed account of the principles underlying corporatisation and its application to Local Government and will be useful in determining if corporatisation of a SBA is appropriate.

This process has already been undertaken by councils. However, all councils will regularly review their activities to determine if there are any activities that should be classified as business activities and/or SBAs and therefore to which the competitive neutrality principles (either corporatisation or full cost attribution, as appropriate) should be applied.

Under NCP, single and joint local government authorities are required to comply with competitive neutrality principles in the CPA. The *Local Government Act 1993* also imposes obligations on single and joint local government authorities to adhere to competitive neutrality principles.

3.1 Full Cost Attribution and Cost Reflective Pricing

Under the full cost attribution model, councils are required to identify the full costs of providing a SBA. Under clause 3(5)(b) of the CPA, it must be ensured that the prices charged for goods and services of SBAs reflect full cost attribution for these activities as well as taking account of taxes and tax equivalents, debt guarantee fees and application of regulations to which the private sector are normally subject, where appropriate. To assist in determining the appropriate prices, the Department of Treasury and Finance has issued the *Cost*

Reflective Pricing Guidelines (2004). These guidelines provide for prices to be set based on the avoidable cost, which is explained in the above document. In determining these costs for an activity, the value of all resources consumed in the provision of that activity must be considered. To determine these costs, the following must be considered:

- operating costs (direct and indirect) per unit or period, including wages, materials and corporate services costs; plus
- capital costs (direct and indirect) per similar unit or period, such as the opportunity cost of capital; plus
- competitive neutrality costs per similar unit or period, including taxation and guarantee fees.

NCP allows councils to charge less than full cost in order to meet CSOs. The *Community Service Obligation Policy and Guidelines for Local Government in Tasmania*, November 2000, sets out when a CSO can be used and how it must be reported and accounted for.

Councils should also refer to the document, titled *Full Cost Attribution Principles for Local Government*, June 1997, for a detailed guide to applying full cost attribution to their business activities. For guidance on setting prices for SBAs, councils should refer to the above-mentioned *Cost Reflective Pricing Guidelines*.

3.2 Functional Separation

Councils should separate policy, regulatory and contract management functions from operational or service delivery functions where feasible. This is necessary to ensure there is no conflict of interest and that business activities do not enjoy any regulatory advantage over their private sector competitors. However, it is recognised that, for smaller councils, it may not be possible to fully separate these functions.

3.3 Corporatisation

Corporatisation involves establishing a separate legal entity to run a commercial business with the relevant government as its sole shareholder or owner. It does not necessarily involve incorporation under Corporations Law.

Under NCP, corporatisation must be considered for local government businesses that are Public Trading Enterprises (PTEs) or Public Financial Enterprises (PFEs), as defined under the Australian Bureau of Statistics' Government Financial Statistics Classification. A corporatisation model should also be considered for SBAs which are not PTEs or PFEs but need only be adopted to the extent that it is in the public benefit.

Corporatisation of an activity should proceed where there will be a demonstrated public benefit. Where this is determined, the corporatisation model requires that:

- full Commonwealth, state and territory taxes or tax equivalent systems be imposed;
- debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees on borrowings be imposed; and
- those regulations to which private sector business are normally subject be imposed on an equivalent basis.

There will also need to be separation of policy, regulatory and contract management functions from operational or service delivery functions if this has not already occurred in the application of full cost attribution.

Where there is a public benefit to corporatisation, the corporatised activity will then need to be established as a separate legal entity. Where it is determined that there is no public benefit in adopting the corporatisation model for a significant business activity, councils are required to continue to apply the full cost attribution model.

Provided that an entity:

- is unambiguously corporatised;
- pays taxes or tax equivalents,
- pays guarantee fees;
- faces the same regulation as the private sector; and
- seeks to earn a commercial rate of return, particularly for new investment projects,

its pricing can usually be assumed to be commercially based, and there will be no requirement for the separate definition and application of a full cost attribution model. In the event of a complaint, where the Tasmanian Economic Regulator is not satisfied that all of these criteria have been met, the Regulator will look for application of full cost attribution principles and cost reflective pricing policies for goods and services.

To ensure that the corporatisation model adopted is unambiguous, councils should ensure that the principles outlined in *Corporatisation Principles for Local Government Business Activities*, December 1998, are adhered to fully. This requires, among other things:

- providing the entity with clear and non-conflicting commercial objectives;
- separation of supplier and purchaser roles, ensuring 'arms length' trading arrangements;
- appointment of an impartial Board of Directors, based on commercial skills and experience for the business activity concerned (with no councillors appointed as Directors);
- specification of a dividend expectation by the owner council via a Charter or equivalent;
- a clear requirement to return a profit and a commercial rate of return on the owner council's investment or interest on internal borrowings; and
- that any CSO funding is in accordance with the CSO Policy.

Assessments as to whether or not corporatisation is appropriate may need to be revisited from time to time and should be undertaken for new activities.

3.4 Public Benefit Assessments

Where councils are required to consider corporatisation of a SBA, they will be required to undertake a thorough and transparent public benefit assessment. For guidance on undertaking a public benefit assessment, councils should refer to clause 1(3) of the *Competition Principles Agreement* and the document titled *The Public Benefit Test for the Corporatisation of Local Government Public Trading Enterprises*, November 1998.

3.5 Complaints Mechanism

Clause 3(8) of the CPA requires each state and territory to establish a complaints mechanism to oversee the application of competitive neutrality principles. In Tasmania this complaints mechanism rests with the Tasmanian Economic Regulator, which, under the Economic Regulator Act, has the power to receive and investigate complaints against State and Local Government SBAs. That is, when a person believes that a government body undertaking a SBA has contravened any of the competitive neutrality principles and considers that he or she is adversely affected by the contravention, that person may complain to the Regulator. The Regulator will only become involved in a matter in the event of a complaint.

At the outset, all Local Government bodies should make their own assessment of the significance of business activities. However, in the event that a complaint is lodged with the Regulator in relation to an activity that has not been defined as a SBA by a Local Government body, the Regulator is responsible for applying the guidelines contained in the document titled *Identification and Management of Significant Business Activities by Local Government in Tasmania to Comply with Competitive Neutrality Principles* (previously known as *Significant Business Activities and Local Government in Tasmania*), to determine if the activity is, firstly, a business activity and then if it is a SBA. If the Regulator finds that the activity is a SBA, and the other requirements of the Act are satisfied, the investigation can then commence. This is a similar process that is used in relation to complaints against Government agencies.

The process for making and assessing competitive neutrality complaints is detailed in the *Competitive Neutrality Complaints Guideline*, 2010, published by the Regulator. Briefly, the process is as follows:

- a formal complaint is lodged in writing with the Regulator (after the complainant has first discussed the complaint with the relevant Local Government body);
- within 30 days of receiving a complaint, the Regulator must determine whether or not an investigation of the complaint is deemed necessary or appropriate. The Regulator will only accept complaints where it is satisfied that:
 - the complaint contains matter to support the allegation that the principles have been contravened;
 - the complaint contains matter showing how the complainant has been adversely affected by an act by the government body; and
 - the complaint is not vexatious or frivolous;
- for the purposes of ascertaining whether a complaint should be investigated the Regulator may make any preliminary inquiries it considers necessary or appropriate. This may involve requiring the complainant or Local Government body to provide further information or documents and/or verify any part of the complaint or other information or document by statutory declaration. A penalty applies in the case of a government body refusing to provide information during this preliminary assessment;
- the Regulator may resolve the complaint without the complaint being investigated if, having regard to the nature and seriousness of the complaints, the Regulator believes that the complaint may be resolved expeditiously, and the parties to the complaint agree to that resolution;

- the Regulator may refuse to investigate, or if it has commenced an investigation, may refuse to continue with the investigation if, in the opinion of the Regulator, the complaint:
 - does not contain:
 - an allegation that one or more of the CNPs have been contravened, or
 - matter to support such an allegation, or
 - matter showing how the complainant has been adversely affected; or
 - the complaint, or the matter raised in the complaint is vexatious, frivolous or not made in good faith; or
 - there is no evidence that the complainant has been adversely affected; or
 - having regard to all the circumstances of the case, the investigation or continuation of the investigation, is unnecessary or unjustifiable;
- If the Regulator does not consider an investigation is necessary or appropriate, the complainant will be advised of the reasons;
- If the Regulator determines to investigate the complaint, the Regulator will provide written notice of its intention to investigate to the complainant, the Local Government body concerned and its Portfolio Minister, and provide the Local Government body concerned and its Portfolio Minister with a copy of the complaint;
- within 30 days of receiving the written notice, the Local Government body must undertake an internal review and advise the Regulator in writing whether the complaint is justified and, if so, what action is proposed to be taken. If the Local Government body does not believe that the complaint is justified, it should provide the reason for such belief and the relevant supporting information to the Regulator;
- the Regulator reviews the statement of findings of the Local Government body and the outcome of the internal review and, if necessary, conducts a further investigation. Unless an extension is granted by the Minister, the Regulator must complete the investigation within 45 days of receiving the statement of findings from the Local Government body.
- following a review of the Local Government body's findings and any further investigation undertaken, if the Regulator finds the complaint justified, it will provide a report with recommendations for appropriate action (the Regulator may recommend no further action where none is found to be necessary) to the complainant, the Treasurer, the Minister responsible for Local Government and the Local Government body;
- the Minister and the Local Government body must advise the Regulator, within 30 days, of what action will be, or has been, taken to address the recommendations; and
- the Regulator must provide an account of complaints and any actions taken arising from its recommendations in its annual report.

Councils and other Local Government bodies (including single and joint authorities) are required to establish their own internal procedures for dealing with competitive neutrality complaints as the complainant must first discuss the issues in question with the Local Government body before a formal complaint may be lodged with the Regulator. If a complaint arises, the most appropriate place for its resolution is with the council or authority itself, rather than the complaint continuing to a full investigation by the Regulator. Councils and authorities should therefore endeavour to resolve the issue at this stage in cases where it assesses that there is a genuine cause for complaint.

In this regard, it is recommended that councils and single and joint local government authorities nominate a particular officer to be responsible for NCP and any competitive neutrality complaints that may arise. Complaints that are unable to be resolved at the Local Government level, for whatever reason, will continue through the complaints process to the Tasmanian Economic Regulator for assessment and possible investigation.

4. Structural Reform of Public Monopolies

Clause 4 of the CPA requires governments considering the introduction of competition to a market traditionally supplied by a public monopoly, or the privatisation of a traditional public monopoly, to undertake a review into the:

- appropriate commercial objectives for the public monopoly;
- merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;
- merits of separating potentially competitive elements of the public monopoly;
- most effective means of separating regulatory functions from commercial functions of the public monopoly;
- most effective means of implementing the competitive neutrality principles set out in the CPA;
- merits of any CSOs undertaken by the public monopoly and the best means of funding and delivering any mandated CSOs;
- price and service regulations to be applied to the industry; and
- appropriate financial relationships between the owner of the public monopoly and the public monopoly, including the rate of return targets, dividends and capital structure.

In addition, before a government introduces competition to a sector traditionally supplied by a public monopoly, it must remove from the public monopoly any regulatory functions in accordance with clause 4.

5 Legislation Review

Clause 5 of the CPA provides that legislation should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

The State Government's Legislation Review Program established a timetable for the systematic review of all legislation that restricts competition, to ensure that only those restrictions that are fully justified in the public benefit are retained. The timetable included State Government legislation that impacts on Local Government and legislation from which Local Government is exempt, but with which its private sector competitors are required to comply.

5.1 Local Government By-laws

Under section 145 of the Local Government Act, a council may make by-laws in respect of any act, matter or thing for which a council has a function or power under that act or any other act.

All proposed by-laws must be made in accordance with the *By-law Making Procedures Manual* administered by the Local Government Division of the Department of Premier and Cabinet. The Manual represents the by-laws section of the Government's Legislation Review Program. It outlines the statutory and administrative requirements for making by-laws and provides guidance to councils on how to comply.

An important requirement under the Local Government Act is that a council must prepare a regulatory impact statement for by-laws it intends to make (section 156A). The only exceptions are where the purpose of a by-law is to repeal an existing by-law or, under certain circumstances, to amend an existing by-law. The purpose of this requirement is to ensure that any restrictions on competition or significant impacts on the community as a result of the by-law are fully justified as being in the public benefit.

Under the Local Government Act, councils are required to obtain certification from the Director of Local Government of the regulatory impact statement and proposed public consultation program. If the Local Government Division is in any doubt as to whether a proposed by-law properly observes the NCP principles, it will consult with the Economic Reform Unit within the Department of Treasury and Finance.

Other important requirements that apply for all proposed by-laws are:

- public consultation is mandatory;
- a qualified legal practitioner must confirm that a by-law was processed in accordance with the Local Government Act and the General Manager of the council must certify that it is in accordance with the Local Government Act;
- once made by a council, a by-law must be confirmed by the Minister for Local Government and then published by the council in the *Gazette*;
- a by-law is effective from the gazettal date or on a later date specified in the by-law;
- a by-law must be laid before each House of Parliament within the first 10 sitting days after gazettal. Either House of Parliament may disallow a by-law; and
- following gazettal, a by-law should also be forwarded to the Subordinate Legislation Committee of Parliament for assessment. If the Committee is not satisfied that the by-law is adequately justified in the public benefit, it may recommend to Parliament that it be disallowed.

6 Third Party Access

Clause 6 of the CPA requires the State Government to give consideration to establishing a legislated right for third parties to negotiate access to services provided by significant infrastructure facilities.

No councils have operated any infrastructure facilities to which clause 6 applies. It is therefore unlikely that councils will be required to take any action under this clause.

7 Reporting

Councils will continue to demonstrate their compliance with NCP by reporting on the following matters in their annual reports:

- progress in implementing competitive neutrality principles;
- the outcome of any public benefit assessments undertaken;
- a list of the councils' SBAs as determined by councils and any determined as such by the Regulator following a competitive neutrality complaint;
- any complaints received and the outcome of investigation of those complaints;
- the outcome of any assessments undertaken of proposed by-laws; and
- the outcome of any review of the structure of a council monopoly.

8 Contact

Copies of this document can be obtained from the Regulation Review section of the Treasury website: <http://www.treasury.tas.gov.au> or by contacting Treasury as set out below:

Assistant Director
Economic Policy Branch
Department of Treasury and Finance
GPO Box 147
HOBART TAS 7001

Ph: (03) 6166 4252
Fax: (03) 6233 5690
Email: economic.reform@treasury.tas.gov.au