COMPETITIVE NEUTRALITY IN AUSTRALIA: OPPORTUNITY FOR POLICY DEVELOPMENT

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Articles

Competitive neutrality in Australia: Opportunity for policy development

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For competition to be effective in markets where government businesses compete with privately owned businesses, there must be a level playing field. A policy of competitive neutrality aims to ensure this. The article begins by briefly discussing the approach to competitive neutrality in the United States and the European Union to provide context for, and as a contrast to, the Australian approach. Then the origins and implementation of Australia's competitive neutrality arrangements and the experience to date are explained and discussed. Using a real-life example, the utility of the current policy is considered, raising several issues of concern, and suggestions are made to address these. Finally, some conclusions are drawn about the current state of competitive neutrality policy in Australia.

Section 1: Introduction and background

Government may be a direct or indirect participant in markets. In the past, it was assumed that in natural monopoly markets, government should own and operate the businesses in order to avoid consumers facing monopoly prices and to address community service obligations ('CSOs'). More recently, these views have been reassessed and many businesses previously operated by government have been privatised. Nevertheless, government retains a role in the supply of many services but now often faces competition from private sector providers. Competitive advantages may accrue to government bodies which are active or compete in markets merely because of their government ownership. This gives rise to concerns that government-associated businesses may not compete on a level playing field, that is, that they gain a competitive advantage from that association.

The basis for competitive neutrality policy is a recognition that government business activities which are in competition with the private sector should not have competitive advantages because of their ownership. Competitive neutrality policy is thus:

> a regulatory framework ... within which public and private enterprises face the same set of rules and ... where no cont[r]act with the state brings competition advantage to any market participant.[1]

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1 Organisation for Economic Co-operation and Development ('OECD'), *Policy Roundtables: State Owned Enterprises and the Principle of Competitive Neutrality* (2009) Introduction.

However, competitive neutrality is an issue of policy, not law, because even where competition law expressly applies to such entities, these 'advantages' do not generally relate to issues or behaviours within the ambit of competition law itself.

Internationally, various jurisdictions recognise the potential problems linked to competitive neutrality and have taken steps to 'level the playing field' for competition between government bodies and the private sector by implementing competitive neutrality policies or rules; others are exploring options to do so.[2] In this context, Australia is seen as a global policy leader, being described as the jurisdiction with '[t]he most complete competitive neutrality framework implemented today'.[3]

The interaction of law and policy in dealing with issues affecting competition is complex and requires nuanced judgments about the weightings to be given to competition as a public benefit and other public benefits. It is important to remember that in any number of areas there are indefinite boundaries and approaches to conduct. As has been said in the context of weighing this balance:

> [Competition] is not 'open slather' ... there is really no such thing as completely unfettered competition in any area of economic life. As on the sports field, market competition occurs within a framework of rules, obligations and rights which constrain the behaviour of the players. To some extent, the question is really about the nature and degree of any constraints and how they affect performance.[4]

This article begins by briefly discussing the approach to competitive neutrality in the United States ('US') and the European Union ('EU') to provide context for, and as a contrast to, the Australian approach. Section 3 then explains and discusses the origins and implementation of Australia's competitive neutrality arrangements and the experience to date. Using a real-life example, Section 4 explores the utility of the current policy, raising several issues of concern, and making suggestions to address these. Section 5 draws conclusions about the current state of competitive neutrality policy in Australia.

Section 2: An international perspective

While there is general acceptance about the need to ensure competitive neutrality, provisions intended to ensure it differ significantly between jurisdictions. This section briefly explains two extreme positions, that of the US and of the EU.

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2 Deborah Healey (ed), *Competitive Neutrality and Its Application in Selected Developing Countries* (United Nations Conference on Trade and Development, 2014); OECD, *Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business: Report on OECD and National Best Practices in Competitive Neutrality* (2012). See also Antonio Capobianco and Hans Christiansen, 'Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options' (OECD Corporate Governance Working Papers No 1, OECD, 1 May 2011).

3 OECD, *Competitive Neutrality: Maintaining a Level Playing Field*, above n 2, 64.

4 Gary Banks, 'Competition and the Public Interest' (Paper presented at the National Competition Council ('NCC') Workshop: The Public Interest Test Under National Competition Policy, Colonial Stadium, Melbourne, 12 July 2001) 7.

The United States

In the US, partly for philosophical reasons reflecting a strong belief in markets, no separate provisions exist for ensuring competitive neutrality. Issues relating to the conduct of state-owned businesses fall for consideration under the antitrust laws. There are relatively few government-owned businesses and:

> Most of these entities have responsibilities that are nearly indistinguishable from traditional government functions or pursue government policies where a market-based approach is not considered appropriate or has failed to achieve governmental objectives.[5]

Under the State Action Doctrine,[6] the conduct of a public or private enterprise that 'follows the direction of [a] clearly articulated and affirmatively expressed state policy and is subject to active state supervision, is protected from antitrust liability'.[7] In addition, the role of government businesses is 'usually specialized and the extent of competition between the government and private sector is at most indirect, and often negligible or non-existent'.[8]

The State Action Doctrine means in effect that state-directed conduct attracts what in Australia is referred to as 'the shield of the crown' or is conduct subject to a 'regulated conduct' defence, that is, it is exempt from antitrust laws. In 2013, in *Phoebe Putney Health*,[9] the Supreme Court 'clarified the narrow meaning of "clear articulation," [and] ... declined to resolve the question of the availability of a "market participant" exception to the state action doctrine ...'.[10]

Following this, the decision of the Supreme Court in *North Carolina State Board of Dental Examiners* in 2015 makes it clear that such exemptions should be exceptional and subject to strict rules.[11] This case was concerned with whether anticompetitive conduct by a state regulatory board was entitled to state action immunity. The North Carolina State Board of Dental Examiners ('Board') has, under the *North Carolina Dental Practice Act*,[12] authority to regulate the practice of dentistry in the state. Included on the Board is a North Carolina resident selected by the state. The case arose out of complaints by dentists to the Board that non-dentists were providing teeth whitening services at significantly lower prices than their own. Following an investigation, the Board issued cease and desist orders to a number of non-dentists who offered these services. The Board also took other actions, including contacting landlords to discourage them from leasing premises to these non-dentists. It successfully stopped the supply of teeth whitening services by non-dentists.

The Federal Trade Commission ('FTC') alleged the Board's conduct raised

5 OECD, *Policy Roundtables*, above n 1, 225.
6 This was first articulated by the Supreme Court in *Parker v Brown*, 317 US 341 (1943).
7 OECD, *Policy Roundtables*, above n 1, 42.
8 Ibid 225.
9 *Federal Trade Commission v Phoebe Putney Health System Inc*, 568 US (2013).
10 OECD, *Roundtable on Competitive Neutrality in Competition Enforcement: Note by the United States* (16–18 June 2015) 7 (citations omitted).
11 *North Carolina State Board of Dental Examiners v Federal Trade Commission*, 574 US (2015).
12 *North Carolina General Statutes* ch 90 art 2.

antitrust issues. The Board claimed it was protected by state action immunity. The court found that a state regulatory body which has 'a controlling number of ... active market participants' as members must show that:

(i) the challenged restraint was a clearly articulated policy of the state; and
(ii) it was actively supervised by the state.

On appeal from the Fourth Circuit, the US Supreme Court found that the Board was not protected by the state action doctrine. Given the 'controlling number of ... active market participants', the Board was found to be a non-sovereign actor in relation to state action immunity. That meant that in order to invoke immunity it had to establish the factors referred to above. The Court found that it had not been shown that the state had actively supervised its anticompetitive actions. The Court did not specify what constitutes 'active supervision'.[13]

The European Union

The position in the EU contrasts sharply with the approach in the US. State aid was prohibited in the *Treaty of Rome 1958* which established the European Economic Community, the predecessor to the present EU. At least in part, this policy has its basis in the need to maintain a level playing field between member states to support the objective of a single market. Article 107(1) of the *Treaty on the Functioning of the European Union* ('*TFEU*') prohibits:

> any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

In order to establish that a state intervention is state aid, it must be shown that:

- an advantage was conferred by state intervention in the market (because, for example, funding was available on better terms);
- it was selective in conferring benefits on a business, industry, sector or region; and
- the intervention distorts or may distort competition and trade.

Article 107(3) of the *TFEU* provides for a balancing of the benefits from addressing a market failure or other objective in the common interest against the distortionary effect of the conduct. Article 107 will be contravened only if the balance is negative.[14]

The state, when purchasing services from a private sector business, may require it to supply services not otherwise provided by the market. For example, the state may impose obligations on suppliers in order to meet social policy objectives such as CSOs, including universal access to supply, and supply at fair and reasonable prices. Compensation paid in such circumstances will not be considered state aid. The European Court of Justice, in its *Altmark*

13 Note, 'North Carolina State Board of Dental Examiners v FTC' (2015) 129 *Harvard Law Review* 371.

14 For a discussion of these factors, see OECD, *Roundtable on Competitive Neutrality in Competition Enforcement: Note by the European Union* (16–18 June 2015) 9–13.

decision in 2003,[15] found that compensation for public services does not constitute state aid if:

- the universal or public service obligation is clearly defined;
- the parameters for compensation are objective, transparent and established in advance;
- compensation does not exceed costs, including a reasonable profit; and
- compensation is determined either through public procurement or on the basis of the typical costs of a well-run company.

In recent years there has been a flurry of highly publicised claims of state aid in the EU. Some industries (airports) and some governments (Ireland) have featured prominently. This is illustrated by the Irish airports tax. Between March 2009 and February 2011, a tax of €10 per passenger was applied to all flights from Irish airports to airports located more than 300 km from Dublin Airport. For airports within 300 km of Dublin, a tax of €2 per passenger applied. Transit and transfer passengers were exempt. In 2012, the European Commission ('EC') found that the rates were incompatible state aid as they conferred a selective economic advantage on domestic flights over cross-border flights. It ordered recovery of the unlawful aid from Ryanair, Aer Lingus and Aer Arann. The amount recoverable was the difference between the €10 charged for long-distance passengers and the €2 charged on flights of less than 300 km. On appeal to the General Court, the EC's decision was annulled. The court found that the EC should have determined the extent to which the airlines had passed on the benefit of the lower rate to passengers as the basis for determining the actual advantage gained. Further, it should have determined the amount repayable to restore competition to what it would have been absent the tax. In 2016, the European Court of Justice confirmed the EC's original decision.

A number of EC decisions in relation to state aid have related to tax advantages conferred by government. For example, in 2016, Ireland was found to have given illegal tax benefits to Apple worth up to €13 billion.[16] Apple Sales International and Apple Operations Europe are incorporated in Ireland but are fully owned subsidiaries of the Apple Group which itself is controlled by its US parent, Apple Inc. Apple Sales International purchases Apple products from equipment manufacturers around the world for sale in Europe and the Middle East, Africa and India. Although stocked by retailers, Apple products are bought directly from Apple Sales International and so all sales and profits occurred in Ireland.

These companies have the rights to use Apple IP to manufacture and sell Apple products outside of North and South America under a 'cost-sharing' agreement. Under this agreement, the Irish companies make annual payments to the US to fund research and development — they contribute more than half of all such spending in the US. The Irish companies deduct these payments

15 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH* (C-280/00) [2003] ECR I-7747.

16 European Commission ('EC'), 'State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth Up To €13 Billion' (Press Release, 30 August 2016) <http://europa.eu/rapid/press-release_IP-16-2923_en.htm>.

from profits for tax purposes as permitted under an Irish tax ruling which commenced in 1991 and was replaced with a similar agreement in 2007. The tax ruling(s) agreed to an allocation of the profits of Apple Sales International such that most were allocated away from Ireland to 'head office'. 'Head office' had no physical location and so profits were untaxed in Ireland or anywhere else. A similar arrangement existed for Apple Operations Europe. The tax ruling ceased to apply in 2015 when the structure of Apple's two Irish companies was altered.

EU state aid control requires that member states do not give some companies better tax treatment than others. It requires that profits must not be allocated between entities in a corporate group in a way that is inconsistent with economic reality. The arrangement with Apple, and the tax ruling that supported it, were not economically realistic. It allowed the two Irish companies to allocate most of their profits to 'head office' which engaged in no production activities and had no capacity to engage in any sort of business. As a consequence, the EC concluded that the conduct represented state aid.

Apple is one of a number of multinationals investigated by the EC in relation to state aid and tax avoidance, and many are American companies.[17] Companies investigated include Starbucks in the Netherlands, Fiat Chrysler, McDonald's and Amazon in Luxembourg, and Google in Belgium. Controversy has surrounded these cases, with claims that the state aid provisions are being used to address tax avoidance rather than competition issues.[18] The EC, on the other hand, argues that the application of state aid rules to tax benefits is justified because these benefits are discriminatory, providing advantages to some companies that are not available to others.

Section 3: Competitive neutrality in Australia

In the early '90s, Australia conducted a broad review of competition law and policy with the support of all states and territories. It is known as the *Hilmer Review*, and competitive neutrality was one of the many reforms in law and policy implemented on its recommendation.[19] It was commenced against the following background:

> The background to [the Hilmer] reforms was increasing participation by government businesses in private sector markets in the late 1980s and early 1990s. Australian competition policy did not then deal with competitive neutrality as a distinct policy element. Australian governments addressed competitive neutrality on an ad hoc basis with moves towards corporatisation. At that time certain commercially oriented government businesses enjoyed various Crown immunities and advantages over private sector counterparts, including immunity from taxes and regulatory requirements, debt guarantees, concessional interest rates, and no requirement to

17 Eg, see US Department of the Treasury, *The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings* (2016) 1.

18 Kroes, eg, claims that rules relating to state aid are being used to determine where a firm's profits can be allocated. From this, she states that the EC is interfering with the sovereign right of member states to make their own tax law: Neelie Kroes, 'Why EU State Aid Is Not The Right Tool To Fight Tax Avoidance', *The Guardian* (online), 1 September 2016 <https://www.theguardian.com/technology/2016/sep/01/eu-state-aid-tax-avoidance-apple>.

19 Frederick Hilmer and Independent Committee of Inquiry into Competition Policy in Australia, *National Competition Policy Review* (1993) ('*Hilmer Review*').

> achieve a commercial rate of return on assets. The potential effect was to reduce allocative efficiency by enabling inefficient government businesses to price below more efficient rivals, and take business from them. The Hilmer Review successfully put competitive neutrality on the agenda in Australia.[20]

The reforms[21] targeted the creation of a true national market in Australia, universal coverage of competition law, and the implementation of a more effective competition policy framework. These reforms were part of a range of economic reforms carried out over a number of years in international trade, domestic regulation and public sector management which increased reliance on markets and competition to promote efficiency and growth.[22] Competitive neutrality was identified as a key concern where government businesses competed with the private sector. In addition to significant amendments to the competition law (then known as the *Trade Practices Act 1974* (Cth) ('*Trade Practices Act*')), which included subjecting more businesses (including more government businesses) to the competition law, a number of National Competition Policy ('NCP') initiatives targeted competition policy objectives.

So, for example, the *Hilmer Review* introduced a system of review for all laws at Commonwealth and state levels to identify those restricting competition.[23] A new term, 'competitive neutrality', entered the competition policy lexicon when a system for competitive neutrality was introduced by agreement of the Commonwealth, the States and the Territories. Despite Australian competition policy and law focusing on the competitive process rather than purely on competitiveness, competitive neutrality policy recognised that if government businesses were to be effectively competitively constrained by private sector rivals, indeed if those rivals were to be able to survive in competition with government-owned businesses, any advantages (or disadvantages) conferred by government ownership needed to be neutralised. However, this was not an unqualified requirement. It applied where addressing the neutrality issue would result in a net benefit to society. Financial rewards were offered to state and territory governments as incentives for implementation of the *Hilmer Review* reforms. Importantly, each party to the *Competition Principles Agreement* who signed following the *Hilmer Review* was able to set its own agenda for implementing competitive neutrality in its own jurisdiction.[24] The effect of this is illustrated by differences in the structure of complaints-handling bodies:

> Some complaint mechanisms are handled by independent units; others by regulators or departments. The Australian Government Competitive Neutrality Complaints

20 OECD, *Roundtable on Competitive Neutrality in Competition Enforcement: Note by Australia* (16–18 June 2015) 2.

21 Ibid.

22 Treasury, *Review of the Commonwealth Government's Competitive Neutrality Policy*, Consultation Paper (March 2017) 1 ('*Treasury Review*').

23 See generally Deborah Healey, 'Competitive Neutrality: Addressing Government Advantage in Australian Markets' in Josef Drexl and Vicente Bagnoli (eds), *State-Initiated Restraints of Competition* (Edward Elgar, 2015) 3–39.

24 See Council of Australian Governments ('COAG'), *Competition Principles Agreement* (11 April 1995), as amended (13 April 2007).

> Office (AGCNCO) is an autonomous unit within the Productivity Commission and operates as the Australian Government's competitive neutrality complaints body.[25]

At the Commonwealth level:

> [AGCNCO] receives and assesses complaints, proceeds with complaints which require investigation and provides independent advice to the Treasurer on each matter. The Government is not obliged to accept this advice. AGCNCO also undertakes research on implementation issues. Any interested party may make a complaint to the AGCNCO on the grounds that: a government business activity has not been exposed to competitive neutrality arrangements; the government business activity is not complying with competitive neutrality arrangements that apply to it; or the current competitive neutrality arrangements are not effective in removing a government business activity's competitive advantage, which arises due to government ownership.[26]

Where the Australian Government Competitive Neutrality Complaints Office ('AGCNCO') (after preliminary investigation) considers that competitive neutrality arrangements are not being followed, it may directly advise government business entities where there are inadequacies in their competitive neutrality arrangements and on how they can improve compliance with the policy. Alternatively, if a suitable resolution of a complaint cannot be achieved by this advisory role, AGCNCO may recommend appropriate remedial action or that the Treasurer hold a formal public inquiry.[27]

The Australian National Competition Council, a body formerly charged with responsibility for parts of NCP implementation, emphasised that a major strength of the Australian approach was the reliance on the spirit of the relevant reforms and the 'flexibility afforded to [individual] governments in meeting their commitments', which was seen to be preferable to a more rigid, prescriptive and legalistic model.[28]

No provision was made for penalties for noncompliance with competitive neutrality policy. Instead, transparent examination of conduct by complaints processes, rectification of conduct or processes by government if warranted, and publication of outcomes, increase the accountability of government businesses and portfolio Ministers to ensure a level playing field for competition in markets in which government competes.

Significant changes to policy were made over the period of the NCP arrangements generally — until the money ran out and other issues took centre stage. At this stage, the resources directed to competition policy generally, including competitive neutrality, by various governments, were cut back.

A decade on from the *Hilmer Review*, in 2005 the Productivity Commission's major review of NCP outcomes noted that the competitive

25 OECD, *Note by Australia*, above n 20, 4.
26 Ibid (citation omitted).
27 Ibid.
28 OECD, *Competitive Neutrality: Maintaining a Level Playing Field*, above n 2, 107 quoting NCC, Submission No 71 to the Productivity Commission, *Review of National Competition Policy Arrangements*, 21 June 2004, 35.

neutrality policies of the various jurisdictions were largely appropriate and should be continued.[29]

In further related developments in 2006, the *Competition and Infrastructure Reform Agreement* ('*CIRA*') enhanced and clarified the obligations of the States, Territories and Commonwealth in relation to various categories of government businesses subject to competitive neutrality processes.[30] Governments agreed, among other things, to:

- clarify objectives and report non-commercial objectives;
- not exercise planning or regulatory approval activities in markets where they competed with the private sector;
- improve governance around board appointments;
- give government business enterprises ('GBEs') operational autonomy;
- specify dividend policies;
- identify competitive neutrality payments transparently; and
- upgrade public reporting functions.

Enhanced reporting agreed to under this process resulted in what is now the *Heads of Treasuries Competitive Neutrality Matrix Report*, which monitors the enhanced operation of competitive neutrality provisions of GBEs arising from *CIRA*. The Matrix generally confirms compliance with each of the specific elements of *CIRA*. It does not cover all government bodies which might be applying competitive neutrality policy. It does not expressly report on the handling or outcomes of individual complaints about breaches of competitive neutrality policy.

The important and more recent Harper *Competition Policy Review* ('*Harper Review*') in 2014–15, and its findings on competitive neutrality, are discussed more fully below. Aside from that, most recently in December 2016, the Commonwealth and five other jurisdictions[31] signed the *Intergovernmental Agreement on Competition and Productivity-Enhancing Reforms* which reaffirmed their commitment to competitive neutrality. Subsequently, and arising out of the *Harper Review* recommendations, Treasury commenced a *Review of the Commonwealth Government's Competitive Neutrality Policy* ('*Treasury Review*') in March 2017.[32] That review is ongoing, and the Treasurer proposes to release a revised competitive neutrality policy and supporting statement that reflects submission from stakeholders and the Competitive Neutrality Review Secretariat's report following completion of the Review.[33]

29 Productivity Commission, *Review of National Competition Reforms*, Inquiry Report No 33 (2005) Recommendation 10.4.

30 See COAG, *Competition and Infrastructure Reform Agreement* (10 February 2006) cls 1.4, 6.1.

31 New South Wales, Western Australia, Tasmania, Australian Capital Territory and Northern Territory. Competitive neutrality was explicitly mentioned in cl 9(f).

32 *Treasury Review*, above n 22.

33 Ibid 1.

Section 4: Addressing a competitive neutrality complaint — A nuclear issue

As noted above, in 2012 the Organisation for Economic Co-operation and Development described Australia's competitive neutrality policy as a world leader.[34] In the 10 years to 2017, AGCNCO conducted just three inquiries — Petnet,[35] NBN Co[36] and Defence Housing Australia[37] — although some inquiries were undertaken at the state level — for example, in 2015 Victoria's Competition and Efficiency Commission investigated a competitive neutrality complaint against the Hobsons Bay City Council in relation to childcare centres. Thus, by 2013, the position was as follows:

> Initially adopted with relative enthusiasm, competitive neutrality has fallen off the radar. Few people know what it is; very few complaints are filed; and, when those complaints are upheld, even fewer responses from government are forthcoming. Indeed, the inadequacy of the enforcement process is a fundamental flaw of the current system.[38]

Experience in application of the policy highlights a variety of problems, in particular the lack of penalty for failure of a government-related entity to respond to a finding that its conduct is not competitively neutral. This is illustrated by the AGCNCO's investigation of a complaint by Cyclopharm Ltd (operating in Australia as Cyclopet) in August 2011. The complaint was that the conduct of Petnet Australia Pty Ltd ('Petnet'), a wholly owned subsidiary of the Australian Nuclear Science and Technology Organisation ('ANSTO'), failed to comply with competitive neutrality policy.[39] AGCNCO issued its report in March 2012, finding that Petnet's business model could not be expected to yield a commercial rate of return over an appropriate period and so was not competitively neutral.

The nuclear medicine industry

ANSTO was established under the *Australian Nuclear Science and Technology Organisation Act 1987* (Cth). Its functions include manufacture and promotion of the use of radiopharmaceuticals. ANSTO's main nuclear medicine product is Technetium-99m which is used in the majority of nuclear medicine imaging procedures, such as Single Photon Emission Computed Tomography ('SPECT'). It also supplies reactor-produced isotopes, and a variety of cyclotron-produced nuclear medicines. Used in positron emission tomography ('PET') imaging, fluorodeoxyglucose ('FDG') is the most

34 OECD, *Competitive Neutrality: Maintaining a Level Playing Field*, above n 2.

35 Australian Government Competitive Neutrality Complaints Office ('AGCNCO'), *PETNET Australia*, Investigation No 15 (2012) 1 <https://www.pc.gov.au/inquiries/completed/petnet/report15-petnet.pdf>.

36 AGCNCO, *NBN Co*, Investigation No 14 (2011) <https://www.pc.gov.au/inquiries/completed/nbnco/report14-nbnco.pdf>.

37 AGCNCO, *Defence Housing Australia*, Investigation No 13 (2008) <https://www.pc.gov.au/inquiries/completed/defence-housing/report13-defencehousing.pdf>.

38 Alexandra Merrett and Rachel Trindade, 'Has Competitive Neutrality Run Its Course?' (2013) 13 *State of Competition* 1.

39 AGCNCO, *PETNET Australia*, above n 35.

common PET radiopharmaceutical.[40] It targets specific tissues/organs and concentrates there. The attached radioscope emits radiation which is then detected by a PET or PET/CT gamma camera. PET imaging is used to detect and locate cancer, neurological disorders and cardiac disease.[41]

As FDG has a half-life of 110 minutes, it is best supplied relatively locally.[42] Thus, following the closure of ANSTO's FDG facility at Camperdown, New South Wales in 2004,[43] the Royal Prince Alfred Hospital supplied FDG for PET imaging in the Sydney area. Then, in July 2007, ANSTO announced that it would enter into a franchise agreement with Siemens, one of the three largest manufacturers of cyclotrons around the world, to facilitate its re-entry into the supply of FDG.[44] To this end, Petnet was established with a small amount of equity from ANSTO, but with most of the start-up finance provided as loans.[45]

Cyclopharm's complaint

NSW Health called for tenders for the supply of FDG to a number of public hospitals, mainly in the Sydney area, and in May 2011 Petnet won the supply contract. It was appointed as the supplier to specific hospitals, thereby excluding rival suppliers from those hospitals for the duration of the contract and leaving in doubt the role of the Royal Prince Alfred Hospital as a supplier to other hospitals.

Cyclopharm's complaint to AGCNCO had its origins in Petnet's pricing offer to NSW Health. The specific competitive neutrality issues raised with the AGCNCO by Cyclopharm were the following:

- the lack of transparency in relation to ANSTO's selection of a partner when re-entering FDG supply (ANSTO's franchise arrangements);
- Petnet was not charging prices that reflected true production costs;
- Petnet failed to apply commercial interest rates on borrowings; and
- Petnet would be unable to achieve commercially acceptable profits over a 10-year payback period.[46]

Cyclopharm claimed that:

> through subsidised pricing tactics and noncompliance to competitive neutrality guidelines, ANSTO/PETNET has secured a NSW tender to supply FDG to the public hospital sector.[47]

40 Ibid 2.
41 Ibid 1.
42 Ibid; Australian Nuclear Science and Technology Organisation ('ANSTO'), 'Background Information on PET and Cyclotrons' (Media Release, 6 July 2007) <http://ansto.gov.au/__data/assets/pdf_file/0008/14768/PET_and_FDG__cyclotron_background.pdf>.
43 AGCNCO, *PETNET Australia*, above n 35, 5.
44 Ibid 5–6; Australian Government, 'Landmark $10 million Nuclear Medicine Deal a Life-Saver' (Media Release, 6 July 2007) <http://www.ansto.gov.au/__data/assets/pdf_file/0016/15721/FDG.pdf>. Also Senate Standing Committee on Economics, 'Answers to Questions on Notice: Innovation, Industry, Science and Research Portfolio from ANSTO' (Budget Estimates Hearing 2010–11, 31 May 2010).
45 AGCNCO, *PETNET Australia*, above n 35, 8.
46 Ibid 5.
47 Ibid 2.

It was claimed that the prices '[did] not fully reflect its costs' and the business '[was] not generating commercially acceptable profits'.[48] Cyclopharm alleged that the prices offered by Petnet under the NSW Health contract were only possible because it was a wholly owned subsidiary of ANSTO, a government-owned business, and so did not need to earn a market rate of return on the capital invested in the business.

Following an investigation, AGCNCO rejected the transparency concern as not being a competitive neutrality issue.[49] In relation to production costs, it found that:

> the way the costs of centrally provided services are apportioned and charged (including [an] 18 per cent margin) by ANSTO satisfies the requirements of competitive neutrality.[50]

The issue of commercial rates of interest payable on loans was overtaken by ANSTO acquiring full equity in Petnet. ANSTO provided Petnet with four loans totalling $10 million between 2008 and 2009, maturing in 2015.[51] In June 2011 (after it had won the NSW Health contract), following a review which found that the financing supplied to Petnet was inadequate, ANSTO entered into an agreement with Petnet to vary the terms of the existing loans and convert them into equity.[52] This meant that Petnet was no longer required to pay interest or to provide for the repayment of principle. Consequently, AGCNCO concluded that ANSTO was compliant with the requirement for debt neutrality.[53]

This left Cyclopharm's claim concerning the prices contained in the NSW Health contract, that is, that 'PETNET [was] not competing on a commercial basis'.[54] AGCNCO found that:

> For ANSTO to comply with competitive neutrality policy, it would need to adjust PETNET Australia's business model such that it can be expected to achieve a commercial rate of return that reflects its risk profile and the full investment in PETNET Australia.[55]

AGCNCO went on to state that:

> Competitive neutrality policy requires government businesses to set their prices such that they take into account all attributable costs (including earning a commercial rate of return from their overall business activities ...).[56]

It added:

> What is relevant for compliance with competitive neutrality policy is the rate of return earned on the total amount of capital invested (recognising that the cost of equity is higher than the cost of debt).[57]

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48 Ibid.
49 Ibid 5–7.
50 Ibid 8.
51 Ibid 9.
52 Ibid.
53 Ibid.
54 Ibid 7.
55 Ibid 16.
56 Ibid 7.
57 Ibid 9–10.

The financial restructuring of Petnet resulted in ANSTO having an investment of $17.228 million in Petnet. This provides the denominator for assessing the rate of return from the contract with NSW Health. It was necessary for AGCNCO to determine:

- the appropriate rate of return that should be achieved on this investment; and
- the period within which this should occur.

ANSTO originally stated that the payback period was 10 years, but later increased it to 15 years, to better reflect the useful life of the cyclotron.[58]

In relation to the appropriate rate of return, citing the *Competitive Neutrality Guidelines for Managers*, AGCNCO noted:

> These targets [rate of return targets] should exceed the long-term government bond rate and include a margin for risk to ensure compliance with competitive neutrality.[59]

The expected rate of return on investment in Petnet was 13.5 per cent.[60] However, ANSTO admitted that this was not being achieved due to:

- continued supply by the Royal Prince Alfred Hospital, a supplier not required to obtain *Therapeutic Goods Act 1989* (Cth) ('*TGA*') certification;
- delayed commencement of production due to construction delays and delays obtaining *TGA* certification;
- delays in approval of Medicare rebates for lymphoma; and
- restrictions on the demand for discretionary imaging due to health care funding constraints.[61]

AGCNCO found that Petnet's expected internal rate of return over 10 years was around 5.3 per cent, well below the weighted average cost of capital.[62] Over a 15-year payback period, Petnet's commercial rate of return was found to be 9.2 per cent, still well short of the 13.5 per cent target of ANSTO.[63] Hence AGCNCO concluded that:

> Revenue and expenditure forecasts over 10 and 15 years demonstrate that PETNET Australia's commercial operations are unlikely to achieve a commercial rate of return on the equity invested over either time period. This represents an *ex ante breach* of competitive neutrality policy.[64]

Thus, in the absence of a change of policy, at the end of the relevant time period, the rate of return would not be commercial and so it would not be competitively neutral.

No doubt this finding afforded the complainant a brief period of relief to Cyclopharm. It stated:

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58 Ibid 13, citing Economics Legislation Committee, *Estimates*, Senate, 19 October 2011, 26 (Dr Adrian Paterson).
59 AGCNCO, *PETNET Australia*, above n 35, 10 citing Australian Government, *Competitive Neutrality Guidelines for Managers* (2004) 30.
60 AGCNCO, *PETNET Australia*, above n 35, 11.
61 Ibid.
62 Ibid 13.
63 Ibid 15.
64 Ibid 15 (emphasis added).

> First of all, we'd expect that the New South Wales Department of Health rescind the tender based on the fact that ANSTO was supposed to be in compliance with competitive neutrality, which they are clearly not ...
>
> The second thing that we would be seeking is that the New South Wales Department of Health re-let the tender, and the third thing is that we have been disadvantaged from day one because of this tender and we would expect that the New South Wales Department of Health would do the right thing in awarding us the tender while this review process is underway.[65]

These hopes were soon dashed. The contract had been lost and no one was charged with ensuring that ANSTO responded to the finding. As far as it is possible to tell, nothing changed in relation to the conduct of ANSTO's business, either in respect of that or other transactions, as a result of AGCNCO's finding. However, the contract price set a new, much lower market price.

Fighting for survival, Cyclopharm was not yet ready to give up. One strategy was to seek sales for FDG in Brisbane. As noted above, supply of FDG needs to be relatively local given the rate at which it deteriorates and the costs associated with transporting it. However, hospitals without a local source of supply have no choice but to accept interstate supply and the associated costs and risks. While not a long-term solution for Cyclopharm, it did provide a 'breathing space'. Then, in August 2012, Cyclopharm announced that it would establish a cyclotron facility in Brisbane. That project did not proceed however, '[a]s a result of the uneconomic market conditions established by the actions of ANSTO/Petnet in this sector'.[66]

A second strategy was to seek redress under the competition law, claiming breaches of ss 52 and 45 of the *Trade Practices Act* and ss 18, 45 and 46 of the *Competition and Consumer Act 2010* (Cth) ('*CCA*').[67] However, in April 2014, before the competition case was heard, Cyclopharm closed down its FDG business.[68] It stated:

> The decision to shut down our cyclotron operation was forced upon us when it became known that Petnet was entering into new contracts at prices considerably lower than those already raised in our claim as predatory.[69]

The competition case was settled. Consequently, the following discussion of the difficulties that would likely have been encountered had the case run is somewhat speculative.

A claim under s 45 of the *CCA* could be made if Petnet's arrangement with NSW Health could have the purpose or the effect or the likely effect of substantially lessening competition in a relevant market. This would depend

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65 Peter Ryan, 'Nuclear Agency "Breached Competition Rules"', *ABC News* (online) 5 April 2012 <http://www.abc.net.au/news/2012-04-05/nuclear-agency-accused-of-anti-competitive-behaviour/3934180> quoting James McBrayer.

66 Cyclopharm Ltd, *Annual Report 2013* (2014) 9 <http://member.afraccess.com/media?id=CMN://2A790753&filename=20140331/CYC_01505332.pdf>.

67 Ibid.

68 Cyclopharm Ltd, *Annual Report 2014* (2015) 3 <http://cyc.live.irmau.com/irm/PDF/1394/2014AnnualReport>.

69 Cyclopharm Ltd, *Annual Report 2013*, above n 66.

upon the assumption that the *CCA* applied.[70] The contract was said to be for exclusive supply,[71] but, as noted below, that term was only partly enforced. To establish that the contract substantially lessened competition, it would need to be established that, as a result of the contract, rivals would be unable to access sufficient customers during the life of the contract to achieve minimum efficient scale. In addition, it could be expected that the prices offered by Petnet to secure the NSW Health contract — they were claimed to be 20–30 per cent lower than the market price at the time[72] — would cause remaining customers to lower their price expectations. It would need to be established that at these prices an efficient producer would not be viable. If an existing supplier was foreclosed in these circumstances, given the height of barriers to entry, re-entry would be unlikely when the contract came up for renewal.

Nevertheless, the exclusion of any particular rival does not necessarily amount to a substantial lessening of competition. The Royal Prince Alfred Hospital continued to self-supply. Thus, despite the contract, a significant competitor, and one willing to supply third parties, remained in the market. More importantly, it appears that despite the exclusivity provision in the contract, it was not enforced and the Royal Prince Alfred Hospital continued to supply other hospitals.[73] So arguably it remained a vigorous and effective competitor in the market.

A second, or alternative, claim was that ANSTO/Petnet had taken advantage of its market power for an anticompetitive purpose, thus contravening s 46 of the *CCA*. Such a claim would be along the lines that the prices at which Petnet offered to supply NSW Health were uncommercially low in order to exclude competitors from the market (that is, they were predatory). This would require establishing that ANSTO possessed a substantial degree of power in the relevant market. Given the role of ANSTO as a supplier of nuclear medicine — it claimed to account for over 80 per cent of supply in Australia[74] — and the high barriers to entry faced by potential entrants, especially the sunk costs incurred to establish a cyclotron,[75] this may have been fairly straightforward.

Establishing that ANSTO had taken advantage of, or used, its market power in relation to the terms on which supply was offered to NSW Health would have posed some interesting and challenging problems. One approach would be to analyse the price offered in the tender and assess whether such a price

70 As to this, see *Australian Competition and Consumer Commission v Baxter Healthcare Pty Ltd* (2007) 232 CLR 1.

71 Leigh Dayton, 'PET Peeve Provokes a Stoush', *The Australian* (online) 28 July 2012 <https://www.theaustralian.com.au/news/health-science/pet-peeve-provokes-a-stoush/news-story/8dfc92978c9ae3be7be98aba5d6a2726?sv=841329c927e33fa57ac25ba87c3ef98c>quoting James McBrayer.

72 Ibid.

73 Ibid.

74 Richard Garrett, *ANSTO: A Brief Introduction* (2011) <http://www.ainse.edu.au/__data/assets/pdf_file/0003/49530/ANSTO_Overview_201012_Garrett.pdf>.

75 Between 2006 and 2012, Cyclopharm spent $10 million establishing a business to produce and supply FDG: Dayton, above n 71. A similar sum was quoted for ANSTO's facility: Australian Government, 'Landmark $10 million Nuclear Medicine Deal', above n 44.

was likely to be offered in a competitive market. Clearly, determining this would not be simple, especially as ANSTO could argue that it was competition that drove prices down towards cost. Cyclopharm claimed that the prices offered by Petnet to NSW Health were 20–30 per cent below the current market value. ANSTO would likely have responded that these prices were still higher than those charged by the Royal Prince Alfred Hospital.[76] Further, ANSTO may have pointed out that all tenderers for the NSW Health contract bid similar prices, implying that this was a genuine market price reflective of cost.

Assuming that Petnet was reasonably confident of the range within which Cyclopharm's bid would fall, it need only undercut this by a modest amount to win the contract. Given this, a price reduction of 20–30 per cent needs explanation — was Petnet expecting to be able to radically reduce its costs? If so, how? Absent such an explanation, the profits foregone by the pricing model would not be able to be recovered in an otherwise competitive market in the future. They could only be recovered in a market where Petnet had substantial pricing discretion.

This makes an assessment of Petnet's economic cost of supply important. In the short run, a firm may ignore its fixed costs and, irrespective of the time period, its sunk costs, when competing to secure a contract if market conditions necessitate this. Classifying the costs of a business is never uncontroversial. If the cyclotron is assumed to have no alternative use, and so represented a sunk cost, it would not be regarded as an economic cost until such time as it needed to be replaced. Based on the nature of the business, it is assumed that most of the operating costs would be variable.

A critical consideration would be whether it was necessary for Petnet to include normal profit as a cost in a 3-year contract (or assuming a rollover, in effect a 5–6-year contract). As a result of ANSTO having converted its loans to equity in the business around the time of the NSW Health contract, interest on loans need no longer be paid and the risk that failure to meet this payment, as well as repayment of principal, could force a shutdown was avoided. Nevertheless, while in the short run a firm may respond to market conditions by electing to forego a return on capital invested, to do so for a business' primary (perhaps only) contract seems unlikely. If a listed company is priced in this way, its share price would likely suffer.

AGCNCO stated that rate of return:

(i) should exceed the long-term bond rate; and
(ii) should reflect the degree of risk associated with the activity.

Little detail was provided for AGCNCO's reasoning in this respect. Petnet's expected rate of return on equity was claimed to be 13.8 per cent,[77] compared to the 5.3 per cent over 10 years or 9.2 per cent over 15 years that the contract prices would deliver. But, perhaps surprisingly, AGCNCO's findings would be

76 Ryan, above n 65. The Royal Prince Alfred Hospital had a lower cost base because it was not required to obtain Good Manufacturing Practice ('GMP') certification from the Therapeutic Goods Administration. Conversely, this reduced its costs, but also created some concern about the quality of its product. See also AGCNCO, *PETNET Australia*, above n 35, 15.

77 AGCNCO, *PETNET Australia*, above n 35, 15.

of little assistance in determining Petnet's normal profit. First, the rate of return was calculated based on accounting costs, while average variable cost, including normal profit, is determined from economic costs. Second, while expected revenue from the contract was inadequate to yield a return comparable to that expected from an alternative investment with a similar risk profile, the contract was for only 3 years (presumably with option to extend). AGCNCO's adverse finding was of 'ex ante' noncompliance. This would enable ANSTO to argue that even if it was pricing below cost, over the longer period it could alter its operations to overcome the deficiency and increase the rate of return to an acceptable level. Further, ANSTO may well have argued that its assumptions in relation to market conditions turned out to be wrong and that was why the price failed to yield an adequate return.

Even if it were possible to establish that ANSTO/Petnet had taken advantage of its market power by offering uncommercially low prices to secure the NSW Health contract, it would still be necessary to establish it had a subjective anticompetitive purpose. ANSTO may have argued that as a start-up business it needed to secure the NSW Health contract to underpin the business and so it simply put in a bid that would achieve that outcome. In addition, ANSTO/Petnet might argue that Petnet won the contract not on price but because it was regarded as a better supplier. It offered greater reliability because it operated two smaller cyclotrons rather than one larger cyclotron. If there was evidence to support such a claim, it would be unlikely that the purpose element would be made out.

It is clear that Cyclopharm would have faced considerable difficulty in establishing that ANSTO/Petnet had contravened the *CCA*.

Certain things follow from this case study. First, the cost of attempting to obtain compliance with competitive neutrality policies seems to fall squarely on the victims. That cost is not insignificant for a small business in making the complaint, particularly if it involves litigation under pt IV of the *CCA*, in circumstances where the outcome is perhaps 50:50 at best. Second, under s 46, it would be necessary to establish not simply that the price results in an uncommercial rate of return, but that this was a strategy made possible by the market power of a government-owned business. This is likely to raise questions about the practical application of concepts such as 'normal profit'. Then, of course, there is the problem of establishing whether there was an anticompetitive purpose.

A number of troubling issues concerning competitive neutrality are reinforced by the case study:

- There is no need for government action following a successful claim in relation to competitive neutrality.
- There is no need for the government to formally justify this non-action.
- Depending upon the individual circumstances, action may not be available under the *CCA*.
- The complainant may thus have no remedy either in terms of amended conduct going forward, or redress for loss suffered prior to the complaint, or after the complaint is upheld. This includes compensation for ongoing legal costs in its attempts to change its situation.

These issues will be considered below, along with the questions raised by the *Treasury Review*.

Section 5: Moving forward

The *Harper Review*

Competitive neutrality returned to the competition law and policy agenda in 2014–15 as part of the *Competition Policy Review* headed by Professor Harper.[78] The terms of reference required the Panel to examine, among other things, 'whether government business activities and services providers serve the public interest [by] promot[ing] competition and productivity',[79] and stated that 'government should not be a substitute for the private sector where markets are, or can, function effectively or where contestability can be realised'.[80] The terms of reference also recognised that the Commonwealth Government still owns a number of businesses, including Australia Post, Medibank Private, Australia Rail Track Corporation, Australian Government Solicitor, Defence Housing Australia, NBN Co and ASC Pty Ltd, and that States and Territories also have significant business ownership.[81]

The *Harper Review's* recommendations on competitive neutrality policy noted that it should apply to government provision of services competing with the private sector, whether for-profit or not-for-profit. Recommendations included that each jurisdiction should review its competitive neutrality policy, and that there should be oversight of policy implementation by an independent body. Increased transparency and effectiveness of jurisdictional complaint processes, and annual reporting against complaints and compliance with competitive neutrality principles by jurisdictions, were also on the recommendation list. The government ultimately did not adopt the recommendation for an independent jointly funded Australian Council for Competition Policy to oversee and lead the evolving competition policy agenda.[82]

Further review

Following on from the recommendations of the *Harper Review*, and seeking submissions from stakeholders, Treasury is currently reviewing the Commonwealth Government's existing competitive neutrality policy in order to revise it. While the *Treasury Review* is of Commonwealth policy alone, Treasury is liaising with the States and Territories on issues of common interest in relation to issues identified about competitive neutrality.

The *Treasury Review* is considering and will report on the following issues:

- whether the scope of the current [competitive neutrality] Policy remains appropriate including, in particular, the level and relevance of the threshold

78 Ian Harper et al, *Competition Policy Review: Final Report* (2015) ('*Harper Review*').
79 Ibid 528.
80 Ibid 526.
81 Ibid.
82 Ibid 50–1 Recommendations 15–17; Australian Government, *Australian Government Response to the Competition Policy Review* (2015) 5, 16 <https://static.treasury.gov.au/uploads/sites/1/2017/06/Govt_response_CPR.pdf>.

for a 'significant' business activity, and the possible application of competitive neutrality to other government activities;
- how the [competitive neutrality] Policy should apply to government businesses at the start-up stage and whether this could be improved, including through changes to guidance material;
- the effectiveness of the Commonwealth's complaints mechanism, including how the Commonwealth responds to the findings of the Competitive Neutrality Complaints Office;
- whether the current reporting arrangements, including the annual Competitive Neutrality Matrix Report, provide sufficient transparency and accountability for compliance with the competitive neutrality principles; and
- whether current arrangements for the oversight and administration of the [competitive neutrality] Policy are satisfactory to ensure there is appropriate guidance, reporting, compliance and enforcement by government entities.[83]

Scope and application of competitive neutrality policy

Clarity around the scope and application of competitive neutrality policy has been raised in a number of contexts, most recently by the current *Treasury Review*.

As was noted in the *Harper Review*, policy dictates that competitive neutrality only applies where a significant business activity charges for goods and services, has an actual or potential competitor, and a degree of independence in relation to production, supply and price.[84]

Under competitive neutrality policy implemented after the *Hilmer Review*, significant GBEs in each jurisdiction classified by the Australian Bureau of Statistics as Public Trading Enterprises and Public Financial Enterprises were made subject to full Commonwealth, state and territory taxes or tax equivalent systems, and debt-guarantee fees directed towards offsetting the competitive advantages which they might have. These bodies were also subjected to the types of regulations which ordinarily applied to the private sector, such as environment, planning and approval processes, as though they were private businesses. So, this application of competitive neutrality policy was relatively clear.

Other agencies undertaking 'significant business activities' as part of a broader range of functions were also to implement the nominated competitive neutrality processes if appropriate. Alternatively, they were at least to ensure that prices charged for goods or services took these issues into account and reflected full cost attribution for the activities.[85] The application definition changed slightly with the 2004 *Competitive Neutrality Guidelines for Managers*.[86] In all circumstances, competitive neutrality was to be

83 *Treasury Review*, above n 22, 2.
84 *Harper Review*, above n 78, 256.
85 See COAG, above n 24, cls 3(4)–(5).
86 Australian Government, *Competitive Neutrality Guidelines for Managers*, above n 59. The *Treasury Review* Consultation Paper suggests that the current list may need to be updated to take account of changes arising from the *Public Governance, Performance and Accountability Act 2013* (Cth).

implemented only to the extent that the benefits outweighed the costs, as to which see below.[87]

Commonwealth Government businesses outside the proscribed categories are subject to competitive neutrality policy where their commercial turnover is at least $10 million, which has been set to exclude smaller scale activities. The current *Treasury Review* Consultation Paper asks whether this $10 million threshold level is still appropriate. Other jurisdictions do not use this threshold but assess application of the policy without using a threshold test on a case-by-case basis (New South Wales, Victoria and Northern Territory).[88]

The application of competitive neutrality policy needs to strike a balance between fostering competition in the public interest and overburdening smaller government and local government bodies with regulatory obligations and investigations which are overly costly and time-consuming. Particularly in the case of some regional and rural local government bodies these examinations will be completely outside the skillset of their employees.

One suspects that the $10 million threshold presumption used at the Commonwealth level is a reasonable and cost-effective filter which precludes the need for everything to be on the table in relation to relatively small business activities each time they occur. Without this threshold, a detailed examination would be required in each instance. In terms of real dollar values, the threshold is certainly now at a far lower level than it was when originally implemented. Presumably this means that many more low-value activities are caught currently than would have originally been the case.

Public interest test

Whether application of competitive neutrality policy is appropriate in an individual case also depends upon the net competitive advantage or whether the benefits of its application outweigh the costs. This test involves an individual consideration of the actual facts and circumstances of each case, and 'every factor which contributes to an ownership-related advantage or disadvantage should be identified and, to the extent practicable, the advantage or disadvantage [should be] eliminated'.[89] Factors relevant to the consideration of benefits and detriments include the interests of consumers, competitiveness of the business generally, ecologically sustainable development, social welfare and equity, industrial relations, occupational health and safety, access and equity, economic growth and regional development, and the efficient allocation of resources.[90]

The test was that:

> the legislation or government policy should not restrict competition unless:
>
> - the benefits of the restriction to the community as a whole outweigh the costs; and

87 Australian Government, *Competitive Neutrality Guidelines for Managers*, above n 59, cl 3(6).

88 *Treasury Review*, above n 22, 9–10.

89 See NCC, *Competitive Neutrality Reform: Issues in Implementing Clause 3 of the Competition Principles Agreement* (1997) 8.

90 See COAG, above n 24, cl 1(3); ibid 11–12.

- the objectives of the legislation or government policy can only be achieved by restricting competition.[91]

In the context of the NCP generally it has been stated:

> the best definition of public interest was in fact expressed in two words, public interest, because that then defies every attempt by those that wish to try and confine the public interest.[92]

The Senate Select Committee on Socio-Economic Consequences of the National Competition Policy in that instance recommended that the Council of Australian Governments should agree on a method of assessment of public interest which would 'provide a numerical weighting that can be attributed to environmental, social, and employment factors, wherever possible'.[93]

Public interest in the context of NCP has been an extremely contentious issue generally, with complaints made about the lack of clarity and consistency around the application of the public interest test.[94]

The *Harper Review* reinforced the existing application of the public interest test on the basis that:

> [it] enshrines the correct principle — that competition should not be impeded unless it must be, in order to secure the public interest. It also acknowledges the fact that competition is not an end in itself — the test should continue to be applied by assessing the costs and benefits of the regulation overall (including any impact on competition) in order to meet the policy objective.[95]

States such as Victoria apply a broader public interest test in addition to a cost benefit test,[96] however, the outcome of the two approaches appears to be very similar in practice.

Whether to adopt a separate public interest or public benefit test at Commonwealth level clearly raises the question of which issues would fall outside the former but inside the latter. To support changes to the test these issues would need to be carefully identified and assessed.

The ongoing implementation of the Australian broadband network raised a number of competitive neutrality issues around application of the policy for competitors who were existing operators in the wholesale market for broadband infrastructure. And this aspect is discussed here. (Further references will be made to other aspects of the complaint in later material.)

NBN Co is a company established by the Commonwealth Government in 2009 as a wholly owned GBE to design, build and operate a wholesale-only

91 *Harper Review*, above n 78, 97.

92 Commonwealth, *Parliamentary Debates*, Senate, 1 November 1999, 826 (Graeme Samuel), quoted in Parliament of the Commonwealth of Australia, *Riding the Waves of Change: A Report of the Senate Select Committee on the Socio-Economic Consequences of the National Competition Policy* (2000) 33.

93 Parliament of the Commonwealth of Australia, above n 92, Recommendation 1. See also House of Representatives Standing Committee on Financial Institutions and Public Administration (Cth), *Cultivating Competition: Report of the Inquiry into Aspects of the National Competition Policy Reform Package* (1997) ch 2.

94 House of Representatives Standing Committee on Financial Institutions and Public Administration (Cth) ch 4 generally.

95 *Harper Review*, above n 78, 97–8.

96 *Treasury Review*, above n 22, 10.

national broadband network ('NBN') across Australia. The purpose of the NBN is redress of various perceived market failures in the supply of broadband services. It was expected that around 93 per cent of Australian homes, schools and workplaces would ultimately be connected to the network, delivering broadband at fast speeds to users, and completed in approximately 2020. NBN Co had a corporate plan, an independent board and management team, and was to be funded by government equity until it had sufficient cash flows to support private sector debt. In the longer term, the government expected it to be self-funding, and intended to sell down its interest within 5 years of the NBN being fully operational. The government expected NBN Co to operate in a commercial manner, charging for access to the network (fibre, wireless or satellite) at the point of interconnection. It was planned that retail service providers would transport their data from the point of interconnection to the point of presence (the backhaul).

The actual application of competitive neutrality policy to particular circumstances raised a number of issues in the 2011 complaint. Firstly, it was alleged by competitors that NBN Co actively sought business in commercially viable developments, despite the fact that it had been announced by government as a 'provider of last resort'. The complainants argued that the provision of infrastructure and connections at no cost in these commercial developments was an option unavailable to private providers, and thus in breach of competitive neutrality principles. This conduct was judged by AGCNCO to be outside the ambit of competitive neutrality policy. While 'provider of last resort' was argued by the complainant to mean that NBN Co would only provide wholesale infrastructure in instances where no other supplier would do so at a commercial price, government documents setting out the expectations of NBN Co took a broader view, and the Department of Broadband, Communications and the Digital Economy ('DBCDE'), responsible for the NBN, argued that it was never stated that the role of NBN Co in new developments would be limited in that way. In finding that competitive neutrality principles did not apply to this particular part of the conduct, AGCNCO cited the 1996 *Competitive Neutrality Policy Statement* to the effect that:

> Competitive neutrality does not imply that government businesses cannot be successful in competition with private businesses. Government businesses can achieve success as a result of their own merits and intrinsic strengths, but not as a consequence of unfair advantages flowing from government ownership.[97]

Other complaints which were found to be outside the ambit of competitive neutrality policy related to:

- Ministerial determinations of technical specifications;
- the nature of the particular tendering processes adopted (which were said not to be fair and transparent);
- the setting of operational standards; and
- the definition of the footprint for the NBN.

Some of these issues were found to be operational decisions and not within competitive neutrality policy. AGCNCO noted that some advantages of

97 *Competitive Neutrality Policy Statement* (1996) 5 (emphasis altered).

NBN Co were because of its size and not of government ownership. Arguably some of these issues could have been resolved by provision of clearer information in tender documents, although it is accepted that not everything can be included in such documents, which are very large in any event.

Three issues were, however, found to be covered by competitive neutrality policy:

- the pricing of infrastructure in greenfield developments;
- the expected rate of return of NBN Co and related issues; and
- NBN Co allegedly gaining advantages through Ministerial determinations.

These issues are discussed below.

Issues with start-up businesses

As noted, a particular issue for consideration by the *Treasury Review* (also raised by the previous Productivity Commission report) is the way in which competitive neutrality policy should apply to government businesses at the start-up stage. This issue was highlighted in both the Petnet case (above) and the NBN Co case.

The basic circumstances of the NBN Co complaint are set out above. The relevant part of the complaint for current purposes was that NBN Co's pricing of infrastructure in greenfields developments was contrary to current industry practice, and that the 7 per cent targeted rate of return did not represent a commercial rate of return as required under competitive neutrality policy. In the circumstances, AGCNCO found that competitive neutrality principles applied to the pricing of infrastructure in greenfield developments, and also to the expected rate of return. On the pricing issue, AGCNCO found that the question was whether the business earned a commercial rate of return overall, noting that '[c]onsideration of the impacts on competition of different pricing for particular market segments is not a matter for competitive neutrality policy'.[98] In respect of the expected rate of return on assets, AGCNCO was unable to determine whether the difference between a commercial rate of return and the 7 per cent projected by NBN Co was adequately explained by the non-funded CSOs of NBN Co. It recommended that the government arrange for an analysis of the required non-commercial benefits and put in place accountable and transparent CSO funding. It also recommended that NBN Co adjust its pricing model by taking into account funding by the government for its CSOs, and show how the adjusted pricing model would achieve a commercial rate of return that reflected its risk profile. AGCNCO agreed with the complainants that the expected timeframe for achieving a commercial rate of return (12 years) represented a potential ex ante breach of competitive neutrality policy. AGCNCO did not regard the government's commitment of funds to NBN Co by way of a shareholder loan as a breach of competitive neutrality policy, as equity funding of NBN Co was not subject to the debt neutrality provisions of competitive neutrality policy.

The complexity of the issues raised in this determination, and particularly in the context of an extremely significant government business, suggests that further attention to these details was warranted by the business and that better

98 See AGCNCO, *NBN Co*, above n 36, 26.

guidance is required in assessing competitive neutrality issues in relation to government start-up businesses. In this context, the Law Council of Australia recommended that competitive neutrality of start-up government businesses:

> should be assessed by asking whether the business case justifying government investment did or did not show a positive net present value (NPV). The NPV should be calculated using an estimate of the commercial rate of return (that is, for non-government business undertaking functions similar to those of the government business).[99]

There is little to disagree with in this submission; however, there are many methodologies for determining net present value according to different circumstances and businesses. Clearly more direction is required to ensure that acceptable approaches are taken to this important issue.[100]

Complaints mechanism

Very few complaints in relation to competitive neutrality have been received and examined since the inception of the policy. For example, the Victorian Competition and Efficiency Commission fully investigated just 15 complaints between 2004–5 and 2011–12, while in Queensland just one investigation has resulted in a final report since 2003.[101] At the Commonwealth level, only 15 complaints have been investigated in relation to Commonwealth bodies in total, with only three complaints by the AGCNCO since 2005, albeit two of these are mentioned in this article — the PETNET case and the NBN Co case. The small number of complaints may indicate that competitive neutrality is no longer a problem — many former government businesses have been sold and others have been corporatised and competitive neutrality requirements have been taken on board. These figures also fail to mention complaints raised and dismissed early on by regulators. Yet this does not seem to be the full story.

Anecdotally, there are numerous incidents that suggest that a lack of competitive neutrality is still an issue — especially in the health and education sectors, as well as at the local government level.[102] Generally, complainants, and even the lawyers advising them, have had little idea of what could be done to address competitive neutrality issues when they arose. Worse, when an investigation did take place and noncompliance was found, there was no mechanism for ensuring that the situation was redressed. As has been illustrated, nor is there compensation for private sector firms that may have

99 Law Council of Australia, Submission to Treasury, *Review of the Commonwealth Government's Competitive Neutrality Policy*, 27 April 2017, 4.

100 In its 2005 Report, the Productivity Commission also noted that the majority of government-owned businesses monitored failed to obtain commercial rates of return. The Commonwealth Competitive Neutrality Complaints Office also issued a paper on *Rates of Return Issues*, CCNCO Research Paper (1998) <http://www.pc.gov.au/research/supporting/rate-of-return/cnror.pdf>.

101 Victorian Competition and Efficiency Commission, *Competitive Neutrality Inter-jurisdictional Comparison Paper* (2013).

102 A large number of submissions in relation to competitive neutrality at local government level were made to the *Harper Review*. A large number of submissions to the current *Treasury Review* have been made by tourism operators who compete with local government facilities such as caravan parks and camping areas: Treasury, *Competitive Neutrality Review* <https://consult.treasury.gov.au/market-and-competition-policy-division/competitive-neutrality-review/consultation/published_select_ respondent>.

been driven out of business as a result of a lack of competitive neutrality. Clearly these features do not encourage complaints, which are costly and time-consuming for business. The former problem may be rectified by better reporting and oversight of outcomes, as to which see below.

Section 6: Remaining issues and other possibilities

Notwithstanding what might be regarded as the unsatisfactory application of the policy of competitive neutrality and its general lack of review, the question is: does it really matter whether it is effective? Many government businesses have now been privatised, so arguably the benefits to be expected from policy no longer exceed the costs. Yet it is clear that there are significant areas where competitive neutrality issues are likely to continue to arise — government-run hospitals compete with private hospitals; in education private and government schools compete, while local governments supply services in competition with private suppliers. An effective competitive neutrality policy does matter.

Whether the *Harper Review* recommendations alone can solve the problems identified in the case studies or those identified in the submissions to the *Harper Review* is debatable.

Backgrounding this whole debate is the need for agreement to be reached among participating jurisdictions about changes to competitive neutrality policy. The *Harper Review* envisaged recommitment to a revised set of competition principles by each jurisdiction individually. These would be 'applied through their own processes' with each jurisdiction to 'tailor reforms to meet its own local conditions'. Harper proposed agreement at the level of the Prime Minister, Premiers and Chief Ministers.[103] However, the political environment at the time of the original *Competition Principles Agreement* was indeed unusual.

While it is easy to enthusiastically adopt the concept of competitive neutrality in the abstract, the practical implications and outcomes present considerable difficulty. First, as has been noted, the balance between competition and policy/regulation requires detailed consideration as a matter of principle. Whether it would currently be politically possible to marshal all jurisdictions to agree to reforms which intrude to some extent on their ability to govern is unclear. Only five jurisdictions, for example, recommitted to the existing principles in December 2016.[104]

However, common sense dictates that at least the competitive neutrality policies of individual jurisdictions should clarify the obligations of government to respond to findings of competitive neutrality policy breaches and recommendations arising. How might this be done?

In considering this issue it is important to recognise the tension between a breach of law and a breach of policy, which certainly involves a less precise obligation. The area is unlikely to be amenable to precise outcomes.

The *CIRA* matrix provides some transparent reporting of compliance by jurisdictions in the abstract. It is not tested and overseen at the moment and individual complaints or outcomes are not noted or explained. It also does not apply across the board to government bodies.

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103 *Harper Review*, above n 78, 98.
104 Ibid.

However, where a breach of competitive neutrality policy is found by the designated regulator, there is currently no requirement on government to rectify the breach. One approach might be to direct outcomes to the Australian Competition Tribunal in relation to Commonwealth complaints. But it is really a quasi-judicial consideration of the implementation of policy, which is somewhat troubling.

Another approach which may be effective might be an obligation on the government body involved and the Minister responsible to formally notify its response to the regulator who made the original finding: whether or not the conduct had been stopped, and whether the practice has been rectified, with justification for the failure fully explained on the basis of the public interest test already described.[105] The regulator could then comment on the outcome, and the responsible Minister might be obliged to lay the response of the government body and also the regulator before Parliament. These reports could also be included in the annual report of the government body. To be effective, this would not just apply to the Commonwealth, but would need to apply to all jurisdictions following on from the obligations of all participating jurisdictions to comply with the principles of competitive neutrality. This would also satisfy the *Harper Review* recommendation for annual reporting against complaints and compliance with competitive neutrality principles by jurisdictions. This report could also be included annually in the *CIRA* matrix discussed above. The scope of the *CIRA* matrix would need to be expanded to cover all government bodies to which competitive neutrality applies for this to be effective. Clearly this would not involve much additional time and expense — red tape — because these decisions have to be made in any event. The new practices would enhance transparency and formalise what is already happening. Hopefully, however, it might provide the incentive for the government body to actually change its behaviour, and also for the Minister to carefully consider the appropriate course of action in the circumstances if they are not already doing so. Whether transparency alone will engender better behaviour is debatable, but these initiatives appear to be a logical first step to ensuring compliance. But we note that this would not compensate those suffering loss caused by breach of the policy. We doubt that it is appropriate to insert provisions providing a right of action in this regard when the breach involves policy and not law.

Clearly there are still a number of issues relating to competitive neutrality which need further consideration. We eagerly await the findings of the *Treasury Review* and trust that any initiatives which are recommended can be carefully considered by the Commonwealth and the States and implemented if appropriate to reinvigorate and consolidate this important area of competition policy. Both from the point of view of strengthening existing policy, but also at a time when the Productivity Commission has also been asked by the Commonwealth Government to review the 'introduction of competition and informed user choice into human services', this seems to be absolutely essential.[106]

105 Ibid 97.
106 *Treasury Review*, above n 22, 5.