

SPECIAL BUDGET MEETING 25 JUNE 2018	3
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APPLICATION OF THE COMPETITIVE NEUTRALITY PRINCIPLE TO CAIRNS WORKS

S Owens | 17/25/2-13 | #5692405

RECOMMENDATION:

That council:

1. **Not apply the competitive neutrality principle in the form of commercialisation to Cairns Works for the 2018/19 financial year for the following reasons:**
 - a. **This method of reform is inconsistent with the way Council intends to operate Cairns Works;**
 - b. **The application of the full cost pricing method that is also required under this method of reform is not suitable for the reasons mentioned below; and**
 - c. **The costs of this reform outweigh the benefits to the Community**
2. **Not apply the competitive neutrality principle in the form of full cost pricing to Cairns Works for the 2018/19 financial year for the following reasons:**
 - a. **Cairns Works does not intend to compete in the public market and will only provide goods and services to Council; and**
 - b. **The costs of this reform outweigh the benefits to the Community.**
3. **Wind up the Commercial Business Unit that conducts the Cairns Works business activity. Cairns Works will still continue to operate as an ordinary activity of Council, however it will no longer be subject to the competitive neutrality principle under the National Competition Policy Framework.**

EXECUTIVE SUMMARY:

This report provides an analysis on the effects of implementing the recommendation to not apply the competitive neutrality to Cairns Works.

A public benefit assessment was undertaken as required by the *Local Government Act 2009* which found that the application of the competitive neutrality principle was no longer suitable for Cairns Works.

To implement this recommendation, Council is required to consider the report and decide by resolution whether or not to apply the competitive neutrality principle.

BACKGROUND:

Cairns Works is currently a commercialised business activity of Council which is conducted through a commercial business unit. This structure was implemented under

the National Competition Policy reforms which are contained in various provisions of the *Local Government Act 2009*.

This structure was implemented based on the recommendations of a public benefit assessment undertaken in May 2003. This public benefit assessment recommended that Cairns Works apply the commercialisation method of reform starting on 1 July 2003. Commercialisation was considered the most suitable method of reform at the time as Cairns Works underwent a significant internal transformation where it was restructured to adopt a more commercial and profit-driven approach.

It is no longer intended that Cairns Works operate in the same way as described in the public benefit assessment undertaken in May 2003. As a result, a review has been undertaken to assess if the commercialisation method of reform would still be suitable for Cairns Works given the proposed changes.

This review was undertaken in the form of a public benefit assessment as required by the *Local Government Act 2009*. The findings of the public benefit assessment were that the application of the competitive neutrality is no longer suitable for Cairns Works under either method of reform. That is, the costs of applying the competitive neutrality principle outweigh the benefits to the public from applying the competitive neutrality principle. To implement the recommendations from this public benefit assessment, Council is required to consider the public benefit assessment and pass a resolution to not apply the competitive neutrality principle to Cairns Works.

COMMENT:

A detailed review of the justifications for this recommendation are contained in the attached public benefit assessment.

Essentially, Cairns Works no longer intends to operate in the manner described in the public benefit assessment undertaken in May 2003. As a result, the application of the competitive principle under either method of reform is no longer suitable for Cairns Works.

OPTIONS:

Option 1: (Recommended)

That Council resolve to:

1. Not apply the competitive neutrality principle in the form of commercialisation to Cairns Works for the 2018/19 financial year for the following reasons:
 - a. This method of reform is inconsistent with the way Council intends to operate Cairns Works;
 - b. The application of the full cost pricing method that is also required under this method of reform is not suitable for the reasons mentioned below; and
 - c. The costs of this reform outweigh the benefits to the Community
2. Not apply the competitive neutrality principle in the form of full cost pricing to Cairns Works for the 2018/19 financial year for the following reasons:
 - a. Cairns Works does not intend to compete in the public market and will only provide goods and services to Council; and
 - b. The costs of this reform outweigh the benefits to the Community.
3. Wind up the Cairns Works Commercial Business Unit.

Option 2:

Do not accept the recommendations. Continue to apply the commercialisation method of reform to Cairns Works.

CONSIDERATIONS:Risk Management:

There are regulatory risks involved with the processes of deciding to no longer applying the competitive neutrality principle to Cairns Works. The process and steps involved must comply with the *Local Government Act 2009* and the *Local Government Regulation 2012*. These provisions have been reviewed to ensure Council has discharged all of its legal requirements.

Opinion and guidance was sought from Department of Local Government, Racing and Multicultural Affairs (DLGRMA) to ensure the proposed processes for no longer applying the competitive neutrality principle to Cairns Works were legally valid.

Legal advice was also sought to review the processes and documentation involved to ensure legal compliance.

Statutory:

- Part 2 of the *Local Government Act 2009*
- Part 2 of the *Local Government Regulation 2012*

CONSULTATION:

The *Local Government Act 2009* and the *Local Government Regulation 2012* do not specifically prescribe the method for removing a commercialised business unit. Advice from the DLGRMA is that this must be done by the same process to create the commercialised business unit and would require:

1. Conducting a public benefit assessment of the significant business activity and prepare a report on that assessment;
2. Considering the report and passing a resolution not to apply the competitive neutrality principle to the significant business activity;
3. Providing the Minister with a copy of the report and any resolutions made in relation to the report; and
4. Passing a resolution to wind up the Commercial Business Unit that conducts the significant business activity.

Preston Law was also consulted to ensure Council has fulfilled its legal obligations in regards to this process.

ATTACHMENTS:

- Cairns Works Public Benefit Assessment (April 2018)



Jason Ritchie
Manager Finance



Lisa Whitton
Chief Financial Officer



Cairns Works

Public Benefit Assessment

April 2018

1. Introduction

Cairns Works is a construction and maintenance activity conducted by Cairns Regional Council ("Council"). Cairns Works commenced application of the competitive neutrality principle on 1 July 2003, choosing to apply the commercialisation method of reform to the business activity as recommended by the public benefit assessment undertaken at the time. Due to a change in strategic direction of Cairns Works operations, it is the opinion of Council that Cairns Works no longer meets the definition of 'business activity' for National Competition Policy (NCP) purposes and therefore is no longer required to apply NCP provisions.

As Cairns Works no longer meets the 'business activity' definition for NCP, it is recommended that Council convert the Commercialised Business Unit (CBU) back to an ordinary business unit. To facilitate the wind up of the CBU, Council has reversed the process undertaken to Commercialise Cairns Work by conducting a public benefit assessment of the business activity and preparing this report on that assessment

2. Cairns Works

Cairns Works is a construction and maintenance activity of Council. The core functions of Cairns Works are:

- i. **Maintenance** - activities including roads, drainage, minor works, parks, street litter and public toilet cleaning; and
- ii. **Construction** - Council capital works, predominately road, drainage and parks construction works; and
- iii. **Roads** - Roads Maintenance Performance Contract (RMPC) work which is performed on a sole-supplier basis with the Department of Transport and Main Roads (DTMR).

Cairns Works no longer intends to operate in the same manner as when it was initially commercialised. The current operating intentions of Cairns Works are in contrast to those included in the public benefit assessment when Cairns Works was initially commercialised. This is consistent with Councils' overall 'one-Council' approach to its operations. Under the current proposed changes, there would be:

- No intention to open the services of Cairns Works to the competitive public market.
- No separation between Cairns Works and Council. Cairns Works would carry on its activities as a core internal function of Council.
- No more management autonomy held by Cairns Works than other areas of Council. Complete management autonomy would no longer be required as there would be no commercial or profit-driven elements of Cairns Works. Council would hold control and direction of Cairns Works to allow it to deliver the essential public services it provides.
- Reduced charging or prices set for goods and services provided by Cairns Works. As Cairns Works would only provide services to Council and would no longer be considered a separate unit, to charge for these goods and services would essentially result in Council charging itself.
- No intention to pursue business opportunities outside of the work required to be carried on in achieving Councils core operating functions. The sole focus of Cairns Works would be to provide maintenance and construction services for Council.
 - For the avoidance of doubt, Cairns Works would still complete RMPC work on a sole-supplier arrangement with DTMR.

- No intention for Council to source the goods and services provided by Cairns Works externally, unless there is an overall net benefit to Council in doing so.

The Queensland Government Policy Statement *Competitive Neutrality and Queensland Government Business Activities* provides guidance and states that 'business activities do not include' activities which provide goods/services to only their own department and are not engaging in competition with any other provider outside the department.

Under the current operating environment, Council (inclusive of Cairns Works) is committed to delivering a balanced budget with rate rises at or around CPI. That commitment is supported through strong cost management and planning.

The above mentioned operating environment is key when read in conjunction with the financial analysis.

3. Public Benefit Assessment

A public benefit assessment (PBA) is an assessment of whether the benefit to the public (in terms of service quality and cost) of applying the competitive neutrality principle in relation to a significant business activity outweighs the costs of applying the competitive neutrality principle.

The following 3 reform options have been assessed through a financial and qualitative analysis;

- Base Case – No reform.
- Full Cost Pricing (FCP) – Requires the application of competitive neutrality to account for cost advantages and disadvantages of public ownership.
- Commercialisation – Requires application of competitive neutrality adjustments of FCP and aims to create a more commercial operating environment leading to more rigorous pursuit of profits, efficiency gains and improved service delivery.

3.1. Financial Analysis

An important component of the PBA process is to scope the magnitude of change under different reform options. The results of each reform option compared to the base case would determine which provides the greatest benefits to the business unit, Council and the community. The key decision criterion is the Net Present Value (NPV) to Councils overall net position.

The financial evaluation completed in 2003 suggested the Council consolidated NPV was \$5.8M under the commercialisation option. This NPV was driven significantly by Councils ability to charge external clients.

As Cairns Works is no longer competing for external clients, it can be inferred that the NPV remains neutral between the base case and commercialised business unit options. Whilst Cairns Works can recover the full cost of goods and services from other areas of Council, this Cairns Works revenue is offset via internal expenses in other areas of Council. The net consolidated impact to Council cash flow is nil.

Councils overarching corporate plan and strategic objectives are conducive to building a strong culture of continuous improvement and business efficiencies. Strong downward pressure on rates rises provides increased incentives to managers to realise cost reductions whilst improving service standards. Cairns Works objectives are clearly defined within the budget parameters and service levels within the asset management plans. It is therefore assumed there would be no additional efficiency gains realised through the Commercialisation option over the base case. The net consolidated impact to Council cash flow is nil.

A summary of the above impacts compared to the base case is provided in the table below.

Item	Full Cost Pricing	Commercialisation
Recoup full cost of service from customers	No change	No change
Increased efficiency & cost reductions	No change	No change
Administration costs	Increased Cost	Increased Cost
Overall Benefit/Cost	Marginal Cost	Marginal Cost

Therefore, the financial analysis would recommend that both reforms of Full Cost Pricing and Commercialisation have no financial benefit over the base case option. This is on the basis that the consolidated financial forecast position of Council would be largely be indifferent under each option apart from a marginal increase in cost for the administration.

4. Conclusion

Considering the intention of Cairns Works to no longer offer services to the competitive open market, the Policy Statement *Competitive Neutrality and Queensland Government Business Activities* concludes that Cairns Works is no longer a business unit considered for NCP purposes. In order to De-Commercialise Cairns Works, a public benefit assessment has been undertaken resulting in the recommendation to wind up the CBU. The results of the PBA indicate there is no benefit to Council.

If in the future there was a change in the direction of Council, which resulted in Cairns Works competing with private enterprise, and the unit was over the significant activity threshold, Council would be required to undertake a public benefit assessment to determine the appropriate level of reform.

5. Recommendation

An assessment of the reform options considered by Council indicates no benefit of FCP or commercialisation. It is appropriate for Council to wind up the CBU.