

**Queensland  
Competition  
Authority**

## **Competitive Neutrality Complaint**

Complaint by Robin Russell and Associates  
Against the Wide Bay-Burnett Electricity Corporation

FINDINGS AND RECOMMENDATIONS

**February 1998**

### **Principle of Competitive Neutrality**

The principle of competitive neutrality is that a government agency carrying on a significant business activity should not enjoy a competitive advantage, solely because of the government ownership or control of the agency, over competitors or potential competitors in a particular market.

## CONTENTS

	<b>Page</b>
<b>1. THE COMPLAINT</b>	<b>4</b>
<b>2. LEGISLATIVE TESTS</b>	<b>4</b>
Declared Significant Business Activity	4
Is there a Market	5
Competition Requirement	6
Genuine Attempt to Resolve	6
<b>3. THE CORPORATION'S APPROACH TO COSTING SERVICES</b>	<b>6</b>
Developer Security Arrangements	6
Construction Options	8
If Corporation Designs and Constructs	8
Use of Private Contractors	8
Analysis of Corporation's Estimates	8
Profit Margin	9
Commonwealth, State and Local Government Taxes and Charges	9
Costs of Debt Financing	9
Use of Non-Current Assets	10
Corporate Overhead	10
Direct Design Costs	11
Direct Construction Costs	11
Analysis of Variances	11
Competitive Advantage	11
<b>4. SECTION 49 ISSUES</b>	<b>12</b>
<b>5. COMPETITIVE DISADVANTAGE</b>	<b>17</b>
<b>6. CONCLUSIONS AND RECOMMENDATIONS</b>	<b>17</b>
Substantiation of Allegations	17
Reasons for the Decision	17
Recommendations to Overcome Failure to Comply	18

## **1. THE COMPLAINT**

- 1.1 The Queensland Competition Authority (the Authority) has received a complaint from Robin Russell and Associates (Robin Russell) alleging a breach of the principle of competitive neutrality by the Wide Bay-Burnett Electricity Corporation (the Corporation) in respect of the manner in which the Corporation approaches augmentation of its network.
- 1.2 The Corporation is authorised under the Electricity Amendment Act 1997 to distribute electricity in the Wide Bay-Burnett region. With respect to augmentation of its network, the Corporation either designs and constructs the relevant infrastructure itself, or allows a land developer to design and construct it (either itself or by contracting out to other suppliers of services). This arrangement was established some years ago when the Corporation was unable to meet the demand for augmentation works in a timely manner and, as a result, decided to allow land developers to undertake the work themselves.
- 1.3 In those instances where a land developer decides to design and construct the relevant works itself or to use a private sector contractor to do so on its behalf, the Corporation advises the developer of the Corporation's estimate of the cost of designing and constructing the relevant works. If the land developer decides to proceed with undertaking the work itself, the Corporation will pay the developer the previously advised estimate of the cost (less some minor adjustments) when the works are handed over to the Corporation.
- 1.4 Robin Russell claims that the Corporation's estimates for the design and construction of electricity reticulation and street lighting are too low and that this prevents the private sector from "gaining professional engagement in their area of electricity supply". In particular, Robin Russell wishes to engage in the "area" of design and supervision of construction of electricity reticulation and street lighting (the relevant services) for private land developers who choose to construct the necessary infrastructure themselves. The supervision activity that Robin Russell wishes to engage in relates to the project management supervision of the construction works for the private land developer. This is distinguished from the supervision undertaken by the Corporation to ensure that privately constructed infrastructure is suitable for interconnection with the existing distribution system.

## **2. LEGISLATIVE TESTS**

- 2.1 There exist a number of legislative tests which must be fulfilled to investigate a complaint or sustain a breach of the principle of competitive neutrality. Those issues and their status are outlined below.

### **Declared Significant Business Activity**

*Section 42 of the Act provides that a complaint may be made against "a government agency carrying on a significant business activity" while significant business activity is defined in section 39(1) as a business activity "declared to be a significant business activity by the Ministers[the Premier and the Treasurer] by gazette notice".*

- 2.2 Until 1 July 1997, the Corporation was a subsidiary of the Queensland Transmission and Supply Corporation (QTSC) and as such was subject to the provisions of the Government Owned Corporations Act 1993 (GOC Act). As a subsidiary, the Corporation was also party to QTSC's Corporate Plan and Statement of Corporate Intent, both of which recognise the principles of corporatisation (involving a commitment to competitive neutrality) contained in the GOC Act.
- 2.3 All the business activities of the Corporation were declared on 1 July, 1997 to be significant business activities for the purposes of compliance with the principle of competitive neutrality under the Queensland Competition Authority Act 1997.
- 2.4 The complaint by Robin Russell relates to decisions taken by the Corporation prior to the commencement of the Queensland Competition Authority Act 1997 (the Act) and prior to the declaration of the significant business activities of the Corporation for the purposes of Part 4 of the Act. However, the Act does not constrain the Authority to consider only actions which occurred after its commencement.
- 2.5 Furthermore, although the Corporation has suspended practices against which the complaint is directed pending the resolution of this complaint and the implementation of any recommendations, they are still current.

### **Is there a Market**

*Section 43(2) of the Act requires that there be actual or potential competition "in a particular market".*

- 2.6 In order to subdivide land, developers are required to comply with conditions imposed by the relevant local council. A common condition is the provision of electricity supply to each new lot.
- 2.7 To provide the necessary undertaking that the Corporation will provide electricity to a particular subdivision, the Corporation enters into a contract with the developer to supply the necessary infrastructure or allows the developer to provide the infrastructure itself provided the work meets the requirements of the Corporation. Where the developer decides to construct the infrastructure itself, the Corporation cannot give the undertaking until the construction has been completed or other arrangements are made with the developer to guarantee the construction of the infrastructure to the satisfaction of the local government authority and the Corporation.
- 2.8 Legal advice is that the decision by the Corporation to allow the private sector the option of undertaking its own design and/or construction of the relevant services has created a "market" for the purposes of compliance with the principle of competitive neutrality under the QCA Act.
- 2.9 Correspondingly, the Corporation's decision not to allow private land developers the option of themselves providing other activities associated with the augmentation of its network, such as metering, switching, inspection and induction activities results in the absence of a "market" for these activities. Furthermore, legal advice is that a decision on whether or not to outsource activities is a legitimate business decision unrelated to a body's ownership status and that therefore the inability of a private sector provider to compete with a government agency as a result can not be regarded as a breach by that government agency of the principle of competitive neutrality.

## **Competition Requirement**

*Section 43(2) requires that a complainant must either compete with a government agency or seek to compete with the government agency but be hindered from doing so by the alleged competitive advantage.*

- 2.10 Robin Russell has submitted that it is seeking to participate in the market for the design and supervision of construction of the relevant infrastructure. The Corporation allows a private sector developer to take on the responsibility of constructing the relevant infrastructure and therefore developers can use alternative sources of construction (including design).
- 2.11 The Corporation has submitted that the only area of potential competition with Robin Russell is in relation to the design function (as Robin Russell does not engage in construction activity). Nevertheless, any distortion to the market for construction which prevents private contractors participating in that market will also retard the possible involvement of other private sector contractors seeking to supply services relevant to construction (that is, by Robin Russell in respect of the supervision of construction).
- 2.12 Accordingly, the competition requirements of the Act are fulfilled in the current circumstances.

## **Genuine Attempt to Resolve**

*Section 44(c)(iii) requires that a complainant must have made “a genuine, but unsuccessful, attempt to resolve the subject matter of its complaint”.*

- 2.13 Robin Russell has provided details of several unsuccessful attempts to resolve with the Corporation the basis on which its pricing estimates were based. These requests followed on from requests by the majority shareholder of Jamworth Pty Ltd, to use Robin Russell’s services for the provision of design and supervision services in relation to the relevant services. Jamworth is the developer of Blue Gum Chase, and is a subsidiary of the Pinnacle Properties Group.
- 2.14 Based on the evidence presented, the Authority considered that Robin Russell and Associates had made genuine, but unsuccessful, efforts to resolve the matter with the Corporation and therefore proceeded to investigate the complaint.

## **3. THE CORPORATION’S APPROACH**

### **Developer Security Arrangements**

- 3.1 When a land developer approaches the Corporation regarding the provision of the relevant services to a proposed land development, the Corporation requires that the developer provide security to the Corporation that sufficient revenue will be generated by the new development to cover the costs that will be incurred in augmenting the network. It does this to ensure that new developments do not impose a burden on existing users.

- 3.2 To determine the amount of security required, the Corporation estimates the cost of the necessary works using standard costs in areas where the development falls within internal guidelines. The development which was the source of this complaint fell within the relevant guidelines.
- 3.3 For urban developments with aboveground power, the Corporation currently uses a standard amount per lot. For underground power, it uses a different (higher) standard amount per lot. For rural subdivisions an estimate is made on the basis of the standard cost of the number of anticipated spans (each span consists of one power pole and the distribution lines connecting it to the next span) and the standard cost of the transformers required.
- 3.4 The Corporation uses standard costs so that developers can be quickly advised of the amount of security they are required to provide (and in most instances can determine the amount themselves). Standard costs are also seen by the Corporation as providing a measure of equity across developments as well as across various stages of the one development.
- 3.5 Standard costs are determined on an annual basis, taking account of the previous year's costing experience, and are designed to cover all costs that the Corporation incurs in providing a development, including:
- (a) the costs of metering and switching;
  - (b) the cost of approvals, inductions and inspections;
  - (c) an allocation of overall corporate overheads;
  - (d) design and survey costs; and
  - (e) construction costs.
- 3.6 The developer is given a number of alternative ways in which it can provide the necessary security to the Corporation that sufficient revenue will be generated by the proposed development to meet the cost of the works. These include refundable security deposit arrangements and up front payments.
- 3.7 The Authority has not attempted to determine whether the above arrangements with land developers are reasonable as:
- (a) they relate to the issue of third party access to the Corporation's network;
  - (b) the Corporation has not been declared as a candidate service for the purposes of Part 5 of the Act; and,
  - (c) the current complaint is not about the Corporation's access arrangements but rather is about those practices of the Corporation which effectively prevent the private sector from "gaining professional engagement in their area of electricity supply". The Corporation's access arrangements have no impact on this.

However, the Authority notes that the lack of transparency of these arrangements has led to much of the confusion which was the initial source of this complaint.

- 3.8 The Authority has investigated the variation between standard costs used to determine revenue security amounts and the actual cost of the works undertaken and concluded that, in aggregate, the variances are reasonable.

### **Construction Options**

- 3.9 If a land developer decides to proceed with a development, it has the option of having the relevant services designed and constructed by the Corporation or undertaking the design and construction itself.

### **If Corporation Designs and Constructs**

- 3.10 If the Corporation undertakes the design and construction, then the actual cost of the relevant services is met in full by the Corporation. No revision is made to the amount required as revenue security from the land developer regardless of the actual costs incurred.

### **Use of Private Contractors**

- 3.11 Should a land developer choose to design and construct the relevant services itself or to use a private sector contractor to do so on its behalf, the Corporation advises the developer of the Corporation's estimate of the cost of designing and constructing the relevant services. The Corporation also advises of the additional cost of the Corporation supervising that construction.
- 3.12 The estimate provided to the land developer is also the price which, if the land developer decides to proceed with undertaking the work itself, the Corporation will pay to it for the work when it is handed over to the Corporation (less some minor costs involved in switching, supervising private sector contractors' works and the induction of the contractors' employees).
- 3.13 If the developer decides to proceed with designing and/or constructing the relevant services itself, then any variation between the estimate advised to the developer by the Corporation and the actual cost incurred by the land developer is to the land developer's account. In other words, the Corporation will purchase the works from the land developer at the Corporation's estimate of cost and will not be influenced by the actual costs incurred by the land developer. As is the case if the Corporation designs and/or constructs the relevant services, no revision is made to the amount required as revenue security from the land developer regardless of the actual costs incurred.

### **Analysis of Corporation's Estimates**

- 3.14 An analysis of the manner in which the Corporation calculates its estimates of the costs to it of designing and constructing the relevant services indicates that the estimate given to a developer (as per 3.11 above) only covers direct design and construction costs and does not include:
- any profit in respect of the works;
  - any contribution to overall corporate overheads;
  - sales tax;

- any debt guarantee fees designed to compensate for its cost advantage in the area of debt costs;

### **Profit Margin**

- 3.15 As a matter of long standing practice, the Corporation does not include any profit margin in the design and construction cost estimate it provides to a land developer who is contemplating undertaking the relevant services itself.
- 3.16 This is clearly inconsistent with normal commercial practice.

### **Commonwealth, State and Local Government Taxes and Charges**

- 3.17 The Competition Principles Agreement seeks to remove the effect of any distortions resulting from ownership by requiring the payment of full Commonwealth, State and Territory taxes or tax equivalents.
- 3.18 The Corporation is required by the Government Owned Corporations Act to make tax equivalent payments to the Queensland Government based upon the value of the benefits derived because it is not liable to pay Commonwealth tax. The Corporation also pays all State taxes and charges and local government charges and fees.
- 3.19 Sales tax exemptions do exist in respect of some inputs but these exemptions are also available to the private contractors and therefore do not cause a distortion between the sectors on this matter.
- 3.20 Sales tax is however payable on some inputs. Sales tax has been estimated by the Corporation at about 3 per cent of total costs, on average. In accordance with the State tax equivalents regime, a sales tax equivalent is payable by the Corporation. However, consistent with existing electricity industry practice in Queensland, sales tax equivalents are not allocated to capital works but are treated as a general overhead expense. Any sales tax incurred by the private sector in relation to a particular project will, however, be reflected in its capital works costing.
- 3.21 To the extent that such sales tax obligations exist in relation to costs related to design or construction activities, these costs should be specifically allowed for in respect of each project, and not left in overheads.
- 3.22 Payroll taxes, workers compensation and other labour on-costs are included in estimating construction costs and in estimating design costs.

### **Costs of Debt Financing**

- 3.23 The payment of debt guarantee fees is a specific requirement under the Competition Principles Agreement (clause 4(b)(ii) refers). The Queensland Government's Full Cost Pricing Policy Guidelines (which apply to non-corporatised entities) elaborate on the rationale as follows:

“...SBAs [Significant Business Activities] bear the cost of debt in a manner similar to their private sector counterparts. Where an SBA does not pay interest at full commercial rates in respect of its borrowings, it will be necessary to determine whether that situation is the result of its affiliation with government or whether that is an arrangement that might normally be

available to businesses in the private sector. SBAs will only be required to impute an interest charge on such debt where the advantage arises solely because of the nexus between the SBA and the government. The amount of the charge should reflect the advantage of borrowings being guaranteed by the Government.”<sup>1</sup>

- 3.24 The Corporation does not include any such fees in its cost estimates as, inter alia, the capital structure of the Corporation is yet to be finalised (by the Queensland Electricity Reform Unit by mid-1998). In addition, details of how debt guarantee fees are to be applied are currently being developed by the Queensland Treasury.
- 3.25 The Authority considers that the absence of a debt guarantee fee results in an unfair competitive advantage to the Corporation over the private sector. Nevertheless, the Authority understands that the size of the fee will not be substantial.

#### **Use of Non-Current Assets**

- 3.26 In a normal commercial environment, depreciation and amortisation of non-current assets for the consumption or loss of their service potential would be included when determining the cost of relevant services.
- 3.27 The Corporation has provided to the Authority audited confirmation that the principles applied by the Corporation comply with the relevant standards required by the Financial Administration and Audit Act.
- 3.28 Depreciation of transport assets utilised in respect of construction activities is allocated to each project through the transport costs, the only capital items utilised in this process. All other depreciation expenses are incorporated in corporate overhead.

#### **Corporate Overhead**

- 3.29 The Corporation includes in corporate overhead all operational costs relating to : communication services, engineering services, planning services, corporate management, computer services, financial services, health and safety services, human resource services, administration services, branch administration, property services and training.
- 3.30 Capital works (including those related to the relevant works) are allocated a share of corporate overhead on the basis of the share of total direct labour costs that are applied to capital works. However, no share of corporate overhead is included in the design and construction cost estimate the Corporation provides to a land developer who is contemplating undertaking the relevant services itself.
- 3.31 A private sector operator would need to provide for a share of its corporate overheads in any design and construction work it undertakes. Accordingly, the Corporation’s practice gives it an unfair competitive advantage.

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<sup>1</sup> See discussion on p10 of the Policy.

### **Direct Design Costs**

- 3.32 Each project is allocated a share of the total design costs of the Corporation (which include labour and other direct costs) based on the project's share of total capital expenditure.

### **Direct Construction Costs**

- 3.33 Construction costs include materials, transport, labour (using average labour costs) and also a provision for on-costs.
- 3.34 Materials costs are determined by a moving average inventory method. Labour costs represent the average of the costs relevant to construction (salaries of the non-construction workforce are incorporated in corporate overhead). Transport costs are based on an hourly and kilometre rate which depends on the vehicle being used (and include a provision for depreciation). Stores on-costs reflect the cost of the maintenance of inventories for materials.
- 3.35 Labour overheads include annual leave, leave loading, long service leave, sick leave, public holidays, employer superannuation contributions, payroll tax, bereavement leave, workers compensation and reflect the EBA Electricity payment. These are also applied to each project.

### **Analysis of Variances**

- 3.36 While the Corporation's estimating process appears robust in total, it does not appear to be sufficiently refined to enable it to provide reasonable estimates on an individual basis.

### **Competitive Advantage**

*Section 38 of the Act provides that "The principle of competitive neutrality requires that a government agency carrying on a significant business activity should not enjoy a competitive advantage, solely because of the government ownership or control of the agency, over competitors or potential competitors in a particular market".*

- 3.37 At its narrowest, this might include only such matters as tied arrangements, a lack of a requirement to pay certain government charges, exclusion from the operation of planning laws etc.
- 3.38 However, a narrow interpretation would not take account of other non-commercial activity by government business agencies, such as a failure to include a profit margin in tendered prices, loading up non-contestable parts of their business with costs which are attributable to the commercial part etc.
- 3.39 There is no doubt that governments intend that such activity should be included, as:
- (a) The Competition Principles Agreement (clause 3 (1) refers) states that the objective of competitive neutrality is the elimination of resource allocation distortions arising out of public ownership of entities engaged in significant business activities.

(b) Government owned corporations feature as a “preferred” model under the Competition Principles Agreement (clause (3) (4) (a) refers) to ensure efficiency in resource allocation in sectors in which government business enterprises participate.

(c) The Queensland Government Policy Guidelines for Corporatisation note that:

“Corporatisation is a structural reform process which changes the conditions under which (GOCs) operate, so that they are placed as far as practicable, on a commercial basis in a competitive environment.”<sup>2</sup>

3.40 Accordingly, the Authority has determined that the proviso “*solely because of the government ownership or control of the agency*” includes the persistent failure to act in a normal commercial manner, as a private sector entity would not seek to do so or, if it did so act, would not survive. Such a definition still allows a government agency to take advantage of differences due to its size, assets, skills, experience and culture. Differences of these kinds are the hallmark of a competitive economy<sup>3</sup>.

3.41 This does not require that a profit needs to be made on each and every project. However, a profit margin should generally be incorporated in each project, as part of the Corporation’s overall effort aimed at achieving a commercial rate of return, unless there are good commercial reasons for not doing so in a particular case or cases.

3.42 Such a view is consistent with the full cost pricing policy (FCP) of the Queensland Government (which refers to non-corporatised entities) and which states:

“the FCP Policy aims to achieve competitive neutrality between public and private sector businesses by ensuring that prices charged by SBAs (significant business activities) reflect a similar cost structure to that faced by a private sector competitor. In setting prices under the FCP policy, the SBA must meet all fixed and variable costs (including tax equivalents), and must achieve an appropriate rate of return on equity. This rate of return must be achieved over the medium term”<sup>4</sup>

But further notes:

“...the policy does allow sufficient flexibility for SBAs to price in a competitive manner according to market conditions. For example, the policy permits the setting of “loss-leader” prices provided that a prescribed rate of return is achieved in the medium term.”

#### **4. SECTION 49 ISSUES**

4.1 Section 49 of the Act requires the Authority to have regard to a number of specific matters when it conducts an investigation. The specific matters and the Authority’s consideration of them are outlined below.

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<sup>2</sup> p5 corporatisation in Queensland - Policy Guidelines. 1992.

<sup>3</sup> See discussion of this matter by the Independent Committee of Inquiry into National Competition Policy (1993), p 293.

<sup>4</sup> p2 - Full Cost Pricing Policy: Queensland Treasury

*49(1)(a) “the need to ensure compliance with the principle of competitive neutrality”*

- 4.2 Regard has been had for the need to ensure compliance with the principle of competitive neutrality and the Authority’s findings and recommendations are designed to promote it.

*49(1)(b) “the need for efficient resource allocation”*

- 4.3 Improvements to the pricing practices of the Corporation will improve the basis for decision-making by private developers when seeking to determine whether to employ the services of the Corporation or a private contractor to install electrical reticulation or street lighting services. This will lead to resources being managed, and directed, to those most efficiently able to do so. The cost of augmentation should decline once these practices are put in place.

The Corporation has expressed concern that if the private sector is to construct the relevant infrastructure, it may lead to duplication of resources. The Authority considers that it is unlikely that resources will be duplicated. If anything, there may be a transfer of resources between the public and private sectors.

The Corporation has also expressed the concern that:

- (a) as it becomes responsible for the infrastructure it must supervise and inspect various stages of the construction which in some cases may amount to full time supervision;
- (b) the Corporation would have to approve the design and specifications which may involve a similar amount of work as creating the design itself.

It is possible to allow private sector design and construction of works without needing to undertake comprehensive supervision of the design and construction work. It does however require a change in culture for the Corporation.

The Corporation has also advised that it would have to consider an appropriate fee for calculating the buy back price for the developer which is a lengthy process. The Authority accepts that it is legitimate for the Corporation to charge for any services it provides, provided that the basis for calculating its fee is legitimate. Private sector developers would then take that fee into account in making their decisions.

- 4.4 The Authority has not sought to quantify the distortions to resource allocation that have resulted from the Corporation’s breach of the principle of competitive neutrality.

*49(1)(c) “the need to promote competition”*

- 4.5 The Corporation’s practice of (effectively) underestimating design and construction costs has resulted in a reduction in competition for the work involved in augmenting the Corporation’s network. While the practice of underestimation may not be the sole cause, the Authority notes that the Corporation has advised that only one (or two) developers have decided to undertake the work themselves. By using more reasonable estimates, competition will be promoted.

- 4.6 The Corporation has advised that it is currently reviewing its outsourcing policy in relation to the augmentation of its network with a view to determining whether to continue to allow developers the option of undertaking construction of infrastructure themselves.

The issues influencing this consideration are stated to be the very low demand for this arrangement by developers, possibly for the reasons discussed in 4.23 and that considering the demand, there is little advantage to either the Corporation or community to develop the mechanism whereby -

- The Corporation gives the necessary undertakings to the local government authority that an infrastructure will be provided.
- Protection is provided for the Corporation being considered as the principal contractor, even though the work is being constructed by a private developer.

- 4.7 While there are many valid issues which need to be considered in relation to the net benefits of outsourcing, it is a concern that the Corporation's possible response to a complaint about its compliance with the principle of competitive neutrality is not to change its own practices but rather consider withdrawing the area from competition. This would be a perverse result from a national competition policy perspective. However, it is a matter for the Corporation and the Shareholding Ministers to consider. The Authority suggests that a public benefit test should be implemented before the current policy is reversed.

*49(1)(d) "any government policies or guidelines about the application of the principle of competitive neutrality"*

- 4.8 There are no further Commonwealth or Queensland Government policies on this matter which could provide assistance or direction in the determination of this matter.

*49(1)(e) "any directions about the application of the principle of competitive neutrality given to the government agency by the Government"*

- 4.9 The Minister for Mines and Energy and the Corporation have confirmed that no directions have been given to the Corporation which would require the Corporation to not comply with the principle of competitive neutrality.

*49(1)(f) "any arrangements between the Government and the government agency about the competitive disadvantage suffered by the agency because of government ownership of control of the agency"*

- 4.10 The Authority is unaware of any such arrangements and the Corporation has not claimed that there are any.

*49(1)(g) "any laws about the application of the principle of competitive neutrality"*

- 4.11 There are no further Commonwealth or Queensland Government laws on this matter which could provide assistance or direction in the determination of this matter.

*49(1)(h) “any legislation or government policies relating to ecologically sustainable development”*

4.12 The Corporation has advised that once it acquires the infrastructure it has responsibility for compliance with environmental legislation and laws. And further that the Corporation’s staff are skilled in this area whereas private sector contractors may not be. Therefore the inspection by the Corporation of the construction by the private sector would include a determination as to whether these matters had been complied with to ensure no liability is passed onto the Corporation.

4.13 The Authority is unaware of any legislation or policies in this area that impact differently on the private sector than on the public sector nor is it aware of any compliance differences between the two. However, should any exist it is reasonable for the Corporation to pass on the legitimate costs of inspecting the private sector’s compliance.

*49(1)(i) “social welfare and equity considerations including community service obligations and the availability of goods and services to consumers”*

4.14 The Corporation does not receive any CSOs from Government for the augmentation of infrastructure.

4.15 There would be no impact on the availability of goods and services by complying with the principle of competitive neutrality.

4.16 Overall, consumers of electricity will be advantaged by the adoption of the recommendations due to the lower costs of infrastructure. Land developers will be advantaged by access to private contractors at potentially lower costs.

*49(1)(j) “any legislation or government policies relating to occupational health and safety or industrial relations”*

4.17 The Corporation expresses a view that there must be a mechanism to ensure that the private contractors are appropriately skilled. The Authority recognises that the Corporation is providing induction courses for contractors in respect of workplace health and safety legislation and that is open to the Corporation to charge for them. The courses should, however, not be mandatory unless there are valid health or safety reasons.

4.18 The Authority is unaware of any legislation or policies in this area that impact differently on the private sector than on the public sector nor is it aware of any compliance differences between the two.

*49(1)(k) “economic and regional development issues, including employment and investment growth”*

4.19 The Corporation claims that it currently operates efficiently and effectively because of its purchasing power. The Corporation has also expressed concern that its viability may be affected if the current process for infrastructure acquisition and construction were altered.

- 4.20 The Authority accepts that there may be some effects on the Corporation's current structure and practices. For example, more augmentation work may pass to the private sector and thus affect the viability of some work teams in the region. Nevertheless, the Authority notes that existing teams already work on a flexible basis and service areas outside their current responsibility.
- 4.21 Thus, while some restructuring may occur, and some costs in relation to distribution may also change, it is not evident that these would threaten the Corporation's viability. If anything, its overall competitiveness would be enhanced, as should that of industries in the region.
- 4.22 It should also not be concluded that all or even a major portion of the construction activity would pass to private developers. There is no evidence that the Corporation would not be competitive even if it included all costs as well as a profit margin. The Corporation itself noted that it benefits from its buying power. Furthermore, there is no evidence that the Corporation would not improve its relative competitiveness in these services when faced with real competition.
- 4.23 In addition, even if the private sector was able to do the work at a lower cost than the Corporation, it is not clear that private land developers would seek to undertake the work themselves. The design and construction cost of electricity reticulation represents only a small part of the cost of subdividing land and developers may prefer the simplicity of having the Corporation undertake the work.
- 4.24 Concern has also been expressed by the Corporation that viable projects may be undertaken by the private sector and non-viable projects would need to be undertaken by the Corporation and funded by CSO. If the Corporation's estimates of the cost of undertaking each project are soundly based, this should not be the case. It could, however, happen if the Corporation's estimates were not soundly based (and particularly if too much use was made in individual cases of average costs rather than anticipated actual costs). It is partly for this reason that the Corporation needs to refine its estimation processes.
- 4.25 The Corporation also notes that it is able to employ skilled people in one part of the business because it is also able to utilise their services on the construction projects. Many of such staff will need to be maintained for the maintenance of the system and their cost will rightfully be allocated to this purpose and considered as appropriate when assessing prices. There is no evidence that there are any major structural issues in the workforce that would prevent any necessary adjustments. In this regard, it is noted that existing teams already work on a flexible basis and service areas outside their current responsibility. Furthermore, if there are shared resources (including staff), the Corporation should be more than competitive with private sector providers.
- 4.26 The Authority recognises that, in the unlikely event that all construction services were provided by the private sector, dislocations to the employment base of the Corporation in Wide Bay Burnett could occur. These would, however, most probably be offset by increases in employment by private contractors in the Wide Bay area. In this regard, the average project size is relatively small and is unlikely to attract competitors from outside the area or who would use other than local labour. In addition, there would be a positive employment impact from the increased competitiveness of firms in the region as a result of the lower cost of development.

- 4.27 The Corporation has also expressed concern that there are few private sector competitors in the region, and that if competition is to increase it is likely that it will come from established private sector competitors in other regions and that over time, there may be a deterioration in a skills base for this type of work in the region.

The Authority considers that, if the work is available in the area then, even if there are short term dislocations, the private sector in the area will grow to meet the demand and, accordingly, skills will not be lost to the region.

## **5. COMPETITIVE DISADVANTAGE**

- 5.1 The Corporation has claimed that it suffers a competitive disadvantage as a result of the costs associated with a different regulatory environment and accountability obligations flowing from Government ownership.

The Corporation has not attempted to identify or justify the disadvantage it allegedly suffers as a result of the different “regulatory environment and accountability obligations flowing from Government ownership”. It is likely that these obligations impact more particularly on the Corporation’s electricity supply responsibilities rather than on its construction activities.

## **6. CONCLUSIONS AND RECOMMENDATIONS**

### **Substantiation of Allegations**

- 6.1 The Wide Bay Burnett Electricity Corporation has breached the principle of competitive neutrality in the area of the design and construction of electricity reticulation and street lighting.
- 6.2 The complaint by Robin Russell and Associates that its ability to compete in the market for the design and supervision of the construction of electrical reticulation and street lighting has been adversely affected by the Corporation’s actions is substantiated.

### **Reasons for the Decision**

- 6.3 An analysis of the manner in which the Corporation calculates its estimates of the costs of providing the relevant services indicates that the estimate given to a developer does not include:
- (a) profit;
  - (b) sales tax or debt guarantee fees; and
  - (c) a share of corporate overheads.
- 6.4 In addition, the estimating approach adopted by the Corporation does not produce reliable estimates of cost on an individual project basis.

## **Recommendations to Overcome Failure to Comply**

- 6.5 To ensure that the principle of competitive neutrality is satisfied in the future, it is recommended that Wide Bay Burnett Electricity Corporation should:
- (i) be required to include provisions for the items identified in 6.3 above in any future estimates of the cost of design and construction provided to private sector developers; and
  - (ii) refine its estimating process so that more reliable estimates are produced in respect of individual projects.
- 6.6 The Authority also recommends that:
- (a) a public benefit test should be implemented before any consideration is given to reversing the current policy of allowing private sector developers to undertake the design and construction of electricity reticulation and street lighting;
  - (b) the Corporation should clearly distinguish the general approach to the developer security arrangements from the approach to costing infrastructure and present the details in a simple form available to developers.

In particular, the method of costing to be applied when services are to be provided by the Corporation or the private sector needs to be detailed.