



independent competition and regulatory commission

Final Report
**Competition Inquiry
into
Capital Linen Service**

Report 7 of 2006

March 2006

The Independent Competition and Regulatory Commission (the Commission) was established by the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act) to determine prices for regulated industries, advise government about industry matters, advise on access to infrastructure and determine access disputes. The Commission also has responsibilities under the Act for determining competitive neutrality complaints and providing advice about other government-regulated activities.

The Commission has three commissioners:

Paul Baxter, Senior Commissioner
Robin Creyke, Commissioner
Peter McGhie, Commissioner.

Submissions, correspondence or other enquiries may be directed to the Commission at the addresses below:

The Independent Competition and Regulatory Commission
PO Box 975
CIVIC SQUARE ACT 2608

Level 7 Eclipse House
197 London Circuit
CIVIC ACT

The secretariat may be contacted at the above addresses, by telephone on 6205 0799, or by fax on 6207 5887. The Commission's website is at www.icrc.act.gov.au and its email address is icrc@act.gov.au or ian.primrose@act.gov.au.

For further information on this investigation or any other matters of concern to the Commission please contact Ian Primrose, Chief Executive Officer, on 6205 0779.

Foreword

The Minister for Urban Services requested the Independent Competition and Regulatory Commission (the Commission) to conduct an inquiry under section 19B of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act) into Capital Linen Service (CLS), an ACT Government-owned laundry.

The Commission was asked to inquire whether CLS, by reason of its government ownership, has a competitive advantage in respect of services it provides. In reaching its conclusion, the Commission was asked to consider and report on:

- the market(s) in which CLS operates and the extent to which it is in competition with private sector enterprises, including a consideration of any competitive advantages and/or disadvantages under which CLS operates
- the extent to which cross-subsidisation between market segments exists (for example, private versus public sector customers, health sector versus accommodation/restaurant linen customers)
- whether CLS undertakes any community service obligations (CSOs) and, if so, whether these CSOs are appropriately costed and transparently funded
- the extent to which CLS is complying with the full range of competitive neutrality principles as outlined in the Competition Principles Agreement relating to tax neutrality, borrowing neutrality and regulatory neutrality (see Appendix 2)
- where required, reform option recommendations about the above matters which best achieve the objectives of clause 3 of the Competition Principles Agreement.

In accordance with its statutory obligations under section 19C of the ICRC Act, the Commission wrote to all interested parties immediately involved in the matter, including the Minister and the chief executive of the Department of Urban Services (DUS). A notice was published in the *Gazette*. The reference was published in *The Canberra Times* and on the Commission's website at www.icrc.act.gov.au.

On 11 November 2005, the Commission released an issues paper which set out terms of reference and raised a number of issues which the Commission anticipated addressing as part of its inquiry. The issues paper also called for submissions on the terms of reference.

In November and December 2005 the Commission conducted a series of meetings with CLS, its competitors and suppliers, and other key stakeholders, including government agencies and potential and former customers. These meetings, together with the submissions and the Commission's analysis of financial and operational information on CLS's activities, formed the basis of the Commission's draft report, which was released on 9 January 2006.

The Commission received no further submissions in response to the draft report but held further discussions with key stakeholders. In general, there was widespread agreement with the analysis and recommendations presented in the draft report; hence, the recommendations in this final report reflect those in the draft.

The Commission's main finding is that CLS does not have a competitive advantage in respect of services it provides, and that in fact the opposite is the case. CLS is constrained in its commercial

activities, particularly by its lack of financial autonomy. Accordingly, the Commission believes that the ACT Government should consider allowing CLS to operate as an independent corporation.

This report will be presented to the Minister for Urban Services for his consideration. It is the responsibility of the Minister, and the ACT Government, to decide whether to give effect to the Commission's recommendations.

For further information about this inquiry, please contact Ian Primrose, Chief Executive Officer, on 6205 0799 or by fax on 6207 5887.

Paul Baxter
Senior Commissioner
21 March 2006

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1 Introduction

The Australian Capital Territory (ACT), like other jurisdictions around Australia, is bound by the National Competition Principles, which (among other things) impose important constraints on the way governments undertake commercial activities. These constraints apply in the case of the Capital Linen Service (CLS), a business wholly owned and operated by the ACT Government to supply linen hire and laundry services to public and private customers.

The Commission was required to ascertain whether CLS is complying with the competitive neutrality requirements—that is, tax neutrality, borrowing neutrality and regulatory neutrality—and to establish that CLS is not competing unfairly in the marketplace, including by price gouging or the use of inappropriate cross-subsidisation between customer groups.

The Commission was not asked to determine a detailed new pricing structure for CLS or to reconstruct the business’s financial accounts—those are tasks for CLS managers to fulfil as necessary—but the Commission was charged with reaching a number of conclusions, on the basis of available evidence, about pricing and other issues raised by the terms of reference.

On the basis of its investigations, which included extensive discussions with CLS and other service providers, as well as with numerous customers in the public and private sectors, the Commission has reached a number of major conclusions.

Foremost among these findings (which are set out in more detail in Chapter 7) are the Commission’s conclusions that:

- CLS appears to be disadvantaged, rather than advantaged, as a result of its public ownership, and
- CLS is neither cross-subsidising its hospitality clients through its charges to its health clients nor overcharging customers in general.

In brief, CLS appears to be operating effectively as a business in terms of service quality and customer satisfaction, but less than optimally in terms of financial management because of budgetary and capital planning constraints which arise from being part of an ACT Government agency. The Commission has therefore made a number of recommendations which should remove or ameliorate these constraints.

This final report is structured as follows:

- Chapter 2 provides a brief discussion of obligations under the National Competition Policy, to which the ACT is a party, and consequent competitive neutrality requirements imposed on government-owned enterprises.
- Chapter 3 provides a background to CLS, including its financial position, and discusses whether its costs appear to be reasonable and whether its service standards are meeting customer expectations.
- Chapter 4 discusses the characteristics of the linen services market in the ACT.
- Chapter 5 identifies whether The Canberra Hospital and Calvary Public Hospital are considered to be ‘tied’ customers, and whether CLS’s government ownership provides it with an unfair advantage in the commercial and hospitality linen market.

- Chapter 6 discusses whether CLS appears to be pricing in a manner which is distorting efficient market outcomes and creating a barrier to entry to other businesses.
- Chapter 7 sets out the Commission's conclusions and recommendations.

2 The competition inquiry

The ACT Government, like all governments in Australia, is subject to a number of constraints in operating its own businesses or undertaking business activities. Pre-eminent among those constraints is a set of obligations to which the ACT agreed in 1995, namely the National Competition Policy (NCP). Relevant parts of this policy (which are reproduced in Appendix 2) require government businesses to be subject to the same or equivalent regulations and financial obligations as their privately owned rivals. These are referred to as ‘competitive neutrality’ requirements.

In addition to requiring that government businesses face the same or equivalent regulations (for example, environmental, planning and industrial obligations) as their rivals do, the NCP states that these businesses should not benefit from taxation or financing capabilities different from those of their private sector competitors. Moreover, government businesses should not benefit from arrangements, arising solely from their government ownership, which might potentially distort competitive markets. Such arrangements might include:

- circumstances in which a government entity has ‘tied’ government customers, and over-recovery of revenue from these customers is used to subsidise the provision of services in competitive markets
- situations in which government entities are able to avoid certain costs by virtue of their government ownership and use this advantage to compete against private sector businesses that do not enjoy similar benefits.

Such actions could lead to significant barriers to entry into the market for private sector businesses, and thus hinder competitive outcomes.

The NCP does not require that a market should be equal in respect of all participants, or that there should be regulatory intervention to ensure that competitors are equal. On the contrary, markets are competitive because there are numerous competitors and each offers consumers advantages of one kind or another. Competitive neutrality policy is focused on removing from government-owned businesses any net advantages that are due solely to the government’s ownership.

Usually, failure by a government business to observe its obligations under the NCP is raised as a complaint by a rival in the market. While this investigation touches on competitive neutrality and related issues, this inquiry has not been initiated in response to a complaint. Rather, the government has sought the Commission’s views on certain matters related to competitive neutrality to ensure that CLS does not become the subject of a complaint and operates fairly not only as a competitor in the market for its services but also in dealing with the government clients that use its services.

Most particularly, this review is about ensuring that the outcomes of government ownership and CLS’s pricing arrangements do not impact on competitive markets in a manner inconsistent with the intentions of the NCP.

3 Capital Linen Service

3.1 Background and services provided

CLS is a government-owned business established to provide linen services to the ACT health and hospitality industries. CLS is a business unit in the Department of Urban Services (DUS). It does not have its own board of directors, but is operated as a separate cost centre within DUS. CLS was previously part of the government-owned Totalcare Industries Limited (Totalcare) portfolio, but was reintegrated into the ACT budget sector in May 2004.

CLS operates from a government-owned site in the Canberra industrial suburb of Mitchell. The site is shared with a number of other, mostly ACT Government, facilities. CLS's laundry facility in Mitchell is substantially automated. In the 2004–05 financial year, it processed more than 5,000 tonnes of laundry¹ (including approximately 2,900 tonnes for local hospitals²)—about 100 tonnes per week.

CLS has historically been the linen service provider to the two major hospitals in Canberra: The Canberra Hospital (TCH), located in Woden, and Calvary Public Hospital, located in Bruce. These two hospitals are CLS's largest customers, and generate approximately 45% of its revenue. CLS also has a significant private sector client base which includes both health-related clients and other private sector clients.

Overall, CLS has approximately 110 ACT public sector and private sector clients, including:

- large and small accommodation providers
- restaurants, reception centres and other hospitality industry clients
- a number of large and small private and public health service providers, including private hospitals, doctors' rooms, dental clinics, physiotherapy services and other health centres, as well as a small number of aged care service providers
- the Canberra Sterilising Service.

The fact that CLS generates roughly equal revenue from its health customers and its commercial customers makes it relatively unique—most large-scale laundries provide services to either health or commercial customers, but not both. CLS has a greater profile in the larger hotels and the three-star, four-star and five-star accommodation market in the ACT, compared to its profile in the smaller and less expensive hotels.

¹ ACT Government, Department of Urban Services, *Annual Report 2004–05, Volume 2*, Canberra, p. 102.

² ACT Government, Department of Urban Services, *Annual Report 2004–05, Volume 1*, Canberra, p. 42.

Products and services offered by CLS include:

- supply and laundering for the healthcare sector—hospital linen, general ward linen (sheets, towels, blankets and garments), sterile theatre linen and surgical garments
- supply and laundering for the tourism and hospitality sector—accommodation linen (sheets, pillowcases, towels, washers, bathmats and robes) and restaurant linen (tablecloths, napkins and kitchen linen)
- supply of incontinence products for aged care and health applications
- other laundering and dry-cleaning of uniforms, bedspreads, doona covers, blankets and curtains.

In most cases, CLS provides a hire service—CLS owns the products, which are rented out to customers, delivers the clean products to the customer's premises, and picks up soiled products and transports them to its Mitchell laundry for cleaning. Most customers receive a delivery/pick-up service every business day, although the larger hospitals receive service seven days per week. Smaller customers typically receive deliveries and pick-ups every second business day.

CLS currently employs approximately 110 full-time equivalent employees, drawing from a pool of approximately 130 full-time and part-time workers. Staff are paid in accordance with a certified agreement which operates until 2007 and provides for wage increases determined by the ACT Government (including a 5% increase on 1 April 2004 and 4% increases on 1 April 2005 and 1 April 2006—a cumulative total of 13.6% over three years).

CLS has AS/NZS ISO 9001:2000 Quality Assurance Certification and complies with AS/NZS 4146:2000, which sets out general laundry practice requirements and recommendations for commercial, industrial, hospital, institutional, on-premises and coin-operated laundries, as well as minimum performance requirements which are to be attained in order to provide an acceptable level of service. Importantly, CLS washes all its products to the AS/NZS 4146:2000 standard, which some market participants may not do, as the standard primarily applies to healthcare sector laundry requirements.

3.2 Financial position

In 2004–05, CLS's net operating result was a loss of \$722,000 on revenue of \$9.8 million. Operating losses have been incurred for many years. However, since 2002–03, CLS's cash flows (including cash outflows for capital expenditure) have been positive, although the 2004–05 result includes a \$690,000 capital injection. The forecast is for net cash deficits in 2005–06 and 2006–07. CLS's financial position is summarised in Table 3.1.

Table 3.1 CLS operating results and cash flow (\$'000)

Year ending 30 June	2002–03	2003–04	2004–05	2005–06 budget	2006–07 budget
Linen revenue	9,195	9,914	9,692	9,719	9,962
Other revenue			100		
Total revenue	9,195	9,914	9,792	9,719	9,962
Cost of goods sold			3,431	3,643	3,289
Labour costs, including staff welfare			5,657	6,350	6,601
Other expenses			896	917	947
Corporate allocation			529	457	469
Total expenses	10,287	10,371	10,514	11,368	11,306
Net operating result	-1,092	-457	-722	-1,650	-1,344
Add back non-cash expenditure (depreciation, amortisation)	1,774	2,046	1,999	2,305	1,882
Net cash from operations	682	1,589	1,277	655	538
Less capital expenditure	523	1,445	1,364	3,178	1,873
Add capital injection	0	0	690	2,264	1,120
Net cash flow after capital adjustment	159	144	603	-260	-215

Source: CLS, Commission adjustments.

CLS proposes to undertake a significant capital expenditure program over the next few years in order to replace linen and plant and equipment. Expenditure is expected to average \$660,000 for linen replacement and \$1.5 million for replacement of plant and equipment each year for the next five years. However, CLS is unable to borrow, and major capital expenditure relies on appropriations (capital injections) made through the annual ACT budget process. Other capital expenditure items, including linen, are purchased using operating cash flows.

CLS pays no dividends to government, and no returns are paid on capital injections. In fact, CLS does not currently have its own bank account and instead shares one with a number of other DUS entities. DUS is currently reviewing its banking arrangements, and this may result in CLS having its own bank account in the near future.

3.3 Operating efficiency and customer satisfaction

3.3.1 Operating efficiency

A confidential business review of CLS was undertaken for the ACT Government in 2004 by independent consultant Colin Glenn and Associates Proprietary Limited. This review examined most aspects of CLS's operations and benchmarked CLS against two interstate government-owned health laundries.

This benchmarking needs to be treated with some caution, as:

- CLS launders both health-related and commercial loads, which is a different mix from those of the benchmark laundries
- while the other laundries are also government-owned, they are not required to meet all their operating costs and have a number of special arrangements which make cost comparisons complex³
- there are some problems with the use of weight as the common comparator when products of the same generic type can have different weight characteristics.

Nevertheless, the business review found CLS generally benchmarked well, in terms of both key production benchmarks and cost per unit of output. The statistics in tables 3.2 and 3.3 are taken from the business review and relate to 2003–04.

The business review found that CLS’s 2003–04 costs generally appeared to be at benchmark levels, with the exception of:

- linen replacement costs (which are primarily determined by accounting policies)
- corporate overheads, which are significantly above industry norms
- computer and communications costs.

Reasons for these higher costs are discussed further in Chapter 4.

The business review found that CLS staff costs were consistent with benchmarks in 2003–04. However, these costs have grown significantly since that time, as a result of general ACT Government-determined wage increases. These issues are discussed further in Chapter 5.

Table 3.2 CLS production benchmarks

Benchmark indicator	CLS	Laundry A	Laundry B
Kilograms sold per operator hour	38.46	37.46	38.29
Rewash percentage	3.31	4.54	4.41
Kilograms sold per total staff hours	22.74	19.40	20.46

Note: CLS kilograms sold per total staff hours includes hospital distribution hours; without this, the figure would be 23.8.

Source: Colin Glenn and Associates.

³ For example, neither benchmarked laundry pays insurance, payroll tax or fringe benefits tax (FBT), which CLS is required to fund.

Table 3.3 Costs per kilogram of laundry

Benchmark indicator	CLS	Laundry A	Laundry B
Labour	1.01	1.08	1.11
Linen ¹	0.31	0.09	0.20
Theatre consumables	0.04	0.02	0.05
Linen repairs	0.01	0.01	0.00
Chemicals	0.07	0.05	0.05
Cleaning	0.00	0.00	0.01
Water and sewerage	0.04	0.05	0.04
Gas	0.06	0.05	0.04
Electricity	0.04	0.03	0.02
Fringe benefits ²	0.01	0.00	0.00
Computer systems	0.03	0.01	0.01
Insurance	0.01	0.00	0.00
Building lease ³	0.08	0.24	0.02
Corporate overheads	0.13	0.05	0.03
Depreciation	0.07	0.00	0.06
Information technology and software	0.01	0.00	0.03

Notes: 1 Comparison of linen costs is complex and contentious due to differing accounting practices.

2 Laundry A and Laundry B are not required to pay FBT.

3 No lease costs are paid by Laundry A and Laundry B; figure includes building depreciation only.

Source: Colin Glenn and Associates.

3.3.2 Customer satisfaction

No formal surveys of CLS customer satisfaction have been undertaken. However, the Commission's own consultations with CLS customers, conducted as part of this inquiry, suggest that, in general, current customers are very pleased with CLS's service and overall performance.⁴

In particular, the general consensus from those interviewed indicated that:

- both the linen provided and the laundering performed were considered to be of a very high standard
- responsiveness to customer concerns or questions was regarded as excellent.

However, some customers did complain. For instance:

- One large health customer expressed dissatisfaction regarding CLS's stock control and process for charging for lost or damaged linen, although it was noted that performance had improved recently. The same customer had also experienced difficulty in negotiating arrangements for curtain hanging, which CLS is obliged to provide under its existing contract.
- While most customers were satisfied with the price of services, some believed prices were too high and/or lacked transparency.

⁴ See list of interviewees in Appendix 3.

3.4 General conclusions

Where a government-owned business has a dominant position in a market, there is some risk that its efficiency and customer service levels may be poor. However, having considered the conclusions and recommendations of the business review and taken into account its own discussions with linen customers, the Commission is generally satisfied that this is not the case. CLS appears to be operating in a generally efficient manner, and customer satisfaction with the quality of service appears to be high.

At the same time, a number of issues in relation to certain cost items and CLS's general relationship with government warrant further review and discussion before broader conclusions can be drawn about competitive neutrality issues. These are discussed further in Chapter 5. The pricing of CLS's linen and laundry services to its hospitality and health market clients is discussed further in the next chapter.

4 The ACT linen market

4.1 Services sought by customers

The linen market is normally considered to consist of the following broad customer segments:

- general healthcare sector services—services provided primarily to hospitals and other medical facilities but also to aged care establishments
- provision of sterile theatre linen to hospitals
- tourism and hospitality sector services—primarily the provision of accommodation linen (sheets, towels, face washers, pillowcases, bedspreads, doona covers, blankets and curtains) and restaurant (table) linen
- provision and laundering of uniforms and industrial workwear
- supply of incontinence products for aged care and health applications.

Ancillary services sometimes sought by customers include the provision of an ‘imprest’ service (that is, the delivery of linen to specific sites on a customer’s premises, such as particular hospital wards) and/or uniform design and manufacture. In most cases, customers hire linen and/or uniforms, but some customers provide their own.

No ACT hospital has its own laundry facilities, with the exception of John James Memorial Hospital (JJMH), which has had an on-premises laundry since the hospital’s inception approximately 35 years ago. JJMH also provides linen services to a number of smaller customers.

Several of the major accommodation venues have their own laundries, and some hotels (including the Hyatt and Rydges) have recently installed facilities. This has typically occurred for price-related reasons. In most cases, these on-site laundries focus on towels, face washers and other smaller linen items. Laundering of larger products such as sheets, which require specialised and expensive ironing machines, is often contracted out to other parties. While on-premises laundering remains the exception rather than the rule for major hospitality businesses, it always remains an option should prices charged by commercial laundries become uncompetitive.

JJMH aside, premises which do have on-site laundries tend to focus on their own requirements and usually do not seek to provide services to external clients.

4.2 Market prospects

Historically, growth in the linen services sector has been steady but modest. It is generally dependent on activity in the hospitality and health sectors. Technological change has not had a major impact, and no new markets have opened up in recent years.

In the Canberra area:

- the health market has been slowly growing, consistent with the general ageing of the population
- growth in the hospitality sector has been slow, although over the past two years Canberra has become a relatively more popular venue for conferences, conventions and tourism-related visits, leading to moderate market growth; the period of greatest demand for linen coincides with the Floriade festival in September and October each year.

On the basis of anecdotal evidence, the Commission understands that linen industry margins have fallen recently, although this has been offset by increased volumes.

At the same time, a general trend towards single-use materials and away from the use of linen in certain areas of the health industry is occurring. A revision of the Australian standard on sterilising (AS/NZS 4187:2003), due in 2006, is expected to increase this trend. This will impact on CLS, the only supplier of sterilised linen in the ACT.

4.3 Market competitors

As noted, CLS's market is based around hospitals and health centres, as well as the top end of the hospitality industry. CLS has two main private sector competitors: Ensign and AlSCO. The other provider of linen services in the ACT region is the New South Wales Government, through the South Eastern Sydney and Illawarra Area Health Service and the Greater Western Area Health Service.⁵ These competitors are briefly profiled below.

4.3.1 Ensign

Ensign is a division of the Spotless Group, a company listed on the Australian Stock Exchange. It focuses on industrial uniforms and hospitality and bed linen, and currently has no ACT health sector or government clients.⁶ Ensign owns and operates older-style laundering facilities, in the Fyshwick industrial area, which have a capacity of approximately 50 tonnes per week. The Commission has been informed that Ensign's facilities are currently operating at close to capacity. Ensign also owns and operates larger facilities at Rosebery in Sydney.

Ensign provides services outside the ACT region, including to the public hospital at Nowra on the New South Wales south coast. In this case, bed linen is laundered by Ensign's facilities in Fyshwick, while surgical linen requirements are met via its Rosebery plant.

4.3.2 AlSCO

AlSCO is a wholly owned subsidiary of the Steiner Corporation, a United States-based company. It provides uniform, linen, floorcare and washroom services in the ACT. In the linen and uniform market, it specialises in the workwear and food and beverage areas and thus provides little direct competition to CLS.

⁵ This entity was formed from a merger of South East Health and Illawarra Health on 1 January 2005.

⁶ Ensign has a contract with the National Capital Private Hospital but currently subcontracts back to CLS. CLS has a contract with the Royal Military College but subcontracts to Ensign.

Alsco has a depot in Fyshwick but no ACT-based laundry. Instead, it transports the uniforms and linen to its plant in Campbelltown, in Sydney, for laundering.

Alsco does not propose to move into the ACT health sector, as to do so would require it to establish a new plant in the ACT.

4.3.3 New South Wales Health

New South Wales Health currently owns and operates a number of laundries in New South Wales that concentrate on the provision of services to the health sector. The nearest facilities to Canberra are in Parramatta in Sydney, Port Kembla on the Illawarra coast and Orange in the central west.

The Parramatta laundry has a potential capacity of around 260 tonnes per week. It provides services exclusively to New South Wales customers.

Orange is about 300 kilometres from Canberra. The Orange laundry is around the same size as the CLS facility. It processes around 100 tonnes per week, employs approximately 120 staff and has annual revenue of slightly less than \$10 million. About 65% of its throughput is sourced from metropolitan Sydney, with 35% from regional areas. It has clients both in the public sector and in the private sector.

The Port Kembla laundry provides linen services to health centres in areas surrounding the ACT, including Yass, Goulburn and Queanbeyan.

As part of a reorganisation of the health sector, the New South Wales Government is developing a new shared corporate services strategy. A review of linen arrangements is part of this strategy. The Commission understands that no decisions have yet been made, but a number of industry participants consider that some reduction in the number of state-owned laundries, and a consequent reduction in total capacity, is likely.

4.4 Pricing of linen services

4.4.1 Hospitality market

In interviews undertaken by the Commission, views differed as to the relative prices for commercial and hospitality linen services offered by CLS. Most commercial and hospitality customers contacted by the Commission indicated that linen prices offered by CLS and Ensign were generally similar. While CLS and Ensign might charge different prices for different products, average price differentials were low. As a result, customers tended to prefer one supplier or the other for service quality reasons, or simply because it was easier to stay with their existing supplier.

A number of the hotels consulted (including all the major hotels operating in Canberra) were able to draw comparisons with prices offered by laundry and linen service providers in other states. Again, the comparisons differed from hotel chain to hotel chain, reflecting the comparative corporate purchasing power of the operators and the particular local circumstances of the hotels concerned.

A number of hotels indicated that CLS's prices were highly competitive with prices available in other capital cities, while others reported that the prices they paid in other states were lower than those charged by CLS. However, even where it was reported that CLS's prices were higher (and in one instance where the hotel concerned had installed on-premises laundry facilities to wash its own towels and face washers), these hotels continued to use CLS in recognition of the service and product quality received, despite having the opportunity to use a competing private sector service provider in the ACT.

In general, individual commercial and hospitality customers were not willing to provide actual prices for laundry services in the ACT and other states, presumably to protect their positions for renegotiating linen and laundry services contracts.

4.4.2 Health market

Benchmarking data reported in the business review undertaken by Colin Glenn and Associates demonstrated that CLS's prices for ACT Health customers were an average of \$1.51 per kilogram in 2003–04 (excluding the TCH imprest service). This compares favourably with average prices charged by the benchmarked laundries, reported in the same study by Colin Glenn and Associates, of \$1.80 per kilogram to \$1.88 per kilogram.

Nevertheless, CLS's health clients were generally of the view that their prices were higher than those applying to hospitals elsewhere, particularly in New South Wales. Concern was expressed that CLS's health customers were subsidising private sector clients, and that there was a lack of transparency surrounding CLS's prices and pricing methodology. In particular:

- ACT Health indicated that a separate benchmarking review it had undertaken using information gathered from New South Wales Health laundries suggested that prices in the ACT were higher than those in New South Wales.
- National Capital Private Hospital, which is part of the large Healthscope group, indicated that linen costs quoted by CLS for that hospital in the ACT were approximately \$22 per patient day, while costs for similar-sized hospitals in the group across Australia were \$17 per patient day.

To assess these claims, the Commission has undertaken a review of the information used by ACT Health to reach its conclusion and has considered the reliability of the comparison made by Healthscope.

ACT Health price comparisons

ACT Health has given the Commission access to confidential information used in its price comparisons between CLS and New South Wales Health laundries. It is important to note—and it is acknowledged by ACT Health—that the comparisons ACT Health has been able to undertake have been hampered by the difficulty in obtaining direct pricing quotes from competing laundries operated by New South Wales Health, and by issues relating to different standard weight measurement practices adopted within the industry.

ACT Health has also acknowledged that the cost comparisons it has undertaken do not attempt to assess the availability of capacity in the New South Wales facilities for any additional volume from the ACT. Nevertheless, given the claims made by ACT Health, the claimed price differences require further consideration.

To try to verify these claimed price differences, the Commission contacted the Illawarra and Parramatta laundries operated by New South Wales Health and sought information directly from New South Wales Health about prices for laundry services offered in New South Wales. Unfortunately, no pricing information was provided in response to the Commission's request.

This reflects the high level of competition within the industry and is consistent with the response that the Commission has received from customers in general and from other, private laundry service suppliers. Competing laundries have not been willing to provide directly comparable information, as they recognise that it might disclose any competitive advantage that they have in the market.

In reviewing the confidential information provided by ACT Health, the Commission notes wide variations in the prices charged by the other comparator laundries on a 'per kilogram' basis, with some laundries having prices similar to those charged by CLS and some being cheaper. The information used is based on 2002–03 quantities processed by CLS and on prices per item for other laundries, derived from a number of sources not disclosed in the ACT Health analysis.

The Commission notes the difficulties that any comparison on a 'per kilogram' basis creates because of the different weight standards used by competing laundries for similar products. These different weight standards may affect average per kilogram price comparisons, and such data must therefore be used with caution. For example, CLS has recently reviewed the 'weights' it uses for purposes of operating its laundry. Variations in these product weight standards make comparisons between laundries difficult, without a more extensive and fully informed benchmarking exercise.

The confidential analysis provided by ACT Health attempts to overcome this problem by comparing the price of a 'basket' of products used by TCH, based on the quantity of these individual products used in the 2002–03 year. For the basket of laundry products, based on the prices obtained from other laundries via various sources, the ACT Health analysis calculates an average price for laundered linen per occupied bed day. This suggests that average CLS prices are up to 6% higher than those of some laundries but 11% cheaper than those of other laundries.

The Commission has not been able to verify the prices for individual laundries used in this analysis by ACT Health and notes that the information has been obtained from a number of undisclosed sources. This analysis also has not included all New South Wales Government laundries, especially all those located closest to the ACT.

Pricing of laundry services will reflect a number of factors, including the quality of the linen items, the level of cleaning required, and delivery arrangements. Other factors that will influence costs and pricing from individual laundries will be the size of the laundry and the volume of product processed over the pricing period.

The Commission is aware that the New South Wales Government is considering a proposal to centralise some of its laundry facilities to achieve greater economies of scale, reflecting the fact that not all laundries in the New South Wales public system are as cost-effective as others. This suggests that a more comprehensive benchmarking exercise would probably highlight a wide range in costs and prices across those New South Wales laundries. This is in part confirmed by the range of average prices for a specific basket of laundered linen that is evident from the analysis of different laundry prices presented by ACT Health.

The Commission does not believe that the information provided by ACT Health provides independent support for the view that CLS prices are higher than those of New South Wales

Health laundries. Rather, the Commission has found that the only independent, published comparative analysis available is that prepared by Colin Glenn and Associates as part of the CLS business review. That analysis demonstrates that the prices charged by CLS are well within the bounds of competitive prices charged by other laundries and are more price efficient than the prices of some of the New South Wales laundries located close to the ACT region.

Healthscope price comparison

The Commission has considered the evidence presented by Healthscope that suggests considerably higher costs in the ACT compared to other locations across Australia. The Commission notes that the difference between average costs quoted by the National Capital Private Hospital for CLS services and those available under Healthscope's national contract for laundry services reflects the larger throughput volumes of laundry in other parts of the country and the existence of a long-term national contract.

Despite this arrangement, the provider of the laundry service under the Healthscope group contract could not deliver the contracted service into the ACT market and, until recently, subcontracted the work to CLS. The comparison of the CLS price (which is understood to remain under negotiation between Healthscope and CLS) with the 'national' price offered by the competitor cannot, therefore, be considered a valid comparison.

Summary of health market price comparisons

Having reviewed the information provided by ACT Health and Healthscope, the Commission is not able to satisfy itself that the price comparisons offered by them can be either verified or treated as legitimate comparisons of competitive prices. Rather, the Commission has drawn on the independent benchmarking data prepared by consultants Colin Glenn and Associates, who are widely accepted in the industry as being an authority on these matters. That benchmark data, disclosed in the CLS business review, demonstrates that CLS's prices are at most no more expensive than comparable prices from New South Wales and, on face value, appear to be considerably cheaper.

The Commission notes that the benchmark prices provided by Colin Glenn and Associates do not include the imprest service provided for TCH, or theatre linen. There are also other services that it is understood the health market may also require from its laundry service provider in the ACT (such as the hanging of ward and theatre curtains). These are matters that would be open to negotiation with the laundry and linen service provider. However, the Commission does not believe that the inclusion of these costs would necessarily alter a 'like for like' comparison of prices, as is provided in the published benchmarking analysis of Colin Glenn and Associates.

4.5 Conclusions

In the accommodation and hospitality sector, the presence of CLS, AlSCO and Ensign, combined with the opportunities for customers from this sector to either operate their own facilities or use interstate suppliers, means these users benefit from having access to services supplied in a contestable market. Competition appears to be occurring both in price and in service levels. While, for some users, prices were reported to be higher than in interstate capitals, this was not a universal complaint. In some cases, CLS clients have obtained services from competitors; in others, CLS clients have returned to CLS after using alternative arrangements.

However, in the health sector within the ACT, competitive options are more limited. Currently, CLS has the only facility in the ACT meeting the national health standard. While hospitals can own and operate their own facilities (as does JJMH), limited available land and potential economies of scale mean this may not be a realistic option for several hospitals and most smaller health sector customers.

Also, access to suppliers from interstate might not be a realistic option for some health customers. For example, one major ACT hospital was unable to secure a quote from a commercial laundry provider as the cost of providing a supply from its interstate laundry was regarded as prohibitive. Opportunities for interstate supply might improve if a number of hospitals sought a joint quote, although the volume at which an interstate supply might become viable is not clear.

Further, it is possible that the foreshadowed reorganisation of the New South Wales Government-owned health linen sector (see 4.3.3 and 4.4.2 above) might reduce overall industry capacity available from the existing regional facilities, and thereby further limit competitive options.

Price comparisons that the Commission was able to verify for the health sector were limited. However, the independent benchmarking by Colin Glenn and Associates supports the view that CLS is price competitive with interstate laundries and appears to be cheaper than a number of those laundries. Ultimately, the ‘total cost’ for a specific linen and laundering service will be the best comparison. While price differences on individual product items will exist, the final price comparison must be made in the context of the total service received and the quality and timeliness of that service. For the health market, the Commission is satisfied that the prices being offered by CLS compare favourably, for a total service package, with those available from viable alternative service providers.

A further issue related to actual price comparisons is a claim made by some health clients that CLS is subsidising private sector clients through its sales to the health sector. This issue is discussed in Chapter 6, where it is shown that CLS’s health market clients do not subsidise its hospitality clients.

5 Competition policy

5.1 Key issues

The key competitive neutrality issues associated with CLS's operations and reviewed by the Commission include:

- whether CLS's ACT Government health sector clients are 'tied'
- the degree to which CLS's operating and capital costs are artificially high or low because it is government-owned or is required to deal with government entities when purchasing goods and services
- other issues arising from CLS's public ownership.

5.2 Tied customers

In considering whether public ownership confers a competitive advantage on CLS, a pertinent issue is whether ACT Health customers, particularly TCH and Calvary Public Hospital, are required by the government to obtain linen services from CLS. As noted in the Commission's issues paper, if these customers are 'tied' to CLS, this does not necessarily have any competitive neutrality implications as long as there is no distortionary impact on external markets.⁷ However, the existence of tied customers raises the possibility that such customers might be subsidising other customers in the external (commercial) market, and therefore warrants closer examination of CLS's cost allocation and pricing policies.

CLS held a four-year contract with TCH and Calvary Public Hospital that expired in May 2005. The contract has yet to be renegotiated, pending the outcome of this inquiry.

In separate discussions between the Commission and TCH, Calvary Public Hospital and ACT Health, all parties indicated that in the past there had been no written direction given by government requiring them to source linen services from CLS (then Totalcare). However, TCH and ACT Health also indicated that in 2001 they felt there was a strong expectation from government that they would use CLS. This 'implied expectation', while perhaps not formally documented, may have influenced the hospitals' considerations of their options for linen services when the 2001 contract was let.

For the moment, linen services to the hospitals are being supplied by CLS consistent with the terms of the 2001 contracts. The Commission understands that the government has advised both CLS and ACT Health that these arrangements will continue until the Commission's review has been completed. Therefore, at least for the moment, TCH and Calvary Public Hospital are for practical purposes tied to CLS. However, this should not be interpreted to mean that there is a formal decision that a tied arrangement should apply in the longer term.

⁷ As the Commission's issues paper noted, price discrimination may be used to increase efficiency and thus benefit CLS and its clients. Price discrimination is used in the transport industry to fill seats that otherwise might be empty, benefiting all travellers.

Irrespective of whether TCH and Calvary Public Hospital are formally tied to CLS in the long term, a key issue is whether the hospitals have realistic alternatives. As noted in Section 4.5, the lack of existing alternative health-standard linen facilities within 300 kilometres of Canberra may prevent an alternative, competitively priced supply being provided, at least in the medium term. Thus, regardless of whether there is a direct requirement for ACT hospitals to use CLS services, or an ‘implied expectation’, the fact that an alternative supplier is some distance from the ACT may still allow CLS to apply discretionary pricing practices in the health sector. Given this, and given concerns that have been raised about CLS’s costs and pricing to the hospital and commercial sectors, the Commission believes it will be beneficial to all parties for expenditure, cost allocation and pricing issues associated with CLS’s government ownership to be examined further. These matters are discussed below and in Chapter 6.

5.3 Operating expenditure

The Commission has identified a number of areas in which CLS’s operating expenditure is affected by its government ownership. These include:

- salaries and on-costs
- vehicle leases
- computer systems and communications
- corporate overheads
- building lease costs
- energy costs
- costs arising from the implementation of the *Territory Records Act 2002*.

These issues are discussed below. In each case, the Commission has calculated an estimate of costs that would be incurred if CLS were not an ACT Government entity, were not required to deal with ACT Government service providers, or both. These estimated costs, which are based on comparative private sector costs, are indicative only, but when taken together provide a picture of CLS’s relative cost position compared to that of a private sector provider.

5.3.1 Salaries and on-costs

CLS employees are remunerated according to the terms of an enterprise bargaining agreement (EBA) which came into place following the transfer of employees from Totalcare to DUS in May 2004.

In general, the salary and related provisions of the EBA and of employment in the ACT Public Service are more generous than would apply to CLS employees if they were working for a private sector linen company.

For example:

- CLS employees are entitled to superannuation contributions of 14.5%, rather than the 9% provided under the *Superannuation Guarantee (Administration) Act 1992*, which applies to most private sector laundry workers.

- CLS employees are entitled to accrued days off (ADOs), which provide an extra day's leave every four weeks. Most private sector laundry operators do not offer ADOs, and this entitlement has recently been removed for new staff under the EBA applying to JJMH employees working in that hospital's laundry.
- Base wage rates for CLS employees are currently higher than those applying elsewhere. Wages for a CLS worker on \$31,388 per year are approximately \$3,000 higher than those for an equivalent worker under, for example, the JJMH or Aarons Linen Service (Queensland) EBAs.
- A further wage increase of 4% for CLS workers will take effect on 1 April 2006, following increases of 5% on 1 April 2004 and 4% on 1 April 2005. The Commission's research suggests that these increases are generally higher than those applying elsewhere in the laundry industry and are not tied to productivity increases.
- CLS's overtime provisions and pay scales are more restrictive and more expensive than those applying in private linen services. The business review noted that CLS wages and on-cost payments represented 49.4% of revenue, which compared well to an industry benchmark of 50%. However, this was based on the 2003–04 result; since reintegration into DUS, these costs have increased, to 56% of revenue in 2004–05 and a budgeted 64% of revenue in 2005–06.
- Other potential wage cost disparities include the ACT Government's decision to grant extended maternity leave entitlements, a benefit not available elsewhere in the laundry industry.

The Commission has examined each of these issues and has calculated the cost differential between the salaries and on-costs currently paid by CLS and the cost that would apply without the extra impost flowing from ACT Government ownership. Based on this analysis, the Commission has estimated that wages and on-cost payments for CLS in 2004–05 are at least 20% higher than would apply to a private sector organisation, and will be around 22% higher in 2005–06 and 2006–07 after further agreed wage increases.⁸

Table 5.1 shows the effect of 20% to 22% higher wages on CLS's costs, and estimates the comparative cost that CLS would incur if it were a private sector organisation.

Table 5.1 Salaries and on-costs (\$'000)

Year	Salaries and on-costs	Adjustment factor	Adjustment	Private sector comparative estimate
2004–05 actual	5,481	-20%	-1,096	4,385
2005–06 budget	6,139	-22%	-1,351	4,788
2006–07 budget	6,384	-22%	-1,404	4,980

Source: ICRC estimates.

5.3.2 Vehicle lease costs

CLS uses a number of leased vehicles for linen delivery, and a vehicle for management purposes.

⁸ In its submission, CLS stated that its wages and related costs are 13% to 53% higher than those paid in private sector laundries, although it has not stated the basis on which these estimates were calculated.

CLS is required to source these vehicles from Rhodium Asset Solutions. Rhodium is an ACT Government-owned corporation which provides vehicle (and other asset) leasing services to the ACT Government, to other governments and to the private sector.

Rhodium was previously part of Totalcare Fleet Services, a division of Totalcare. It became an independent ACT Government-owned corporation on 1 January 2005. In this form, it has embarked on a program of developing the business as a commercial enterprise. Its client base includes not only ACT Government departments and agencies (such as CLS) but also the Australian Government Department of Defence, ActewAGL, Centrelink and Stericorp.

Rhodium offers market-competitive rates for vehicle and equipment leasing. It must meet the market in its overall pricing, service delivery and product support. The requirement to use Rhodium services does not confer any competitive advantage or disadvantage on CLS, as the rates charged by Rhodium are commensurate with competitive market rates. Therefore, no adjustment needs to be made to CLS's cost estimates as part of this analysis of the net cost or benefit of being an agency within the ACT Government sector.

5.3.3 Computer systems and communications

CLS's computer systems and communications costs cover two separate areas:

- Linenweb software and hardware (Linenweb is a specialist linen management package)
- general telephony, data and computer software and hardware services provided by InTACT, a business unit within the ACT Department of Treasury that provides information technology services to the ACT Government (CLS is required to use InTACT for these services).

The business review noted that computer systems and communications costs for CLS were abnormally high, and that system performance was poor. However, this comment was directed primarily at the Linenweb package, which CLS is currently replacing. Expenditure on Linenweb is unrelated to CLS's status as part of the ACT Government.

CLS currently pays \$16,000–\$18,000 per quarter to InTACT for the provision of telephony and computer hardware and software services. This amount is likely to increase in future as core business applications on the old Totalcare systems are transferred to InTACT.

According to CLS, InTACT services are more comprehensive and complex than CLS requires from its information technology system. CLS has also cited several instances of disruptions to service which may not have occurred if CLS had not been part of a larger network. CLS has also found it extremely difficult to integrate its new linen management software with the InTACT system. Nevertheless, the Commission recognises that certain 'insurance' benefits accrue from being part of the InTACT network, such as data backups, helpdesk capability, network security firewalls and similar services.

Accordingly, the Commission does not propose to make an allowance for any additional 'cost' or 'benefit' that CLS might incur or receive from its use of InTACT.

5.3.4 Corporate overheads

CLS pays a monthly fee to DUS for the provision of certain corporate services.

The CLS business review noted that CLS’s 2003–04 payments of \$675,000 were ‘significantly greater than the normal [for a] government-owned linen service’. These costs fell to \$529,000 in 2004–05 and are projected to be \$457,000 in 2005–06 and \$469,000 in 2006–07. However, the review found that they:

- are still much higher than ‘benchmark’ levels
- appear excessive given the level of service provided.

Although there are no agreements in place to define the relationship between DUS and CLS, CLS advises that the services provided are limited to banking services and legal advice. Other services provided by DUS, such as recruitment, payroll services, workers compensation and injury management, are billed separately.

To some extent, the existing payments reflect contributions made towards Totalcare overheads, including Board costs. The Commission understands that these overhead costs are to be reviewed soon by DUS and CLS, reflecting the changed circumstances concerning Totalcare. Depending on the services to be provided, the Commission expects that the cost of these overheads will decrease, possibly significantly, from current levels.

Using the costs incurred by the benchmarked linen providers quoted in the Colin Glenn and Associates analysis, the Commission has adopted a cost of \$0.05 per kilogram for corporate overheads as a reasonable estimate for the purposes of this report.⁹ Given that CLS processes approximately 5,000,000 kilograms of linen each year, this results in a total benchmark payment of \$250,000 per year in 2003–04 terms (which the Commission has increased annually by the CPI to represent projected costs out to 2006–07, as shown in Table 5.2).

Table 5.2 Corporate overhead costs (\$’000)

Year	Corporate overheads	Adjustment	Private sector comparative analysis
2004–05 actual	529	-273	256
2005–06 budget	457	-194	263
2006–07 budget	469	-200	269

Source: ICRC estimates.

Following the DUS–CLS negotiations, the overhead costs are expected to be reduced. Irrespective of the final negotiated outcome, the Commission considers that there is a need for CLS and DUS to better define the services provided and to agree to a commercially acceptable fee for these services. This should be done as a matter of priority, to remove confusion about CLS’s cost base.

5.3.5 Building lease

CLS rents premises owned by the ACT Government. Total lease payments in 2004–05 were \$351,000, which included rental of 6,367 square metres of building space plus associated services including cleaning, security, pest control, and repairs and maintenance. CLS has been advised that rent has increased to \$400,000 in 2005–06.

⁹ See Table 3.3. Note that this estimate is based on comparable public sector linen providers. The Commission has been unable to identify a reasonable level of overheads for a private sector provider. Given this, and the fact that the services provided by DUS are not detailed, a more realistic benchmark may be even lower than that used in this report.

Enquiries by the Commission suggest that a lease rental of \$400,000 is low by comparison to the commercial market. Informal advice from real estate agents suggests that more commercial rental rates (including security, cleaning and so on) in 2005–06 for a 6,000 square metre building would be around \$600,000 in Mitchell (or around \$500,000 in the Hume industrial estate, or as much as \$950,000 in Fyshwick). CLS therefore appears to be paying around \$200,000 (adjusted for inflation) or 33% less in rent by virtue of its government ownership.

Table 5.3 Lease costs (\$'000)

Year	Lease costs	Adjustment	Private sector comparative analysis
2004–05 actual	351	+234	585
2005–06 budget	400	+200	600
2006–07 budget	410	+205	615

Source: ICRC estimates.

5.3.6 Energy costs

CLS's electricity and gas costs are based on energy prices negotiated between the ACT Government and competing retail energy companies. The government has recently completed such an agreement with ActewAGL, which it owns jointly with AGL. CLS benefits from the ACT Government's purchasing power, although these benefits from economies of scale would be available to any large private sector entity or buying group. Conversely, CLS cannot negotiate particular rates to suit its load profile and must accept the general government rate. A separate negotiation of its energy needs might result in some adjustment to energy costs for CLS. However, it is not possible to estimate this adjustment with any precision and, accordingly, no adjustment has been made for this factor.

CLS has also advised that its energy costs will increase by \$17,000 in 2006–07 as a result of an ACT Government direction to all government agencies to buy a proportion of their energy needs as 'green energy'. The Commission believes this expenditure would not necessarily be incurred if CLS were a private sector entity, and its benchmark costs should be adjusted accordingly.

Table 5.4 Energy costs (\$'000)

Year	Energy costs	Adjustment	Private sector comparative analysis
2004–05 actual	182	0	182
2005–06 budget	226	0	226
2006–07 budget	249	-17	232

Source: ICRC estimates.

5.3.7 Costs arising from the *Territory Records Act 2002*

As a government entity, CLS is subject to the provisions of the *Territory Records Act 2002*. The Commission understand that, like many agencies, CLS is still working towards full compliance with the Act, which imposes relatively extensive and rigorous processes for record keeping, file management and information handling. Based on the Commission's own observations and experience, full compliance with the Act, which it is assumed will occur in 2006–07, has been

estimated to impose one-off costs of \$10,000 plus annual costs of a similar amount. Such an amount would be unlikely to be incurred by a private sector entity.

Table 5.5 Cost of compliance with the Territory Records Act (\$'000)

Year	General expenses	Adjustment	Private sector comparative analysis
2004–05 actual	44	0	44
2005–06 budget	10	0	10
2006–07 budget	10	+20	30

Source: ICRC estimates.

5.4 Capital expenditure and returns to shareholder

As noted in Chapter 3, CLS is unable to borrow, and funds minor capital expenditure from operating cash flows. Major capital expenditure relies on appropriations (capital injections) made through the annual ACT budget process. CLS pays no dividends or financial returns to government based on an assessment of an appropriate return on the investment in the business. Rather, all cash from the business is included in the total cash reserves of DUS.

These arrangements confer both advantages and disadvantages on CLS.

In terms of disadvantages, CLS's reliance on the budget for funding makes both short-term and longer term capital planning more difficult and uncertain. Regardless of the financial worthiness of an individual project, CLS's ability to invest in a particular year depends partly on the general ACT Government financial position and the priority given to funding bids from other agencies. There are even fewer guarantees that multi-year investments will receive funding. This is highly unsatisfactory for a business which relies on long-life capital assets to provide services.

CLS has also indicated that the process it must follow to obtain funding is quite bureaucratic and time consuming, although it accepts that this also ensures that capital projects are carefully evaluated. The Commission notes that within any organisation there will be a degree of formal procedure and process in examining investment funding proposals, although in a more commercial business it may occur in an environment more responsive to commercial imperatives and outcomes than in a government departmental budgetary cycle.

At the same time, once capital funding (usually in the form of a capital injection) has been provided, CLS does not have to pay a return on this equity. This gives CLS an advantage over its private sector competitors, who must factor into their prices either borrowing repayments or a return to shareholders. This return is usually expressed as a percentage of asset value.

The extent of this advantage is not easy to gauge, and depends on the value of the business's assets. This is discussed below.

5.4.1 Asset valuation

The written-down value of fixed assets in CLS's books at 30 June 2005 is shown in Table 5.6.

Table 5.6 CLS asset values, 30 June 2005 (\$'000)

Asset	Valuation	Accumulated depreciation	Written-down value
Plant and equipment	6,021	2,400	3,621
Linen	3,238	2,212	1,026
Furniture and fittings	51	24	27
Works in progress	425	0	425
Total	9,735	4,636	5,099

Source: CLS.

These asset values are partly an outcome of a review of asset values undertaken in 1998. The basis of the revaluation is not entirely clear. However, the Commission understands that the review increased written-down asset values primarily by extending depreciable lives and hence reducing annual depreciation.

A number of approaches can be adopted to determine an asset value for pricing purposes, including:

- historic cost—the purchase price of the assets, less accumulated depreciation
- replacement cost—the cost of replacing the existing stock of assets with identical assets in the same condition
- the recoverable amount—the future revenue stream, less cash operating costs, that the assets will generate
- net realisable value—the value at which the assets can be sold in the open market.

When examining these alternative methods of valuing assets, consideration is also given to the optimal combination of assets for running the business. The existing assets reflect investment decisions that were made in the past under different circumstances, and so may not reflect an appropriate asset base for the current operations. Use of the historic cost valuation or replacement cost valuation without some form of ‘optimisation’ of the asset base to reflect current requirements would be likely to result in an inappropriate asset/investment valuation.

The net realisable value and recoverable amounts value are more appropriate valuations for the purposes of pricing, as they will reflect the value of the assets either as stand-alone assets in an ‘as is’ sale form, or as a reflection of the value of the assets in an ongoing operating business. A physical optimisation of the asset base, for the purposes of these two valuation methods, is not relevant. Effectively, these methods calculate a financial rather than physical assessment of the assets for use as a proxy for investment in the business. Any ongoing physical optimisation and improvement in the assets can be made separate from this valuation (assuming the business remains a going concern), and this asset (or investment) valuation can be adjusted in the future to reflect the write-off of assets no longer required or the inclusion of new equipment to improve productivity or meet increased output requirements.

An independent valuation conducted by Pickles Auctions Proprietary Limited in 2003 estimated the total replacement cost (that is, replacement with new assets, not assets in their existing condition or optimised in some form) of CLS’s plant and equipment at 1 July 2002 at \$10.9 million. The same report estimated the ‘fair value’ of plant and equipment assets at

\$3.5 million. Fair value is defined in the accounting standards as ‘the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction.’¹⁰

It is clear that a relatively wide range of asset values could be adopted. The Commission has calculated an asset valuation of \$4.3 million using the recoverable amounts test. This amount happens to be broadly consistent with the written-down historic value of the assets in CLS’s books and the 2003 fair value assessment. There is no reason why the fair value, recoverable amounts test value and the written-down historic value should be similar, but the similarity demonstrates that, whichever figure is taken, there is little difference in the overall result for this particular business at this time.

The Commission has used the recoverable amounts test to estimate the return on assets that a private sector entity would be required to generate, although the fair value figure could equally have been used, adjusted to 2004–05 values. A real pre-tax weighted average cost of capital of 7% (equivalent to a post-tax nominal cost of equity of approximately 10%) has been used for the purposes of this analysis.¹¹ Based on this rate and an estimated asset/investment value of \$4.3 million, CLS should generate a return on assets of approximately \$300,000 per year.

5.5 Statutory hire levy

Under Chapter 6 of the *Duties Act 1999*, commercial hire entities are required to pay a tax of 1.5% on the hire of goods. A ‘commercial hire business’ is one that receives hiring charges in excess of \$6,000 per month. Significantly, linen hired to hospitals, schools or charitable organisations is excluded from the definition of ‘hire of goods’. It is important to note also that the 1.5% tax applies only to the *hire* of linen (and not, for example, to the delivery, maintenance or cleaning of linen).

Businesses, including AlSCO and Ensign, are liable to pay such a duty in respect of their commercial clients, and these costs must be factored into their pricing regimes. However, despite general provisions in the *Taxation (Government Business Enterprises Act) 2003*, which are intended to provide for taxation neutrality between government and commercial businesses, section 4 of the *Duties Act* effectively provides that CLS is not required to pay such a tax on its commercial client accounts. Thus, CLS has an advantage over its competitors in attracting commercial business.

The magnitude of this advantage depends on the proportion of charges attributable to linen hire, as distinct from delivery, maintenance or linen cleaning. Given the substantial proportion of CLS’s costs attributable to delivery and cleaning, the ‘hire service’ component of the charges made to commercial customers could be in the region of 20% to 40% of total costs for those clients. In such a case, the Commission estimates that CLS’s competitive advantage for non-hospital clients may be around 0.3% to 0.6% (1.5% of 20%, to 1.5% of 40%) of the total charge made for the linen/laundry service. Nevertheless, this remains an advantage for which there is little or no economic justification, and which appears to be inconsistent with the principles of competitive neutrality.

¹⁰ Australian Accounting Standards Board, *Compiled Accounting Standard AASB 116: Property, Plant and Equipment*, Australian Government, Canberra, 21 January 2005, p. 10.

¹¹ This is the rate used by the Commission to set electricity, gas and water/sewerage prices in the ACT. This should be taken as an indicative rate only.

Based on value of sales to other non-government private clients (of \$3.8 million), the potential cost advantage to CLS could be in the order of \$11,500 to \$23,000. An allowance for this level of advantage has been built into the overall assessment summarised in Table 5.7.

5.6 Community service obligations

A community service obligation (CSO) is a service provided by an entity at the direction of government that would not be provided or would be provided at a higher price if the organisation were either not reimbursed for the cost in some way or forced to bear the cost. The cost of providing a CSO is the difference between the cost of providing the service and the price that would have been charged except for the government's direction.

CLS has no formal CSO obligations with the ACT Government. However, CLS management believes that if an emergency (for example, a bird flu epidemic) generated a significant increase in hospital linen, CLS would be expected to put aside commercial considerations in the interests of general community welfare. CLS would incur substantially higher costs if it started to run more than one shift per day, as it would be liable to pay high levels of overtime.

The Commission agrees that in such circumstances this extra workload might be considered to be a CSO and some sort of compensation from government might be appropriate. However, in a normal operating environment CLS has no CSO obligations that affect its costs or revenue. Therefore, there is no need to make an adjustment to costs for the purposes of this analysis.

5.7 Other issues

CLS has argued that a key disadvantage of being part of mainstream government is the relative lack of managerial autonomy. Aside from relatively complex procurement processes and the requirement to use agencies such as InTACT and Rhodium (discussed above), CLS cites:

- Relatively complex recruitment procedures that must be followed. This is exacerbated when an internal appointee fills a vacant position, which means another round (and possibly subsequent future rounds) of recruiting must be undertaken.
- The requirement to follow various Acts to which its competitors are not subject or are subject to a lesser extent. These include the *Public Sector Management Act 1994*, *Administrative Decisions (Judicial Review) Act 1989*, *Annual Report (Government Agencies) Act 2004*, *Freedom of Information Act 1989*, *Ombudsman Act 1988* and *Privacy Act 1988* (Cth), among others.

The Commission agrees that these obligations are likely to impose costs on CLS which would not be borne by a private sector entity. At the same time, a private sector entity might have obligations with which CLS is not required to comply—for example, compliance with corporations law and consumer protection statutes. On balance, however, the costs incurred by CLS are likely to outweigh the benefits, although it is difficult to estimate the level of these costs.

In terms of taxation neutrality, the Commission notes that CLS is obliged to comply with GST and FBT obligations. Commonwealth income tax and ACT taxes and charges, including payroll tax, also apply to CLS as they would to a private sector provider. CLS therefore appears to have no advantages or disadvantages in relation to taxation (other than the statutory hire levy discussed above).

5.8 Net position

Table 5.7 summarises CLS’s ‘competitively neutral’ cost position—the net advantages and disadvantages which the Commission believes arise as a result of CLS’s government ownership and/or its requirement to deal with government entities. These represent the items to which the Commission has been able to ascribe a cost; for other matters, such as those discussed in Section 5.7, the Commission has not attempted to estimate an impact.

On balance, the Commission believes that CLS is at a relative cost disadvantage by virtue of its government ownership. This arises primarily because the disadvantage of its high labour and corporate overhead costs more than outweighs its advantage from paying relatively low rent and not having to earn a return on its assets.

Table 5.7 Net impact of government ownership to CLS (\$’000)

Issue	2004–05		2005–06		2006–07	
	Cost adv.	Cost disadv.	Cost adv.	Cost disadv.	Cost adv.	Cost disadv.
Salaries and on-costs		1,096		1,351		1,404
Corporate overheads		273		194		200
Building lease	234		200		205	
Energy costs						17
Territory Records Act costs						20
Hire of goods levy	23		23		23	
Return on assets	300		300		300	
Total	557	1,369	523	1,545	528	1,641
Net position	812 disadvantage		1,022 disadvantage		1,113 disadvantage	

Source: ICRC estimates.

5.9 Conclusions

Two of the key matters the Commission has sought to establish in this inquiry are:

- whether CLS has, by virtue of its government ownership, a competitive advantage compared to its private sector rivals in the hospitality and accommodation linen market
- whether TCH and Calvary Public Hospital are ‘tied’ to using CLS, and therefore whether CLS has a further competitive advantage through the ability to cross-subsidise hospitality and accommodation customers through this tied arrangement.

In relation to the first matter, the Commission has concluded that CLS’s government ownership actually provides CLS with a net competitive disadvantage. At the same time, the Commission believes that the small advantage CLS receives through not being required to pay the statutory hire levy is not consistent with the principles of competitive neutrality, and this benefit should be removed.

In relation to the second matter, no evidence has been provided to the Commission to suggest that TCH and Calvary Public Hospital are formally tied to CLS. The question of whether the lack of an alternative supplier with health accreditation might place CLS in a position whereby, despite there being no tied arrangement with government-owned customers in the ACT, it would be possible for

CLS to use its position to apply distortionary pricing practices in the health sector, is discussed in Chapter 6.

The Commission has identified certain advantages and disadvantages that affect CLS's business and that should be addressed to ensure that CLS operates on a 'level playing field' with other commercial laundry service providers. In particular, the Commission has noted:

- the difference between salary and wage rates in the public sector and those in private sector laundries
- the high corporate overhead charges incurred by CLS (and the current plans to renegotiate this arrangement)
- the apparent undervaluing of the building rental fees for the facility used by CLS
- the requirement by CLS to abide by government 'green energy' standards not required for private sector competitors
- the costs associated with the requirement to meet the provisions of the Territory Records Act
- the lack of any clear separation of financial arrangements between CLS and DUS, and the lack of a requirement for CLS to earn a commercial rate of return on an appropriate valuation of the investment in the business
- the exemption for CLS from the provisions of the hire of goods levy in the Duties Act.

These are issues that need to be addressed as part of a process of moving CLS towards operating as a stand-alone commercial business.

6 Cost allocation and revenue

6.1 Overview

In discussions, ACT Health and other health customers, including TCH, expressed a view that CLS's prices were higher than comparable benchmarks and that the health sector was cross-subsidising CLS's commercial clients. At the same time, some accommodation and hospitality clients also expressed concern that their prices were too high. Concern was expressed by both groups about the lack of transparency in CLS's pricing regime.

Discussion in Chapter 4 addresses the issue of price comparisons with alternative linen and laundry service providers, and indicates that CLS's prices are at or below market levels for both health and hospitality clients. However, given the concern about the transparency of these prices, the Commission believes it is important to undertake a broader review of CLS's allocation of the costs of supplying key customer segments, as well as of the revenue generated from each segment. This should give all parties a better understanding of where and why particular customer segments are over-recovering or under-recovering the costs of providing services.

In reviewing cost allocation, the Commission is not attempting to dictate to CLS how it should price individual products or individual customers. The Commission notes that CLS is currently developing an improved cost allocation system and that this will provide a more rigorous assessment of cost allocation and pricing. However, for the purposes of this review, the Commission's analysis will provide some transparency about the way CLS is recovering its costs and whether this is consistent with competitive neutrality objectives.

The Commission's broad approach has been as follows:

1. Define CLS's overall level of costs under two scenarios: first, CLS's actual costs incurred; and second, costs which CLS might incur if it were a private sector organisation (as described in Chapter 5).
2. Allocate the costs to the two key customer segments:
 - category 1—ACT and private sector health entities
 - category 2—commercial and hospitality clients.
3. Compare allocated costs to revenues for the two categories of clients in order to understand whether cost under-recoveries or over-recoveries exist.

6.2 Cost base

The Commission has calculated a cost base consistent with its views on competitively neutral expenditure levels as set out in Chapter 5. In doing so, it has used a 'building-block' approach, whereby CLS's required revenue is the sum of:

- operating costs
- depreciation (as provided by CLS)
- a return on CLS's asset base.

The cost bases under the two scenarios are shown in Table 6.1.

Table 6.1 CLS cost base, 2005–06 (\$'000)

	Actual budgeted position	Budget if CLS in private sector
Operating costs	9,535	8,213
Depreciation	1,833	1,833
Return on assets	0	300
Total	11,368	10,346

Source: CLS, ICRC estimates.

6.3 Cost allocation

The way in which costs are allocated to the two different customer groups is crucial to the analysis. As a first step, the Commission has allocated costs that are clearly and directly attributable to the separate customer groups. For example, the costs of the imprest service at TCH and the sterilising service unit have been fully allocated to category 1 customers.

The remainder of the costs have been allocated under two separate approaches: first, based on the number of items processed; and second, based on the total (in kilograms) attributable to each group.

The Commission's approach essentially recognises that both customer categories are important to CLS's operations. Alternative cost allocation approaches—for example, allocating costs on an 'avoidable cost' basis¹² to category 2 customers—are not appropriate. While the health sector provides a steady base load against which fixed costs might be recovered, treating commercial customers as marginal and therefore non-contributors to the recovery of fixed costs (as is implied by an avoidable cost approach) would be inconsistent with CLS's actual operations. In practice, if CLS were to lose either customer group, its operational position would be severely compromised.

6.4 Costs and revenue

The Commission's modelling generally demonstrates that:

- neither customer group recovers the 'full cost' of providing services, either under CLS's existing arrangements or if CLS were acting as a private entity
- the deficit is greater for the health customers than for the commercial and hospitality customers.

This is shown in tables 6.2 and 6.3.

¹² Avoidable costs may be defined as costs that are not incurred if operations cease; that is, 'That part of the cost of any output that could be saved by not producing it' (*Oxford Dictionary of Economics*, 2nd edition, 2003). Fixed capital costs, such as plant and machinery costs, must often continue to be met even though some production may have ceased. Therefore, these costs become unavoidable in the short to medium term even though production volumes might change.

Table 6.2 CLS cost recovery—actual cost base 2005–06 (\$)

	Revenue per item	Cost per item	Net per item	Revenue per kg	Cost per kg	Net per kg
Category 1—health entities	0.959	1.175	−0.215	1.996	2.445	−0.448
Category 2—other customers	0.685	0.748	−0.063	1.843	2.012	−0.169
Average	0.828	0.971	−0.143	1.933	2.266	−0.333

Source: ICRC estimates.

Table 6.3 CLS cost recovery—cost base if private sector entity 2005–06 (\$)

	Revenue per item	Cost per item	Net per item	Revenue per kg	Cost per kg	Net per kg
Category 1—health entities	0.959	1.074	−0.115	1.996	2.236	−0.240
Category 2—other customers	0.685	0.671	−0.014	1.843	1.805	0.038
Average	0.828	0.882	−0.053	1.933	2.058	−0.125

Source: ICRC estimates.

The results presented in tables 6.2 and 6.3 show an overall under-recovery of revenue against costs.¹³ This under-recovery is evident under both scenarios (that is, based on the actual cost base and based on the adjusted ‘private sector’ scenario). However, there is a difference between the two customer bases: while the health entities have an under-recovery of revenue under both scenarios, the commercial entities would generate a small surplus on a per unit basis under the private sector scenario.

The Commission has identified issues in the treatment of depreciation as being the main contributor to this apparent under-recovery of revenue under the private sector scenario even when adjustments are made, for example to allow for a return on investment.

The allowance for depreciation reported in Table 6.1 is based on an accelerated write-off of assets for the purposes of funding new capital investment and replacement of assets such as existing linen stocks. It is understood that depreciation is being calculated on the basis of a replacement cost value, which may not reflect the economic value of the asset being depreciated (as reflected in the ‘fair value’ or ‘recoverable amounts’ valuation of assets discussed above). This issue will need to be examined in more detail by CLS as part of the development of its own pricing and cost allocation models. However, it further highlights the need for the development of accounting and funding policies for CLS that are more sophisticated than the current accounting treatments and that reflect the commercial operating nature of CLS’s activities.

Even allowing for adjustments in the cost allocation process that can be expected as part of a more detailed pricing model of the type being developed by CLS, it is apparent from tables 6.2 and 6.3 that the commercial/non-health clients are subsidising the health clients on both per item and per kilogram average cost/price comparisons. It is estimated that this subsidy from one group to the other could average around 5.5 cents per item or 13 cents per kilogram, based on allocation assumptions used by the Commission (and after adjusting for valuation of depreciation issues).

This is not an abuse of competitive neutrality or market position, as the commercial non-health customers have alternative laundry service suppliers, and from previous comments it is clear that

¹³ Table 3.1 demonstrates this loss on operations using CLS actual total costs.

CLS is charging a generally accepted market rate for the service it provides to this customer category. Furthermore, these customers are not ‘tied’ or obliged to use CLS’s services; indeed, in some cases they have installed their own laundry facilities to meet their particular needs or have opted to use alternative service providers. Also, as the health sector represents approximately 60% of CLS’s total revenue base, there could be expected to be some economies of scale in servicing that client group, particularly when a large part of this market comprises services to two main clients. Thus the cost allocation approach used in the Commission’s modelling may have overallocated some of the administrative and overhead costs to the health sector group.

What is clear from this preliminary allocation of costs by the Commission is that the health sector is not subsidising the commercial non-health sector. This should help to remove some concerns of the health sector about the way in which CLS’s prices reflect actual costs, and provide greater transparency about the contribution each customer group makes towards recovering CLS’s total costs.

As a consequence of the current development of new pricing models by CLS, it is anticipated that greater precision will be applied in the future to the cost allocation between different items and product groups and, desirably, there will be greater transparency for purposes of renegotiating contracts with clients, including the main health sector clients.

6.5 Conclusions

The results of the cost allocation modelling undertaken by the Commission indicate that:

- At present, the health sector is not subsidising other customers—in fact, the reverse is more likely to be true.
- The extent to which there may be any cross-subsidy from other customers to health customers may be explained in part by the preliminary cost allocation model used by the Commission and by the existence of economies of scale in handling, distribution and broader administrative costs applying to the health sector and, in particular, to TCH and Calvary Public Hospital.
- The development of new pricing models by CLS will provide greater detail and transparency for its negotiations on future contracts.
- A number of accounting issues need to be resolved within CLS, including the treatment of depreciation charges for pricing purposes.

CLS does not currently have a sophisticated cost allocation and pricing model, but such a model is under development. CLS’s current approach to pricing is based on simpler ‘rules of thumb’ arrangements which would benefit from the additional rigour provided by such a model. The Commission strongly encourages CLS to complete this model and, in doing so, to bear in mind the outcomes of the Commission’s analysis above.¹⁴

¹⁴ At the same time, the Commission accepts that CLS’s pricing for individual customers must reflect such things as the customer’s specific service requirements, credit risk and history of care of linen; the strength of the existing relationship between the two parties; and current spare capacity.

7 Findings and recommendations

The terms of reference required the Commission to establish whether CLS, by reason of its government ownership, has a competitive advantage in respect of services it provides.

In essence, the Commission's brief was to ensure CLS's ongoing compliance with competitive neutrality requirements, and to advise on ways to place the business on a more commercial footing while improving its cost allocation practices and pricing transparency.

On the basis of the investigation, the Commission's main findings are as follows:

1. The Commission finds that there is no long-term requirement for ACT public hospitals to use the services of CLS exclusively (that is, as tied customers).
2. The Commission finds that CLS is not using public hospital customers to subsidise other, commercial customers and, in general, CLS does not appear to be overcharging customers in a competitive market.
3. The Commission finds that CLS enjoys no particular competitive advantage from being government owned. On the contrary, the Commission finds that CLS appears to be at a net disadvantage as a result of public ownership. However, to be consistent with competitive neutrality principles, the small benefit CLS receives from not having to pay the statutory hire levy should be removed (except, as applies to all service providers, for health, education and charitable customers).
4. The Commission finds that, despite these restraints, CLS appears to be operating with high reported levels of customer satisfaction and service quality.
5. Finally, the Commission finds that CLS is not able to operate optimally in terms of financial efficiency or long-term planning. This is due to CLS's reliance on the government and its budgetary process for capital funding, its inability to borrow, and other restrictions on its banking and financial management practices.

On the basis of these findings, the Commission provides the following advice and recommendations to the Minister. *The Commission believes that recommendations 1–7 need to be addressed as a whole and not in a piecemeal manner.* The Commission also believes that Recommendation 8—that CLS be permitted to operate as an independent corporation—should be strongly considered by the ACT Government. Recommendation 8 would also have the effect of implementing most, if not all, of the preceding recommendations.

Recommendation 1

The Commission recommends that CLS's governance and financial management relationships with DUS be better defined, in particular in terms of CLS's accounting arrangements and the payment of corporate overheads, which should better reflect CLS's business requirements and more commercially appropriate charges.

Recommendation 2

The Commission recommends that CLS continue to develop an improved cost allocation model and pricing methodology.

Recommendation 3

The Commission recommends that CLS's capital expenditure requirements be reconsidered, in particular to determine whether CLS should remain part of the government capital budgeting process or instead be subject to separate planning and financing arrangements which would allow greater transparency.

Recommendation 4

The Commission recommends that the ACT Government consider providing transparent funding arrangements to cover the difference between public sector and private sector costs for wages, salaries and salary on-costs.

Recommendation 5

The Commission recommends that CLS be charged a commercial equivalent rent for its premises at Mitchell.

Recommendation 6

The Commission recommends that CLS, as a business, be required to make a normal commercial return on a reasonably valued asset base.

Recommendation 7

The Commission recommends that, to be consistent with competitive neutrality principles, CLS be subject to the hire of goods levy provisions of the *Duties Act 1999* on the same terms as apply to private sector providers.

Recommendation 8

The Commission recommends that the ACT Government should strongly consider allowing CLS to operate in a normal business manner as an independent corporation, on a similar basis to, for example, Rhodium Asset Solutions.¹⁵

¹⁵ Like CLS, Rhodium Asset Solutions was created out of a former division of Totalcare. While most units within Totalcare were reabsorbed into the ACT Public Service, Rhodium (formed from Totalcare Fleet Services) became an independent ACT Government territory-owned corporation on 1 January 2005. Rhodium supplies leasing services and asset solutions to government and the corporate sector.

Appendix 1 Terms of reference

Australian Capital Territory

Independent Competition and Regulatory Commission (Notice of Acceptance) 2005 (No 1)

Notifiable instrument NI2005

made under the *Independent Competition and Regulatory Commission Act 1997*, s. 19C (Acceptance of regulatory references—government-regulated activities), s. 19E (Terms of regulatory references) and s. 19H (Procedure for regulatory reference investigations)

Terms of reference

for an investigation into Capital Linen Service

Specified requirements in relation to investigation under s. 19C:

Following a request from the Minister for Urban Services and pursuant to s. 19C(1) of the Act, I specify the following requirements in relation to the conduct of the investigation:

The Independent Competition and Regulatory Commission (the Commission) will investigate whether Capital Linen Service (CLS), by reason of its government ownership, has a competitive advantage, in respect of services it provides, to the private sector. In reaching its conclusion, the Commission will consider and report on:

1. An assessment of the market(s) in which CLS operates and the extent to which it is in competition with private sector enterprises, including a consideration of any competitive advantages and/or disadvantages under which CLS operates.
2. The extent to which cross-subsidisation between market segments exists (for example, private versus public sector customers, health sector versus accommodation/restaurant linen customers).
3. Whether CLS undertakes any community service obligations (CSOs) and, if so, whether these CSOs are appropriately costed and transparently funded.
4. The extent to which CLS is complying with the full range of competitive neutrality principles as outlined in the Competition Principles Agreement relating to tax neutrality, borrowing neutrality and regulatory neutrality.
5. Reform option recommendations about the above matters which best achieve the objectives of clause 3 of the Competition Principles Agreement.

Specified requirements in relation to investigation under s. 19E:

Pursuant to s. 19E(1)(a) of the Act, I specify the following requirement in relation to the conduct of the investigation:

- In undertaking the investigation, the Commission is to report on the matter no later than 24 February 2006.

Specified requirements in relation to investigation under s. 19H:

Pursuant to s. 19H(2)(a) of the Act, I specify the following requirement in relation to the conduct of the investigation:

- In undertaking the investigation, the Commission is to request submissions from key interested parties and the wider public.

Paul Baxter
Senior Commissioner

for the Independent Competition and Regulatory Commission

21 October 2005

Appendix 2 Extracts from the Competition Principles Agreement

Competition policy considerations

Interpretation

[Competition Principles Agreement cl 1 (3) (d)–(j)]

1 (3)

- (d) government legislation and policies relating to ecologically sustainable development;
- (e) social welfare and equity considerations, including community service obligations;
- (f) government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- (g) economic and regional development, including employment and investment growth;
- (h) the interests of consumers generally or of a class of consumers;
- (i) the competitiveness of Australian businesses;
- (j) the efficient allocation of resources.

Competitive neutrality principles

Competitive neutrality policy and principles

[Competition Principles Agreement cl 3 (1) & (4)–(7)]

- 3 (1) The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities.
- (4) Subject to subclause (6), for significant Government business enterprises which are classified as ‘Public Trading Enterprises’ and ‘Public Financial Enterprises’ under the Government Financial Statistics Classification:

- (a) the Parties† will, where appropriate, adopt a corporatisation model for these Government business enterprises (noting that a possible approach to corporatisation is the model developed by the intergovernmental committee responsible for GTE National Performance Monitoring); and
 - (b) the Parties† will impose on the Government business enterprise:
 - (i) full Commonwealth, State and Territory taxes or tax equivalent systems;
 - (ii) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and
 - (iii) those regulations to which private sector businesses are normally subject, such as those relating to the protection of the environment, and planning and approval processes, on an equivalent basis to private sector competitors.
- (5) Subject to subclause (6), where an agency (other than an agency covered by subclause (4)) undertakes significant business activities as part of a broader range of functions, the Parties† will, in respect of the business activities:
- (a) where appropriate, implement the principles outlined in subclause (4); or
 - (b) ensure that the prices charged for goods and services will take account, where appropriate, of the items listed in subclause (4)(b), and reflect full cost attribution for these activities.
- (6) Subclauses (4) and (5) only require the Parties† to implement the principles specified in those subclauses to the extent that the benefits to be realised from implementation outweigh the costs.
- (7) Subclause (4) (b) (iii) shall not be interpreted to require the removal of regulation which applies to a Government business enterprise or agency (but which does not apply to the private sector) where the Party† responsible for the regulation considers the regulation to be appropriate.

Note [not included in the agreement]:

† Party is defined in the agreement (cl 1 (1)) to mean the Commonwealth, a State, the Australian Capital Territory or the Northern Territory of Australia, if the jurisdiction concerned has signed the agreement and has not withdrawn. The Australian Capital Territory has signed the agreement and has not withdrawn from it; thus, it is a Party.

Legislation review principles

Legislation review

[Competition Principles Agreement cl 5 (1) & (9)]

- 5 (1) The guiding principle is that legislation (including Acts, enactments, ordinances or regulations) should not restrict competition unless it can be demonstrated that:
- (a) the benefits of the restriction to the community as a whole outweigh the costs; and
 - (b) the objectives of the legislation can only be achieved by restricting competition.

- (9) Without limiting the terms of reference of a review, a review should:
- (a) clarify the objectives of the legislation;
 - (b) identify the nature of the restriction on competition;
 - (c) analyse the likely effect of the restriction on competition and on the economy generally;
 - (d) assess and balance the costs and benefits of the restriction; and
 - (e) consider alternative means for achieving the same result including non-legislative approaches.

Appendix 3 List of interviewees

In preparing this report, the Commission held interviews and discussions with the persons representing interested organisations listed below. In addition, the Commission had several discussions with Capital Linen Service managers and senior executives of the Department of Urban Services.

- Ms Wendy Edwards, Manager, ACT Health Sterilising Services
- Ms Irene McKinnon (Executive Director Business and Infrastructure) and Mr Mark Bonato (Support Services and Contracts Manager), The Canberra Hospital
- Ms Sue Leimenn, General Manager, National Capital Private Hospital
- Mr Steve Madex, Contract Manager, Calvary Hospital
- Dr Tony Sherbon, Chief Executive, and Mr Ron Foster, Chief Finance Officer, ACT Health
- Ms Christina Bates, Property Manager, Medina James Court Apartments
- Mr Ray Palmer, General Manager, Canberra Rex Hotel
- Mr Karl Diefenbach, General Manager, Hyatt Hotel Canberra
- Mr Simon Reynolds, General Manager, Hotel Canberra Carotel
- Mr John Wynants, Manager Village Operations, Goodwin Aged Care
- Mr Paull English, General Manager, Saville Park Suites
- Mr Alex Rozycki, General Manager ACT, and Mr Brad Sibraa, Account Manager, Ensign Services (Australia) Proprietary Limited
- Mr Sean Moroney, General Manager, University House
- Mr Michael Jerogin, Regional General Manager, AlSCO Proprietary Limited
- Mr Barry Jackson, Assistant Director Facilities, Department of Parliamentary Services, Parliament House
- Mr Arthur Kalimeris, Hotel Services Manager, John James Memorial Hospital

Glossary and abbreviations

ADOs	accrued days off
business review, the	Review of CLS conducted in 2004 by Colin Glenn and Associates Proprietary Limited
CLS	Capital Linen Service
Commission, the	Independent Competition and Regulatory Commission
CSO	community service obligation
DUS	Department of Urban Services (ACT Government)
EBA	enterprise bargaining agreement
GST	goods and services tax
FBT	fringe benefits tax
ICRC Act	<i>Independent Competition and Regulatory Commission Act 1997</i>
JJMH	John James Memorial Hospital
NCP	National Competition Policy
Rhodium	Rhodium Asset Solutions
TCH	The Canberra Hospital
Totalcare	Totalcare Industries Limited