

Private & Confidential

Independent Competition and Regulatory Commission
PO BOX 161 Civic Square ACT 2608
BY EMAIL: icrc@act.gov.au

24 February 2020

Introduction

Reference is made to the issues paper prepared by the independent competition and regulatory commission ("**Commission**") in January 2020 ("**Issues Paper**") which sought feedback to assist the development of a draft report in connection with the proposed new crematorium facility to be built at the Gungahlin Cemetery in Canberra and operated by the ACT Public Cemeteries Authority ("**Canberra Cemeteries**").

Specific Questions

1. *Do you wish to make any comments on the Commission's description of the cemetery and crematorium services market characteristics and the operation of the industry? Are there other features of the market that the Commission should be aware of?*

The Issues Paper states that the rationale behind the ACT Government's decision to open a new crematorium was that the new public facility will contribute to "better meeting the cultural needs of the ACT's diverse cultural communities". This statement implies that Norwood Park does not currently meet "the cultural needs of the ACT's diverse cultural communities", a suggestion which Norwood Park strongly refutes. In this regard, it is noted that the ACT Government never sought any input or response from Norwood Park to discuss that Norwood Park were not in fact meeting "the cultural needs of the ACT's diverse cultural communities". In addition to the unused land at its existing facilities, Norwood Park has recently been granted a lease over land situated next door to its existing facilities. Accordingly, Norwood Park has ample space to meet "the cultural needs of the ACT's diverse cultural communities".

In the Issues Paper, it states that the main purpose of the Competition Principles Agreement ("**CPA**") is to "support higher and sustainable economic and employment growth by improving economic productivity and efficiency". However, the logic of establishing a new crematoria 200 meters away from the existing facility, which has ample capacity, rather than within the proposed new Southern Memorial Park in Long Gully Road in South Canberra, is questioned. Clearly, if the new crematorium has a negative impact on the number of cremations that Norwood Park conducts, the likely result will be a loss of jobs at, and investment in, Norwood Park (therefore, rather than supporting "higher and sustainable economic and employment growth", the proposed crematoria would likely have the opposite effect).

As would be known to the ACT Government, the Port Macquarie-Hastings Council recently agreed a transaction pursuant to which it would sell the Innes Gardens Memorial Park Crematorium and Lawn Cemetery, after concluding it was too expensive to operate and maintain themselves and it wanted to deploy their limited funds in alternative community projects. Other councils have done the same. Although it is a matter for the ACT Government, it does seem incongruous that the ACT Government would deploy public funds into a project where an incumbent operator has capacity, in an industry where other government organisations are seeking to privatise their operations.

Relevant questions for the Commission include:

- the Issues Paper does not consider the significant current and future capacity of Norwood Park;
- the Issues Paper does not consider the likely negative economic and employment impact of the crematoria at Norwood Park or the other crematoria used by the Canberra community;
- given councils around the country (e.g. Port Macquarie-Hastings Council) have sold and/or outsourced crematoria due to viability concerns, the Issues Paper does not provide evidence or research to indicate the proposed crematoria will be commercially viable; and

- the Issues Paper does not provide evidence or research which confirms the proposed crematoria will not 'crowd out' the private sector.

2. *Do you have any comments on the overall approach the Commission has proposed to develop detailed pricing principles? Are there other broad pricing principles that the Commission should consider?*

We agree with the broad pricing principles identified by the Commission. However, we note the Commission's observation that:

"Economic theory states that the efficient costs of operating a crematorium lie between the costs of stand-alone operation and the marginal (or incremental) costs incurred in operating a crematorium as part of a joint operation (that is, in conjunction with a cemetery). Any allocation methodology that falls within this range will be economically efficient and will, in the Commission's view, meet the competitive neutrality requirements." (Emphasis added, p.18)

We disagree with the statement that "Any allocation methodology that falls within this range will be economically efficient and will ... meet the competitive neutrality requirements." Multiple methods may fall within this range, providing different values; they cannot all be efficient.

Any methodology needs to be practically and appropriately applied to simulate an efficient outcome and be a competitively neutral outcome. On this basis, a preferred pricing approach is suggested in section 4.

3. *Has the Commission identified the full costs that are likely to be incurred in operating a crematorium facility? Are there other costs or cost categories that should be included?*

In respect of the Commission's preliminary research and analysis regarding the types of costs that may be incurred to operate a crematorium facility, we note the following items that were omitted:

- capital costs associated with buildings, plant and equipment including tools and machinery for grounds and garden maintenance;
- capital costs associated with building memorial gardens held for sale;
- perpetual care costs;
- fuel costs;
- staff amenities and staff training;
- uniforms;
- cleaning expenses;
- bank and merchant charges; and
- legal and professional fees.

It should also be noted that:

- profitability is highly correlated to the utilisation of the cremator (i.e. at low to medium utilisation, crematoria are typically loss making); and
- profitability can be materially impacted by summer months due to high maintenance costs (up keep of grounds and memorial gardens) and, therefore, a greater than 'normal' level of cash can be required (and should be required by the Government, at a cost).

[Redacted]

4. *Do you have any suggestions on how shared costs and overheads could be allocated to ensure competitive neutrality?*

We suggest that a fully distributed cost (“**FDC**”) approach/activity based costing should be applied in this instance as a pragmatic approach.

Using a FDC approach, a Canberra Cemeteries’ cost base comprises all costs exclusive to the crematorium (i.e. direct costs) and a pro-rata share of Canberra Cemeteries’ overheads and capital costs (i.e. indirect costs).

Under the FDC method, the total costs of the business are allocated across all outputs. Where an asset is used exclusively to deliver crematorium services all capital costs are allocated to that service. But where Canberra Cemeteries use surplus capacity in assets it controls then a judgement is required as to what costs are direct and what are indirect and how best to apportion them.

In the simplest form of FDC, indirect costs are allocated to activities on a pro-rata basis. Indirect costs are those costs which cannot be directly allocated to the provision of crematorium services but a share of which needs to be attributed to the activity by some means of apportionment.

Indirect costs can also be apportioned to activities using suitable cost drivers. Costs may, for instance, be allocated as a proportion of:

- staff involved in the activity as a percentage of total staff;
- the direct resource use of the activity as a percentage of total resource use; or
- the budget for the activity as a percentage of the total business budget.

We note that the FDC approach is really a simplified form of activity based costing (“**ABC**”). ABC is a sophisticated method of allocating the indirect cost pool. The underlying assumption of ABC is that corporate overheads tend to vary not only with the volume of job items, but more specifically with their range, diversity and complexity.

Therefore, a connection needs to be made between the decisions made about jobs and the demands these jobs create for Canberra Cemeteries’ resources whose costs are considered ‘fixed’. ABC extends the number and type of variables by which costs are allowed to vary, as well as the time period to expect cost variability, and charges overheads accordingly.

Under the ABC approach, categories of indirect cost are identified, and these costs are allocated to products using criteria (often called ‘drivers’) which most closely reflect usage by each product.

However, while ABC more accurately allocates indirect costs according to usage, it still remains a way of fully distributing all costs.

If the Commission considers that an ABC exercise is practical, then this should be employed, but we suggest that it is more likely that the FDC approach will be a pragmatic compromise.

We consider the two other approaches identified in the Discussion Paper, in the current circumstances, are likely to:

- in the case of Ramsey Pricing, be problematic to apply transparently and consistently. This approach would require the Commission to identify crematorium services (or baskets of services) that have similar elasticities, setting prices above marginal cost according to each service’s (or baskets of services’) price elasticity of demand. We do not consider this a practical approach, particularly given the relevant market is already competitive (i.e. across the ACT and into NSW); and
- in the case of marginal costs pricing, be inefficient to compensate the operator because of the existence of scale economies and fixed costs associated with running a crematorium. Canberra Cemeteries pricing crematorium services on a marginal cost basis would unfairly disadvantage the incumbents by allowing Canberra Cemeteries to price in a manner that would not adequately cover the fixed costs of its operations, a luxury not afforded to the incumbents.

5. *Do you have any views in the commercial rate of return on investments by a private crematorium facility?*

[Redacted]

It is assumed that the Commission has or will conduct its own investigations regarding the cost of debt for small and medium enterprises. Given the start up nature of the project, it is doubted that debt would be available and therefore would have to be entirely equity funded. The response to question 6 in respect of the assessment to be made by third party financiers is also relevant.

6. *Do you have any comments on whether competitive neutrality is likely to be satisfied in regard to borrowing costs, tax and tax equivalent payments, and regulation?*

In the case of borrowing costs, it is assumed that the Commission will conduct its own analysis, but would have regard to the fact that a financier would usually have regard to the borrower's credit risk profile (track record, management capability etc), security (directors' guarantees, cash based collateral etc) and tenor. In this instance, if Canberra Cemeteries were to be a private enterprise, then it is questionable that a financier would get comfort on many of these factors, and therefore the cost of debt, to the extent it was accessible at all, would be high.

It is understood from the Issues Paper that government businesses face the same tax obligations as private enterprises. It is assumed that this applies to all taxes (both direct and indirect taxes). To the extent this is the case, no comment is made.

Further, the Issues Paper indicates that government businesses are subject to the same regulatory regime as private enterprises. We assume this will include, but not be limited to matters such as:

- environmental risks and impact analysis;
- traffic risk and impact analysis;
- fire risk and impact analysis, particularly in light of the recent fires in the ACT and on the east coast generally and the proximity of Norwood Park and the Gungahlin Cemetery; and
- compliance with all relevant laws (including industrial relation laws).

7. *Do you have any comments on the most appropriate approach to ensuring that prices for goods and services not directly related to core crematorium services (such as memorialisation products) are consistent with competitive neutrality policy?*

Reference is made to the response to question 4 in relation to the FDC approach.

We also note that the entry of Canberra Cemeteries, at least in the short term, is likely to reduce volumes at incumbent operators. Given the fixed costs in the business, this will likely result in increased prices for consumers. If Canberra Cemeteries is to operate in a competitively neutral manner acknowledgement of this impact needs to be made in setting an appraise price in the short term.

8. *Do you have any other comments or information you would like to give the Commission to assist it in ensuring that the private crematorium facility will operate in a manner that is competitive neutrality?*

To the extent there is a bias for the community to support government business enterprises (because, for example, the community want to support businesses which their tax dollars are funding), how does the competitive neutrality requirements remove that advantage?

Any free promotion/advertising by government (e.g. listing on government websites etc) should be explicitly identified/costed as an advantage. Similarly, if any preferential referral/advertising/promotion in government hospices/hospitals are given, then this should be costed also.

We also note that the entry of Canberra Cemeteries, at least in the short term, is likely to reduce volumes at incumbent operators. Given the fixed costs in the business, this will likely result in increased prices for consumers. If Canberra Cemeteries is to operate in a competitively neutral manner acknowledgement of this impact needs to be made in setting an appraise price in the short term.

We finally note that the Issues Paper does not indicate whether or not a competitive analysis is to be conducted only now, or whether such an analysis is to be conducted on a regular ongoing basis (e.g. once a year) to ensure that Canberra Cemeteries continues to operate in a competitively neutral manner.

Disclaimer

The information in this document is of general background only and does not purport to be complete. Norwood Park assumes no obligation to update such information. This document is for information purposes only and is not a prospectus or product disclosure statement, financial product or investment advice or a recommendation to acquire Propel shares or other securities. No representation or warranty, express or implied, is made as to the fairness, accuracy, completeness or correctness of the information, opinions and conclusions contained in this document. To the maximum extent permitted by law, neither Norwood Park nor any of its related bodies corporates, shareholders, directors, officers, employees, agents or advisors, nor any other person accepts any liability, including, without limitation, any liability for any loss arising from the use of this document, or its contents or otherwise arising in connection with it, including, without limitation, any liability from fault or negligence on the part of Norwood Park, its related bodies corporates, shareholders, directors, officers, employees, agents or advisors.
