



COMPETITION COMMISSIONER

**COMPETITIVE NEUTRALITY COMPLAINT AGAINST THE CITY OF PORT
LINCOLN AS OWNER AND OPERATOR OF THE PORT LINCOLN LEISURE
CENTRE**

under the *Government Business Enterprises (Competition) Act 1996*

FINAL REPORT SUMMARY

being a summary of the contents of the report on the outcomes of the
Competition Commissioner's investigation

24 December 2019

COMPETITIVE NEUTRALITY COMPLAINT AGAINST THE CITY OF PORT LINCOLN AS OWNER AND OPERATOR OF THE PORT LINCOLN LEISURE CENTRE

On 9 September 2019, pursuant to Section 12 of the *Government Business Enterprises (Competition) Act 1996* (**the Act**) the Premier requested that I, in my capacity as Competition Commissioner, carry out an investigation of the competitive neutrality complaint concerning services provided by the City of Port Lincoln (Attachment 1). To assist in my investigation the Premier provided a report on the matter prepared by the Essential Services Commission of South Australia (**ESCOSA**) at the request of the Treasurer (Attachment 2). For the record, I declare that I excluded myself from all discussions concerning the review of the complaint by ESCOSA and the preparation of the report to the Treasurer.

I have given consideration to and acknowledge all arguments and submissions in this competitive neutrality complaint process. While I have not adopted all positions put, all submissions have assisted me to consider each of the relevant issues under consideration and to understand the competing viewpoints held.

Where appropriate, I have, either by direct quotation or by reference to themes or arguments, mentioned certain arguments and submissions in the text of the Report Summary to assist stakeholders in responding to the positions I have reached. However, the fact that an argument or submission has not been referenced in this Report Summary does not mean that I have not taken that argument or submission into account in my deliberations.

Summary of the Complaint

The Council owns and operates the Port Lincoln Leisure Centre (**PLLC**), with day-to-day operations managed by the YMCA under a management contract with the Council. The complaint relates to the Council's alleged failure to comply with competitive neutrality principles in relation to its conduct of the PLLC business.

The complainant alleges that the PLLC is offering membership packages which provide a broad range of services over and above that being provided by the private sector, at a price below that which could be offered in the private sector. The complainant is of the view that those actions appear to infringe the competitive neutrality principles arising under the Act, as those principles apply to local government authorities. Further, as a result of the Council's actions, private gym operators are being placed at an unfair disadvantage, which is having a detrimental effect on their businesses. In contrast, the Council is of the view that its activities within the Port Lincoln gym services market are not a significant business activity so the principles of competitive neutrality do not apply.

Findings of the Review by ESCOSA

'In summary, the Commission's advice is that:

1. The Council has failed to properly apply the competitive neutrality principles in coming to the conclusion that its activities within the Port Lincoln gym services market are not a significant business activity.
2. Based on the available evidence, the Council's PLLC-activities (gym services, or gym services bundled with other products) constitute a Category 2 significant business activity (Appendix 2).
3. The failure by the Council to apply competitive neutrality principles might be corrected by the Council assessing the implications of its PLLC-activities in the Port Lincoln gym services market more robustly, by having proper regard to the Clause 7 Statement and applicable guidance material.

To the extent permissible, the Commission also recommends that, if the Commission's advice outlined above is accepted, the Council must commit to a specified timeframe in the very near future within which to undertake this assessment. This is because the complaint was made to the Competitive Neutrality Complaints Secretariat (**Secretariat**) in December 2017. In order to provide transparency and confidence to the assessment, it should be subject to public consultation and publication in some form. This should include all cost-benefit assessments undertaken by the Council to support its proposed position.

Overall, if the outcome of this process is that the Council, or the Competition Commissioner, determines the gym services (or gym services bundled with other products) to be a significant business activity, the Council should implement some form of competitive neutrality approach. Should that prove to be the case, then the Commission further advises that the approach should include the development of private sector-equivalent cost-reflective prices, and that the Council should also consider:

- ▶ Providing both a gym-only and bundled gym-other services product.
- ▶ Developing and implementing a cost-reflective price that accurately reflects the private sector-equivalent cost of providing a gym-only service.
- ▶ Ensuring the price charged for a bundled service accurately reflects the costs associated with providing the other services within the bundle.

An alternative is for all members of private sector gyms in the Port Lincoln region to have access to the services (other than gym access) included within the bundled product on the same terms as members of the Council's PLLC, net of any transaction costs involved.'

I provided a copy of the full report prepared by ESCOSA to the parties for comment.

The Acting Chief Executive Officer of the City of Port Lincoln provided a response on 10 October 2019 (Attachment 3). The response emphasized that the City of Port Lincoln took its legal and regulatory obligations very seriously and has sought to ensure that their activities are fully compliant with competitive neutrality principles at all times. They added that they have sought to respond to the issues raised quickly and cooperatively throughout the investigation of this matter. The Council remains of the view that the gym plainly does not exceed the financial thresholds in category 1 and there is no evidence that it possesses any degree of market power or that it is of a size which is relevant when considered in the context of the size of the market as a whole. Despite their belief that the

gym should not be considered a significant business activity, the Council indicated that they were nevertheless conscious of ensuring that any pricing was fair and appropriate.

The Council expressed concern that adopting the approach proposed by ESCOSA would see gym prices increase substantially, and that requiring pricing which is out of step with the competitive market and causes collateral damage to the delivery of non-commercial outputs is inconsistent with the application of competitive neutrality principles.

I received a further response on 10 December 2019 from Peter Campbell, Partner, HWL Ebsworth Lawyers acting for the City of Port Lincoln which referred to a substantial number of issues previously raised by the Council in response to the competitive neutrality complaint and the ECSOSA investigative report. I considered all the matters previously raised by the Council in reaching my draft findings and any additional matters raised in the latest correspondence.

The complainant contacted me by telephone to indicate his broad support for the approach proposed by ESCOSA.

Competition Commissioner Findings

I accept the analysis contained in section 4.3.1 of the ESCOSA report and determine that Council's PLLC-activities (gym, services, or gym services bundled with other products) constitute a Category 2 significant business activity.

The responses provided by the Council to date fall short of a comprehensive or adequate response to addressing the competitive neutrality issues that have been identified in the ESCOSA report. I recommend the Council develop a revised response which fully examines the development of private sector-equivalent cost-reflective prices, and that the Council should also consider:

- ▶ Providing both a gym-only and bundled gym-other services product.
- ▶ Developing and implementing a cost-reflective price that accurately reflects the private sector-equivalent cost of providing a gym-only service.
- ▶ Ensuring the price charged for a bundled service accurately reflects the costs associated with providing the other services within the bundle.

I should stress that the recommendation that the Council develop a revised response is not directed at making the PLLC-activities uncompetitive with private sector offerings, but rather to ensure that the provision and pricing of non-gym services in bundled service products is not used in a manner which has more than trivial or nominal impact on the operation of the gym market in the Port Lincoln region.

I recommend that the Council's revised response be provided to the Premier within three months of the public release of my final report by the Premier.

Attachments

Attachment 1: Letter from the Premier to the Competition Commissioner requesting an investigation of a competitive neutrality complaint concerning services provided by the City of Port Lincoln

Attachment 2: Competitive Neutrality Advice, City of Port Lincoln, Final, July 2019, Essential Services Commission of South Australia (ESCOSA)

Attachment 3: Letter from the Acting Chief Executive Officer of the City of Port Lincoln providing response to the ESCOSA report



THE HON STEVEN MARSHALL MP

PREMIER OF SOUTH AUSTRALIA

B422643

Mr Brett Rowse
Competition Commissioner
c/o Essential Services Commission of South Australia
GPO Box 2605
ADELAIDE SA 5001

Dear Mr Rowse

Pursuant to Section 12 of the *Government Business Enterprises (Competition) Act 1996* (the Act) I am assigning you as Competition Commissioner to carry out an investigation of competitive neutrality complaints concerning services provided by the Fleurieu Regional Aquatic Centre Authority and the City of Port Lincoln.

To assist you in your investigation I enclose two very comprehensive reports prepared by the Essential Services Commission of South Australia at the request of the Treasurer. The reports contain confidential advice on the two complaints and should assist you with your investigation and subsequent reports:

- Competitive Neutrality Advice – Fleurieu Regional Aquatic Centre Authority (Attachment 1)
- Competitive Neutrality Advice – City of Port Lincoln (Attachment 2)

Pursuant to Section 13 of the Act, you are required initially to prepare a draft report for each of the complaints that sets out the key findings of your investigation, as well as the proposed pricing recommendation and the reasons underpinning that recommendation.

Once the entities under investigation and other interested parties have had a reasonable opportunity to comment on the draft reports, you are required to consider the comments received and make any amendments to the reports you consider appropriate. The final reports, as set in Section 14 of the Act, are subsequently issued to me in my capacity as the responsible Minister.

I look forward to receiving your reports by 30 October 2019.

Should you wish to discuss this assignment further, please contact Murray Arthur-Worsop in the Competitive Neutrality Secretariat on 8429 5104.

Yours sincerely,

A handwritten signature in blue ink, consisting of a stylized 'S' followed by a horizontal line and a loop.

Hon Steven Marshall MP
PREMIER OF SOUTH AUSTRALIA

9 / 9 / 2019

Attachments:

1. Competitive Neutrality Advice – Fleurieu Regional Aquatic Centre Authority
2. Competitive Neutrality Advice – City of Port Lincoln



Competitive Neutrality Advice – City of Port Lincoln

FINAL

July 2019

Public

Enquiries concerning this advice should be addressed to:

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Glossary of terms

City of Port Lincoln	The operator of the PLLC
Clause 7 Statement	Revised Clause 7 Statement on the Application of Competition Principles to Local Government under the Competition Principles Agreement (September 2002)
Commission	Essential Services Commission, established under the ESC Act
Council	City of Port Lincoln
CSO	Community Service Obligation
DPC	Department of the Premier and Cabinet
ESC Act	Essential Services Commission Act 2002
GBE Act	Government Business Enterprises (Competition) Act 1996
Gym services	Health and fitness services via a gym product, provided either by the Council's PLLC or private sector competitors as the context indicates
Implementation Guide	Department of Treasury and Finance Guide to the Implementation of Competitive Neutrality Policy (Revised 2010)
PLLC	Port Lincoln Leisure Centre
Policy Statement	South Australian Government's Competitive Neutrality Policy Statement
Recreational pool access	The Council's PLLC recreational swimming and water play product
Secretariat	Competitive Neutrality Complaints Secretariat (DPC)
Treasurer	Treasurer for the South Australian Government

1 Overview

The Essential Services Commission (**Commission**) is a statutory authority established as an independent economic regulator and advisory body under the Essential Services Commission Act 2002 (**ESC Act**). The Department of the Premier and Cabinet (**DPC**) has referred to the Commission a competitive neutrality complaint concerning the services provided by the City of Port Lincoln (**Council**) at its Port Lincoln Leisure Centre (**PLLC**). Under the standing request for advice issued by the Treasurer (Appendix 1), the Commission has assessed the complaint and provides the following advice to the Treasurer for review and consideration.

The Council owns and operates the PLLC, with day-to-day operations managed by the YMCA under a management contract with the Council. The complaint relates to the Council's alleged failure to comply with competitive neutrality principles in relation to its conduct of the PLLC business.

The complainant alleges that the PLLC is offering membership packages which provide a broad range of services over and above that being provided by the private sector, at a price below that which could be offered in the private sector. The complainant is of the view that those actions appear to infringe the competitive neutrality principles arising under the Government Business Enterprises (Competition) Act 1996 (**GBE Act**), as those principles apply to local government authorities. Further, as a result of the Council's actions, private gym operators are being placed at an unfair disadvantage, which is having a detrimental effect on their businesses. In contrast, the Council is of the view that its activities within the Port Lincoln gym services market are not a significant business activity so that the principles of competitive neutrality do not apply.

In summary, the Commission's advice is that:

1. The Council has failed to properly apply the competitive neutrality principles in coming to the conclusion that its activities within the Port Lincoln gym services market are not a significant business activity.
2. Based on the available evidence, the Council's PLLC-activities (gym services, or gym services bundled with other products) constitute a Category 2 significant business activity (Appendix 2).
3. The failure by the Council to apply competitive neutrality principles might be corrected by the Council assessing the implications of its PLLC-activities in the Port Lincoln gym services market more robustly, by having proper regard to the Clause 7 Statement and applicable guidance material.

To the extent permissible, the Commission also recommends that, if the Commission's advice outlined above is accepted, the Council must commit to a specified timeframe in the very near future within which to undertake this assessment. This is because the complaint was made to the Competitive Neutrality Complaints Secretariat (**Secretariat**) in December 2017. In order to provide transparency and confidence to the assessment, it should be subject to public consultation and publication in some form. This should include all cost-benefit assessments undertaken by the Council to support its proposed position.

Overall, if the outcome of this process is that the Council, or the Competition Commissioner, determines the gym services (or gym services bundled with other products) to be a significant business activity, the Council should implement some form of competitive neutrality approach. Should that prove to be the case, then the Commission further advises that the approach should include the development of private sector-equivalent cost-reflective prices, and that the Council should also consider:

- ▶ Providing both a gym-only and bundled gym-other services product.
- ▶ Developing and implementing a cost-reflective price that accurately reflects the private sector-equivalent cost of providing a gym-only service.
- ▶ Ensuring the price charged for a bundled service accurately reflects the costs associated with providing the other services within the bundle.

An alternative is for all members of private sector gyms in the Port Lincoln region to have access to the services (other than gym access) included within the bundled product on the same terms as members of the Council's PLLC, net of any transaction costs involved.

2 Complaint

Summary

- ▶ The Council owns and operates the PLLC, with day-to-day operations managed by the YMCA under a management contract with the Council. The complaint relates to the Council's alleged failure to comply with competitive neutrality principles in relation to its conduct of the PLLC business.
- ▶ The complaint referred to the Commission for advice alleges that the City of Port Lincoln is offering membership packages at its PLLC that bundle gym services with other services, such as pool services, to provide a broad range of services over and above that being provided by the private sector gym-only operators, at a price well below that which could be offered in the private sector.
- ▶ As a result, the complainant alleges that his gym, and at least two other private gym operators, are at an unfair disadvantage, which is having a detrimental effect on their business.
- ▶ The Secretariat referred the complaint to the Commission for advice in February 2019, in accordance with the standing referral issued by the Treasurer under section 5(f) of ESC Act.

In accordance with the standing referral from the Treasurer (see Appendix 1), the Commission's role is to provide advice regarding those aspects of a complaint that specifically relate to an alleged breach of the competitive neutrality principles. It is not to comment on any other allegations within a complaint, or to comment on the process undertaken by the DPC and how this resulted in the Commission's advice being requested.

In this context, this chapter outlines the nature of the complaint received and the referral of the complaint. The Commission's advice in relation to the complaint is provided in chapter 4.

2.1 Summary of complaint

The complaint which is the subject of this advice was made in December 2017, by Mr Daniel Weeks, owner and operator of 24fit Port Lincoln, to the Secretariat.

The complaint relates to the actions of the Council at its PLLC. In terms of the specifics of the competitive neutrality principles, the Commission's understanding of the complaint is that the Council offers PLLC membership packages that bundle a broad range of services over and above gym-only services (for example, recreational swimming and drop-in stadium access – see Table 4.1), allegedly on non-commercial terms. As a result, the complainant alleges that his gym and two other competitor private gym operators are at an unfair disadvantage,¹ which is having a detrimental effect on their business.

The PLLC was constructed in the 1980s. It was in private hands for 15 years, until July 2015, when the Council resolved to borrow \$4.2 million to finance the purchase of the PLLC and associated business on 31 August 2015.² The facility comprises aquatic, fitness/gym and stadium sports facilities. The aquatic facilities were refurbished during 2016-17. The facility re-opened in March 2017. Based on the available evidence, the Commission understands a Commonwealth Government grant of \$4.4 million is

¹ Mr Daniel Weeks, 24fit (the complainant) advised the Secretariat that he had spoken to and has the full support of his competitors Anytime Fitness Port Lincoln and Maisha Fitness Port Lincoln. Source: Daniel Weeks email to the Secretariat, dated 1 December 2017.

² City of Port Lincoln, *Annual Report 2017-18*, p.49, available at <http://portlincoln.sa.gov.au/webdata/resources/files/18.68.1.1%20FINAL201821%20Annual%20Report%202017-2018%2020181105.pdf>.

meeting some of the funding requirements for both the aquatic centre refurbishments and the ongoing sports stadium extension. The PLLC has not been established as a corporatised body. The Council retains ownership, with YMCA operating the facility on a day to day basis under a management contract.

2.2 Request for the Commission's advice

In accordance with the standing referral issued by the Treasurer under section 5(f) of ESC Act, the Secretariat has referred the complaint to the Commission for advice.

The Secretariat contacted the Council and the complainant (identified by the Secretariat as 24fit) on 14 February 2019, informing the parties that the Premier (as the Minister responsible for the Government Business Enterprises (Competition) Act 1996) was referring the complaint to the Commission for advice. The parties were also informed that the Commission would be in contact with parties regarding that process.

The Secretariat provided the Commission with a copy of the contents of its file regarding the complaint, including a copy of a letter to the Secretariat from the Council dated 9 March 2018. This letter, responding to an earlier approach from the Secretariat, sought to provide justification for the Council's view that competitive neutrality considerations have not been violated.

2.3 The Council's response to the complaint

In its 2017-18 annual report, the Council states:³

Under the requirements of the Local Government Act, 1999 Schedule 4 1(j) and the National Competition Policy there were no significant Council-owned or operated business activities created, undertaken or ceased for 2017/2018. There was one complaint received by Council in February 2018 regarding the application of competitive neutrality in its business dealings. Council responded to the complaint through the Department of the Premier and Cabinet, detailing why the complaint was not valid and have not received any further response.

Further to this public response, Commission staff met with Council staff, and the Commission has received two letters directly from the Council, dated 22 March 2019 and 9 May 2019, responding to the Commission's work on the competitive neutrality complaint. Both these letters indicate that the Council is of the view that it does not undertake any significant business activities. In an email to the Commission dated 31 May 2019, the Council maintains that the pricing of the gym package by the PLLC-operator (YMCA) is reasonable. Together, this correspondence provides the Council's reasons as to why this is the case. Chapter 4 and Appendix 4 outline the Commission's advice in respect of its assessment of these reasons in having regard to the requirements of the Clause 7 Statement and the Implementation Guide.

The Commission has encouraged the Council to provide evidence supporting its view on a number of occasions during the course of assessing this complaint. The Council has not provided any more than the correspondence outlined above, nor has it indicated that it has anything further. The Council requested that the Commission confirm that the complaint would be dismissed, because in its view the complaint has no merit.⁴ However, following a meeting with Commission staff, the Council advised that it would undertake a further review,⁵ but subsequently advised the Commission that it did not expect any outcome would be reported prior to the Commission completing this advice for the Treasurer⁶.

³ City of Port Lincoln, *Annual Report 2017-18*, p.54.

⁴ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.7.

⁵ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.3.

⁶ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, email to Commission dated 31 May 2019.

3 Context and Commission approach

Summary

- ▶ The legislative and policy context for the application of competitive neutrality principles by local government agencies is contained within the following documents:
 - Government Business Enterprises (Competition) Act 1996 (**GBE Act**)
 - Revised Clause 7 Statement on the Application of Competition Principles to Local Government under the Competition Principles Agreement (**Clause 7 Statement**),
 - South Australian Government's Competitive Neutrality Policy Statement (**Policy Statement**) and
 - Guide to the Implementation of Competitive Neutrality Policy (**Implementation Guide**).
- ▶ The Commission does not have a procedural or substantive role in that legislative and policy context. Instead, it provides a separate advisory function, giving advice to the Treasurer (under section 5(f) of the ESC Act) in relation to a competitive neutrality complaint received and then referred to the Commission by the Department for Premier and Cabinet. This advisory function is undertaken within the parameters prescribed by the ESC Act and the standing referral of the Treasurer (refer Appendix 1).
- ▶ When advising on a competitive neutrality complaint, the Commission's primary focus is whether or not a local government agency has applied the competitive neutrality principles in a manner that ensures consistency with the economic intent of the competitive neutrality policy. It does this through tracking how a local government authority has applied the Clause 7 Statement and the Implementation Guide and linking this back to the economic intent of the competitive neutrality policy.
- ▶ The assessment of a local government agency's approach to competitive neutrality relates not just to process, but also to the methodological approach adopted by the local government agency and subsequent effects of the approach adopted. Accordingly, in preparing advice, the Commission does not simply adopt a procedural check list approach but instead looks closely at methodologies and outcomes (intended and actual).

3.1 Legislative and policy context

The South Australian Government is a signatory to the 1995 Competition Principles Agreement,⁷ which requires it to ensure that there is a competitive neutrality framework in place. The Government Business Enterprises (Competition) Act 1996 (**GBE Act**) provides for oversight of the prices charged by South Australian government business enterprises and for other purposes. Part 4 of the GBE Act deals with the principles of competitive neutrality.

The principles of competitive neutrality are designed to neutralise any net competitive advantage that a government or local government agency⁸ engaged in significant business activities⁹ would otherwise have, by virtue of its control by the government or local government, over private businesses operating

⁷ COAG, *Competition Principles Agreement – 11 April 1995* (As amended to 13 April 2007), available at: http://ncc.gov.au/images/uploads/cpa_amended_2007.pdf.

⁸ The GBE Act (section 3) and Clause 7 Statement (p.8) define a 'local government agency' to include a council, a body established by a council or councils under the Local Government Act 1999 and the Local Government Finance Authority of South Australia.

⁹ Defined in Appendix 2 and discussed in section 3.5.1.

in the same market.¹⁰ The principles of competitive neutrality are identified in policies published by the Minister.¹¹

Clause 7 of the Competition Principles Agreement deals with the application of competitive neutrality principles to local government. The principles of competitive neutrality that South Australian local government agencies must comply with are set out in the document: 'Revised Clause 7 Statement on the Application of Competition Principles to Local Government under the Competition Principles Agreement' September 2002 (**Clause 7 Statement**).¹²

Other important documents that provide guidance on the implementation of competitive neutrality principles include the:

- ▶ South Australian Government's Competitive Neutrality Policy Statement (**Policy Statement**),¹³ and
- ▶ Guide to the Implementation of Competitive Neutrality Policy (**Implementation Guide**).¹⁴

As the Implementation Guide notes, the efficiency ground for competitive neutrality policy is that the existence of a net competitive advantage for a government business, purely as a result of its government ownership, may enable it to price below an equally or more efficient private sector competitor, and potentially force such a service provider out of the market. Such a distortion of resource allocation reduces the overall economic welfare of the community. Efficient pricing involves setting prices to reflect competitive market prices, or where a market is not competitive, the full costs of supply.¹⁵

The Clause 7 Statement states that competitive neutrality principles should be applied, where appropriate, to a significant business activity¹⁶ carried out by a local government agency, unless the costs of implementing the principles are greater than the benefits.¹⁷ This is a matter for the local government agency to determine. The factors required to be taken into account in determining whether the activity is significant are presented in section 3.5.1, and the cost-benefit factors a local government agency should account for are presented in section 3.5.2.

3.2 Competitive neutrality complaint

Pursuant to section 17 of the GBE Act, a person that competes, or seeks to compete, in a particular market may make a complaint to the Minister¹⁸ alleging an infringement of competitive neutrality principles by a local government agency operating in the same market. A complaint must be in writing, contain the full details of the alleged infringement and must contain any further information required under the regulations.¹⁹

The Competitive Neutrality Complaints Secretariat (**Secretariat**) manages competitive neutrality complaints on behalf of the Department of the Premier and Cabinet (**DPC**). The role of the Secretariat

¹⁰ Section 16(1) of the GBE Act.

¹¹ Section 16(2) of the GBE Act. Pursuant to section 5 of the Administrative Arrangements Act 1994, the GBE Act is currently committed to the Premier (available at: <https://www.parliament.sa.gov.au/AboutParliament/ParliamentHouse/Documents/Acts%20Committed%20to%20Ministers.pdf>, viewed 8 May 2019).

¹² Government of South Australia, *Revised Clause 7 Statement on the Application of Competition Principles to Local Government under the Competition Principles Agreement*, September 2002, available at <https://www.dpc.sa.gov.au/documents/rendition/B18570>.

¹³ South Australian Government, *Competitive Neutrality*, Policy Statement, July 2002, available at <https://dpc.sa.gov.au/documents/rendition/B18463>.

¹⁴ Department of Treasury and Finance, *A Guide to the Implementation of Competitive Neutrality Policy*, Revised 2010, available at <https://dpc.sa.gov.au/documents/rendition/B18578>.

¹⁵ Implementation Guide, p.7.

¹⁶ Clause 7 Statement, p.9 defines a 'business activity'. A 'significant business activity' is defined in Appendix 2 and discussed in section 3.5.1.

¹⁷ Clause 7 Statement, p.8.

¹⁸ Being the Premier, as the Minister responsible for the GBE Act

¹⁹ Section 17 of the GBE Act. Also see Clause 7 Statement, p.11.

includes referring the matter for investigation to the local government agency against which the complaint has been made.²⁰ The Secretariat assesses whether or not a complaint falls with the GBE Act,²¹ in that it raises a genuine issue as to an infringement of the principles of competitive neutrality by a local government agency. As noted in section 3.4 below, the Secretariat (as a constituent part of the DPC) also has a role in referring competitive neutrality complaints to the Commission.

3.3 Competition Commissioner

Competition Commissioners can be appointed under Part 2 of the GBE Act.

The Minister can assign a Competition Commissioner to investigate complaints of infringements of the principles of competitive neutrality.²² The Minister must not assign a complaint to a Competition Commissioner unless the Minister is satisfied that the matter has been referred to the relevant government or local government agency for investigation first and is satisfied that there is no reasonable prospect of the matter being resolved by agreement between the parties.²³ This provides the local government agency the opportunity to respond prior to an investigation being instigated.

The Minister can also refuse to assign a complaint if the Minister considers the complaint frivolous, vexatious, trivial, or subject to a previous investigation which found no infringement; and there has been no change that affects the relevance of that finding.²⁴

The Competition Commissioner's role is to investigate the complaint (and relevant evidence) in order to determine whether or not the principles of competitive neutrality (as established by and under the GBE Act and the Clause 7 Statement) have been infringed.²⁵ The Competition Commissioner must prepare a report on the outcome of the investigation and provide this to the Minister, complainant and relevant local government agency.²⁶ The report must set out/include:

- ▶ A determination as to whether the grounds of the complaint have been substantiated.
- ▶ The Competition Commissioner's reasons for making the determination.
- ▶ If the Competition Commissioner finds the principles of competitive neutrality have been infringed, the Competition Commissioner's recommendations. These may include recommendations for the implementation of policies or practices to avoid further infringement of the same kind.²⁷

A summary of a Competition Commissioner's decision on an investigation is published on the Secretariat's website.²⁸ This summary must not contain any confidential information and the Minister must ensure that the summary is publicly available.²⁹

²⁰ Section 18(2) requires that the Premier must not assign a complaint to a Commissioner unless the Premier is satisfied that the matter has been referred to the relevant government or local government agency for investigation and is satisfied that there is no reasonable prospect of the matter being resolved by agreement between the parties.

²¹ Section 17 of the GBE Act.

²² Section 18(1) of the GBE Act.

²³ Section 18(2)(a) of the GBE Act.

²⁴ Section 18(2)(b)-(c) of the GBE Act.

²⁵ Section 19(1) of the GBE Act. The Competition Commissioner's role is also summarised in the Clause 7 Statement, p.11.

²⁶ Section 19(3) of the GBE Act.

²⁷ Such recommendations are not binding on the relevant local government agency.

²⁸ Section 19(5) of the GBE Act requires the Competition Commissioner to prepare a summary of the report required under section 19(4) of the GBE Act. Copies of summaries of previous Competition Commissioner' investigations are available at <https://dpc.sa.gov.au/resources-and-publications/competitive-neutrality>.

²⁹ Sections 19(7) and 19(6) respectively of the GBE Act.

3.4 Nature and scope of Commission advice

The Commission has an advisory role, arising on an as-needs basis, in relation to a competitive neutrality complaint referred to it by the Secretariat (see section 3.2), pursuant to a standing request for advice the Commission received from the Treasurer under section 5(f) of the ESC Act (see Appendix 1).

Based on the evidence available to it, and in accordance with requirements of the standing request issued by the Treasurer, the Commission advises on whether, in its view, a local government agency has properly applied the competitive neutrality principles having regard to the specifics of a complaint that is made. The Commission's advice is non-binding but may be considered in the assessment of any competitive neutrality complaint.

3.5 Application of competition neutrality principles and the local government agency decision-making process

In applying competitive neutrality principles, a local government agency has various decisions to make. To support those decisions, an assessment has to be undertaken across a broad range of factors, as shown in Figure 3.1.³⁰ Key requirements are discussed in subsequent sections.

At any stage in this decision-making process, a local government agency may make a decision that can infringe the principles of competitive neutrality. For example, a local government agency may:

- ▶ decide that a particular business activity is not a significant business activity when it is
- ▶ adopt an inappropriate approach to implementing competitive neutrality principles based on the scale of the significant business activity
- ▶ not appropriately scope its cost-benefit assessment
- ▶ use inappropriate methodologies to derive private sector-equivalent pricing, or
- ▶ adopt pricing strategies that infringe the Competition and Consumer Act 2010.³¹

The decision process in Figure 3.1 has been developed to generally illustrate how a local government agency decides whether and how competitive neutrality is implemented. In doing so, a local government agency must consider various questions and draw upon the guidance provided.

From Figure 3.1, the key threshold questions for a local government agency are:

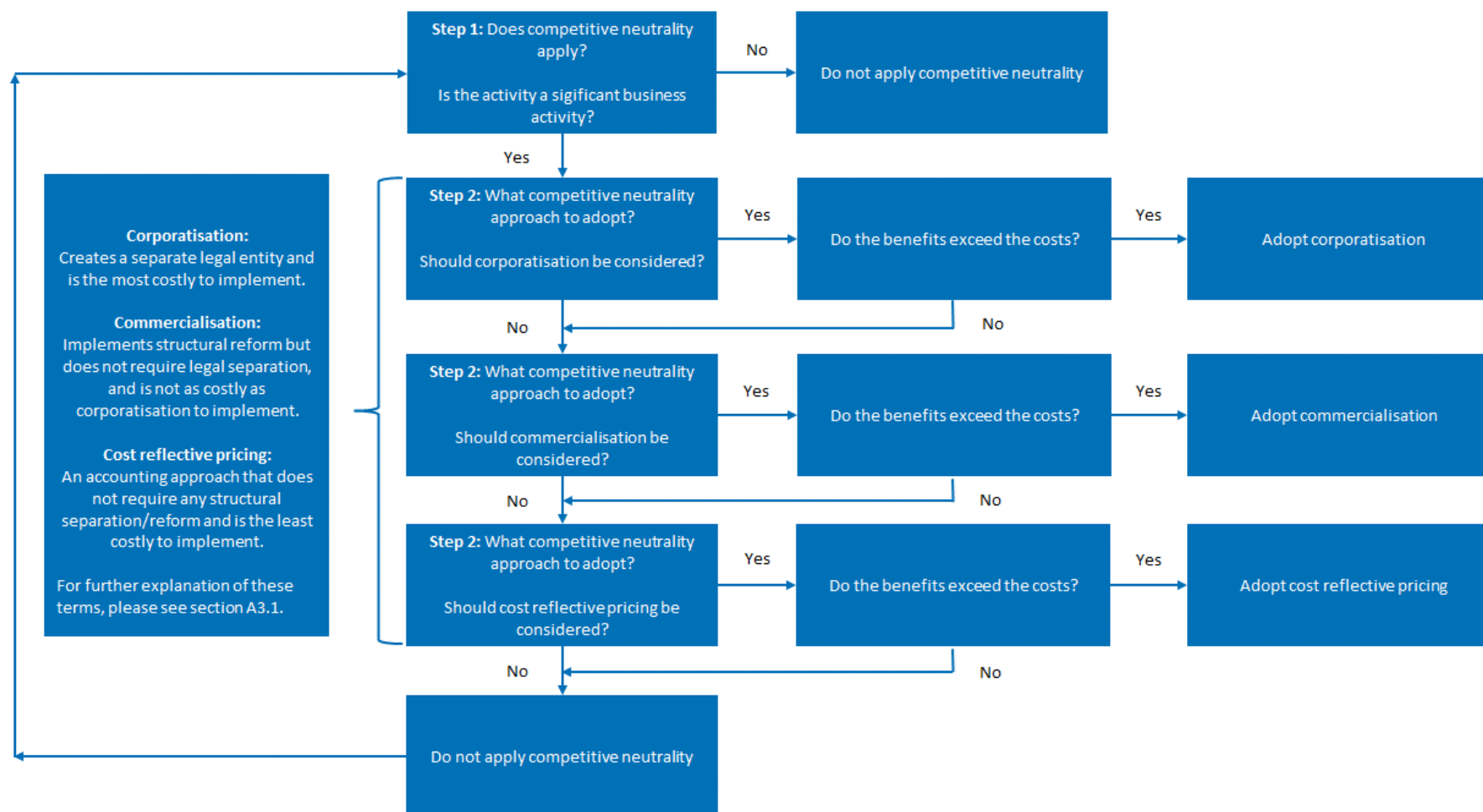
- ▶ Has it assessed whether the business activities it undertakes constitute significant business activities? If not, why not?
- ▶ If it concludes that business activities undertaken represent significant business activities but does not consider implementation of competitive neutrality principles should be applied, how has this position been reached and how does it satisfy the requirements of the Clause 7 Statement and Implementation Guide?
- ▶ If it concludes that business activities undertaken represent significant business activities and does consider the implementation of competitive neutrality principles relevant, what approach is to be adopted and why? How does the practical implementation of the approach adopted satisfy the requirements of the Clause 7 Statement and Implementation Guide?

An important aspect of this decision process is that it is dynamic. Whether an activity is a significant business activity can change over time depending on how the market related to the activity evolves. In this context, a local government agency needs to assess the extent to which it has significant business activities on a regular basis.

³⁰ This decision process is based on the requirements of the Clause 7 Statement and the Implementation Guide.

³¹ The Trade Practices Act 1974 referred to in the Clause 7 Statement was repealed in 2010 and largely replaced by the Competition and Consumer Act 2010.

Figure 3.1: Implementing competitive neutrality



Source: Commission based on Implementation Guide, Diagram 3.1.

3.5.1 What is a significant business activity?

In broad terms, significant business activities are those activities undertaken by a local government agency that are in more than 'nominal or trivial' competition with private sector operators in the relevant market.

The Clause 7 Statement requires that competitive neutrality principles should be applied, where appropriate, to a significant business activity carried out by a local government agency, unless the cost of implementing the principles are greater than the benefits to be realised from implementation.³² In assessing this, a local government agency has to consider the definition of a significant business activity in the local government agency context. This definition is provided in Appendix 2 and is taken from the Clause 7 Statement.³³ Guidance on the application of this is also provided by the significant government business activity checklist contained in the Policy Statement.³⁴

The first step in determining whether an activity is a significant business activity is to assess whether the activity meets the definition of a 'business activity'. The Clause 7 Statement guidance is that a business activity requires the activity to:

- ▶ be primarily for sale in the market
- ▶ have a profit-making focus
- ▶ have user charging, and
- ▶ not be primarily funded from rate or grant revenue (see Appendix 2).

Whether a business activity is significant will depend on its size and influence in the relevant market.³⁵ In deciding whether an activity is a significant business activity to which competitive neutrality principles should be applied, the Clause 7 Statement requires the local government agency to take into account (Appendix 2):³⁶

- ▶ *the intent of National Competition Policy*³⁷
- ▶ *whether the business activity possesses sufficient market power to create a competitive impact in the market that is more than nominal or trivial*,³⁸ and
- ▶ *whether the size of the business activity relative to the size of the market as a whole is more than nominal or trivial*.

As noted in Appendix 2, an action (to use a neutral term) is not a business activity (and therefore cannot be a significant business activity) if the achievement of community benefits is the main priority of the activity, such as Community Service Obligations (CSOs). A defining characteristic of a CSO is that it meets a specific public policy objective benefiting the community rather than the fulfilment of the business's commercial objectives.³⁹

However, it is important to consider what constitutes a CSO, when the same activity can be used both in a commercial and CSO context, and can be bundled with services for commercial reasons to compete with private sector operators. How to deal with such a situation is not contemplated within the competitive neutrality legislation and guidelines. The Commission's approach is that, even if an

³² Clause 7 Statement, p.8.

³³ Clause 7 Statement, pp.8-9.

³⁴ Policy Statement, pp.20-23 (Appendix C).

³⁵ Clause 7 Statement, p.8.

³⁶ Clause 7 Statement, p.9.

³⁷ For more information on National Competition Policy, refer to the National Competition Policy website, available at <http://ncp.ncc.gov.au/>. A key principle of National Competition Policy is that competitive markets will generally best serve the interests of consumers and the wider community.

³⁸ In practice a firm does not need to have market power to have a competitive impact.

³⁹ Policy Statement, p.7.

activity is ostensibly established to meet a broad community benefit, if such an activity is (even in part) used directly to compete with private sector operators it should not be treated as if it were a CSO.

The alternative would be to permit the pricing of such services at zero within the bundled price, which would appear to conflict with the underlying economic intent of competitive neutrality. In practice, it may depend on the specifics of the market in which the relevant activities are being provided. For example, it may depend on whether it is feasible for private sector operators to provide a comparable bundled product.

By way of further explanation:

- ▶ An activity that is undertaken solely for the purposes of a CSO will not attract the operation of competitive neutrality principles.
- ▶ An activity that is undertaken for the purposes of a CSO but which also in part competes in a market with private sector operators will attract the operation of competitive neutrality principles. This is so regardless of the degree to which, from the local government agency's perspective, the activity falls within the competitive market. For example, even if the activity is 95 percent concerned with delivering a CSO, the residual five percent may have a market impact which is more than 'nominal or trivial'.

What constitutes 'nominal or trivial' is not expressly defined in the legislative and policy documents that establish the competitive neutrality framework. The Commission considers that the terms should be ascribed their common meaning. As defined in the Macquarie Dictionary, 'nominal' means 'slight', 'not real or substantial' or 'in name only', and 'trivial' means 'of little importance', 'trifling' or 'insignificant'. If the competitive impact of the business activity in the relevant market, and the size of the business activity relative to the size of the market as a whole is not nominal or trivial (as these terms are defined above) then the activity should be considered significant. This does not appear to require the significant business activity to have a dominant position within the relevant market, merely sufficient market presence to have more than a trivial or nominal impact on the operation of that market.

In undertaking this assessment, a local government agency has to consider the competitive impact of its business activity without access to the confidential commercial information of its competitors. This impact will need to be estimated through market intelligence, which may include examination of a competitor's published price lists and gaining an understanding of the nature of the specific market, and estimating market size and market shares, to the extent practicable. This assessment will rely on both qualitative and quantitative approaches, the balance of which will depend on the circumstances.

Overall, when considering whether a particular activity is a significant business activity, a local government agency has to attempt to define the market from a product/service, geographic and temporal perspective in order to assess whether a business activity constitutes a significant business activity.

If business activities do constitute significant business activities, the local government agency has to assess whether the benefits of implementing competitive neutrality principles outweigh the costs. In doing so, it has to consider the various potential ways in which competitive neutrality principles might be implemented in practice and the costs and benefits associated with each. This is reflected in Figure 3.1. The factors that a local government agency must consider when undertaking cost-benefit assessments are discussed in the next section.

3.5.2 Assessing the costs and benefits of implementing competitive neutrality

The principles of competitive neutrality only need to be applied where they are appropriate and only to the extent that the benefits from implementation exceed the costs.⁴⁰ Table 3.1 summarises the guidance for local government agencies provided by the Clause 7 Statement and the

⁴⁰ Clause 7 Statement, p.4.

Implementation Guide for making an assessment of the costs and benefits of implementing competitive neutrality.

Table 3.1: Cost-benefit factors a local government agency should account for

Factors	Description
Policy considerations	<ul style="list-style-type: none"> ▶ Government legislation and policy relating to: <ul style="list-style-type: none"> - ecologically sustainable development - occupational health and safety - industrial relations - access and equity ▶ Social welfare and equity considerations, including CSOs ▶ Economic and regional development, including employment and investment growth ▶ Interests of consumers generally or a class of consumers ▶ Competitiveness of Australian businesses ▶ Efficient allocation of resources ▶ Impact on actual/potential competitors of the relevant local government business activity ▶ Local policies relating to: <ul style="list-style-type: none"> - economic and business development - local employment - quality of supply of goods and services, including timeliness of supply ▶ Impact on the local community ▶ Impact on the State and national economies, if any.
Possible benefits	<ul style="list-style-type: none"> ▶ Increased market contestability: <ul style="list-style-type: none"> - producing incentives for lowering costs - increasing consumer choice for customers ▶ Improved assessment of the performance of a significant business activity: <ul style="list-style-type: none"> - leading to operating efficiencies ▶ Clearer definitions of objectives and roles: <ul style="list-style-type: none"> - both the business and non-business components of local government operations.
Possible costs	<ul style="list-style-type: none"> ▶ Management and culture changes ▶ Research and analysis to determine cost-reflective pricing arrangements ▶ Administration of tax equivalent and debt guarantee frameworks ▶ Compliance and the monitoring of compliance.

Source: Clause 7 Statement, p.10

The factors a local government agency has to consider as part of its cost-benefit assessment are broad from an economic, policy and social perspective. They extend beyond the specific business interests and objectives the local government agency may have for the significant business activities. However, while recognising the difficulty of the task, the guidance available does not identify what weight a local government agency should give to any specific factor.⁴¹

Notwithstanding this, the Commission considers that the outcome of any cost-benefit assessment should not conflict with the overall economic intent of the competitive neutrality policy and principles: the efficient allocation, or best use, of the community's resources. As noted previously, this relies on efficient pricing by local authority businesses. This relates back to the importance of identifying private sector-equivalent cost-reflective prices for the significant business activities noted in Section 3.5.1.

⁴¹ Implementation Guide, p.13.

Appendix 3 steps out the remaining requirements for implementing competitive neutrality. Section A3.1.2 (Appendix 3) outlines some of the practical methodological issues that a local government agency has to consider when developing private sector-equivalent cost-reflective pricing.

3.6 Commission's assessment approach

The Commission's assessment approach considers both the economic intent of the competitive neutrality policy and principles and the decision-making process that a local government authority has undertaken with regard to its significant business activities.

As noted in section 3.1, the competitive neutrality policy is based on the principle that significant government business activities should not enjoy any net competitive advantage over private sector businesses operating in the same market simply as a result of their public ownership.⁴² This seeks to achieve a consistent basis of competition across the two ownership sectors, without interfering with differences in size, assets, skills and organisational culture, which are inherent in the competitive process. This relies on efficient pricing by local authority businesses, which involves setting prices to reflect competitive market practices, or where a market is not competitive, at least the full costs of supply. A further efficiency ground for the policy rests on the notion that advantages accruing uniquely to government-owned businesses are 'unfair' to private sector firms competing in the same market.⁴³

The Commission's assessment approach has regard to these factors, the requirements of the Treasurer's standing referral (see Appendix 1) and the legislative and policy framework outlined in section 3.1. Of particular relevance are the Clause 7 Statement and the Implementation Guide. This is because these documents contain specific details with respect to the steps, processes and factors that a local government authority should follow when considering whether competitive neutrality applies to any of its business activities and, if so, what it should do.

These steps, processes and factors aim to ensure the economic intent of the competitive neutrality policy and principles is met. In instances where the Clause 7 Statement and Implementation Guide do not provide specific guidance, consideration is given to the overall economic intent of the policy and the requirements of the GBE Act and National Competition Policy.

In practical terms, the Commission's methodological approach to assessing/addressing competitive neutrality complaints considers the requirements and economic intent of the competitive neutrality framework to assess whether a local government authority has infringed competitive neutrality principles. Importantly, this approach is not in the form of a procedural checklist. The Commission's assessment relates not just to what a local government agency has done, but also how it has been done and the effects.

The Commission's methodological approach seeks to identify the actions taken by the local government agency and track these through a competitive neutrality decision making process. Through this, it is possible to identify any infringements of the competitive neutrality principles and potential remedial actions that the local government agency could adopt. In considering remedial actions, the Commission will, where practicable, consider the materiality of any particular infringement of the competitive neutrality principles, given the context of the specific complaint and the economic efficiency objectives of the competitive neutrality principles.

⁴² Policy Statement, p.4.

⁴³ Implementation Guide, p. 7.

4 Commission's advice

Summary

- ▶ The Council at its PLLC, is bundling a range of services (for example, pool and stadium access) with gym services. This bundled service is competing directly with private sector gym service providers in Port Lincoln. The Council is of the view the activities that constitute its services within the Port Lincoln gym services market are not a significant business activity, so the principles of competitive neutrality do not apply.
- ▶ The Commission's advice is that the Council has failed to properly apply the competitive neutrality principles in coming to that position. In addition, based on the available evidence, it is the Commission's view that the Council's PLLC-activities (gym services, or gym services bundled with other products) constitute a Category 2 significant business activity (see Appendix 2).
- ▶ The Commission's further advice is that this might be corrected by the Council assessing the implications of its PLLC-activities in the Port Lincoln gym services market more robustly by having proper regard to the Clause 7 Statement, and applicable guidance material.
- ▶ To the extent permissible under the GBE Act, the Commission also recommends that, if the Commission's advice outlined above is accepted, the Council must commit to a specified timeframe in the very near future within which to undertake this assessment. This is because the complaint was made to the Secretariat in December 2017. In order to provide transparency and confidence to the assessment, it should be subject to public consultation and publication in some form. This spans all cost-benefit assessments undertaken by the Council to support its proposed position.
- ▶ Overall, if the outcome of this process is that the Council, or the Competition Commissioner, determines the gym services (or gym services bundled with other products) to be a significant business activity, the Council should implement some form of competitive neutrality approach for its PLLC. Should that prove to be the case, then the Commission further advises that the approach should include the development of private sector-equivalent cost-reflective prices, and that the Council should also consider:
 - Providing both a gym-only and bundled gym-other services product.
 - Developing and implementing a cost-reflective price that accurately reflects the private sector-equivalent cost of providing a gym-only service.
 - Ensuring the price charged for a bundled service accurately reflects the costs associated with providing the other services within the bundle.
- ▶ An alternative is for all members of gyms in the Port Lincoln region to have access to the services (other than gym access) included within the bundled product on the same terms as members of the Council's PLLC, net of any transaction costs involved.

4.1 Consultation undertaken by the Commission

The Commission has consulted with the complainant (24fit) and service provider (the Council) in an effort to obtain as much evidence and information as possible, while seeking to provide advice in a timely manner – given the time that has elapsed since the original complaint was made. The consultation process has included reviewing and discussing information received with the relevant parties, and seeking additional information as required.

4.2 Understanding the complaint

The complaint as expressed by the complainant has been set out in section 2.1.

The services being provided by the Council at its PLLC are detailed in section 4.3.1.2, but in summary are:⁴⁴

- ▶ health and fitness activities via a gym⁴⁵ (**gym services**)
- ▶ recreational swimming and water play (**recreational pool access**)
- ▶ stadium sports
- ▶ swimming lessons, and
- ▶ children's birthday parties.⁴⁶

The complaint is that the Council-run PLLC has bundled activities (for example, recreational pool access) with gym services. This bundle is competing with private gym operators, with the price being charged below a reasonable private sector-equivalent. It is alleged that this contravenes the competitive neutrality principles.

The Council does not consider that its PLLC-activities in the Port Lincoln gym services market constitute a significant business activity.⁴⁷ Consequently, the Council does not consider that the competitive neutrality principles apply. The Council's arguments supporting its position are assessed in section 4.3.1 and Appendix 4.

4.3 Commission's assessment

The Commission has analysed the complaint in accordance with the requirements of the Treasurer's referral letter (Appendix 1), having regard to competitive neutrality policy and principles as they apply to the Council, as a local government authority. In doing so, the Commission has adopted the assessment approach outlined in section 3.6. This approach has regard to the objectives of the GBE Act and the requirements of Part 4 and Part 5 of the GBE Act. The key documents relied on by the Commission in developing an assessment approach that meets these requirements, and those of the ESC Act, are the Clause 7 Statement and Implementation Guide (see section 3.6).

In summary, three central questions guide the Commission's two-part assessment in the context of the specifics of this complaint:

Part 1

- ▶ Have significant business activities been identified? If not, should they have been? (section 4.3.1)

If significant business activities have been identified, move to Part 2.

Part 2

- ▶ Have appropriate private-sector equivalent cost-reflective prices for such activities been derived?
- ▶ How do the private-sector equivalent cost-reflective prices relate to the actual pricing strategies?

⁴⁴ PLLC website viewed 24 May 2019.

⁴⁵ Comprising gym access, instructor-led group fitness and personalised fitness programs.

⁴⁶ The PLLC provides for pool parties and stadium parties. See <https://pllc.ymca.org.au/services-facility/birthday-parties>. PLLC website viewed 17 June 2019.

⁴⁷ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

In undertaking this assessment, the Commission may consider that a local government authority has failed Part 1 by concluding that an activity is not a significant business activity, when there are grounds for concluding that it is. In such cases, the Commission might elect to provide advice only in relation to Part 1, or it may suggest potential options that, if applied by the local government authority, might lead to a positive outcome for Part 2.

The Commission has also assessed the factors considered by the Council, and their application, in the Council's cost-benefit assessment (see section 4.3.2 and Appendix 4).

4.3.1 Have significant business activities been identified correctly?

As noted in section 2.3, the Council has publicly reported its belief that it is not operating any significant business activities. Consequently, the Council believes that competitive neutrality principles do not apply.⁴⁸

This section and Appendix 4 considers the relevance of the arguments and evidence put forward by the Council in terms of its consideration and application of the Clause 7 Statement competitive neutrality principles and relevant guidelines. As discussed in section 3.5.1, the first step in determining whether an activity is a significant business activity is to assess whether the activity meets the definition of a 'business activity'. If it does, then the next step is to determine whether the business activity meets the criteria of being a 'significant business activity'.

In relation to the first step, based on the information provided, the Council does not appear to contest that its PLLC's gym services constitutes a business activity. In doing so, the Council appears to focus on the size of the gym, which is not relevant to determining whether the business activity, whatever its physical size, is having a competitive impact that is more than nominal or trivial.⁴⁹ However, the Council does not *explicitly* acknowledge that its PLLC-activities as a whole within the gym services context constitutes a business activity.⁵⁰ In particular, the Council does not *explicitly* indicate that it considers all the services (that is, non-gym services) provided in its PLLC's bundled product constitute business activities (see section 4.3.1.3).

However, the Council's correspondence suggests it is *aware* that all the services within the bundled product are being used as a business activity. The Council notes a reason for adopting the pricing structure it has for the bundled product is to compete with existing service providers, and maximise the use of the PLLC.⁵¹ This suggests the Council is using all the services within the bundled product in direct competition with existing private sector operators, in order to increase the PLLC's customer base.

In this context, in relation to the second step, the Commission considers that the core question is whether the activities, undertaken at and provided through the PLLC in totality within the Port Lincoln gym services market, constitute a significant business activity, not simply the presence of the gym within the PLLC. It is the bundled product that is competing directly in the gym services market, which

⁴⁸ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

⁴⁹ The Council submits that the PLLC '... gym is not a substantial business and is merely one of a number of other gyms and similar operations in Port Lincoln and surrounding areas' (source: Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.1). This, and the Council's approach of focussing on whether its PLLC-gym services represent a significant business activity, indicates to the Commission that the Council is not contesting that its gym services constitute a business activity.

⁵⁰ The closest the Council goes to accepting such a proposition is to '... acknowledge that there is an argument that there is a level of market power arising from the gym's co-location in the Centre and the consequent ability to bundle services'. Source: Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, pp.1-2.

⁵¹ The Council submits that it understands that '... there is a view that cost reflective pricing would mean that the bundled product offered by the YMCA would need to be priced at a much higher level to reflect the value and competitive advantage provided by incorporating access to the Centre in the bundled product. As you would appreciate, pricing gym memberships at an uncompetitive rate would inevitably result in a significant decline in memberships and a consequential reduction in the use of the gym and visits to the Centre. That would be contrary to the community service objectives associated with the Centre.' (Source: Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.2.

is a commercial setting. In assessing this, the Council must take into account the following (as required by the Clause 7 Statement):⁵²

- ▶ *The intent of National Competition policy.*
- ▶ *Whether a business activity possesses sufficient market power to create a competitive impact that is more than nominal or trivial.*
- ▶ *Whether the size of a business activity relative to the size of the market as a whole is more than nominal or trivial.*

As discussed in section 3.5.1, the terms 'nominal' or 'trivial' require the business activity to have more than a trivial or nominal impact on the operation of that market, not a dominant position. Also, the broad intent of the National Competition Policy in this context is to ensure that a local government authority does not have a net competitive advantage over private sector market participants as a result of factors relating to public sector ownership.

These requirements are given a practical context through the definition of the market. Therefore, the Council should be able to provide evidence that it:

- ▶ has defined the relevant market appropriately from a geographic and product/service perspective,⁵³ and
- ▶ has appropriately concluded whether the business activity is or is not a significant business activity in that market.

This leads to a number of questions that the Council's responses to the competitive neutrality complaint would be expected to have explicitly and clearly answered, comprising:

- ▶ What is the geographic region that should be accounted for? (section 4.3.1.1).
- ▶ What are the products/services, what products/services is the Council offering at its PLLC and who are their competitors? (section 4.3.1.2).
- ▶ In determining whether an activity is a significant business activity to which competitive neutrality principles should be applied, has the Council taken into account the economic intent of National Competition Policy, and is the business activity capable of having more than nominal or trivial implications for the market? (section 4.3.1.3).

The Commission assesses the available Council response to each of these questions in turn, in the following sections.

4.3.1.1 What is the geographic region that should be accounted for?

Based on the evidence provided, the Commission considers adopting Port Lincoln as the geographic region is a reasonable working assumption in defining the geographic boundaries of the market, consistent with the Council's definition.

The Council defines the local market as Port Lincoln.⁵⁴ It lists a number of gyms operating in Port Lincoln comprising, 24fit, F45, Crossfit Eyre, Anytime Fitness, Maisha Fitness,⁵⁵ Port Lincoln Freelance

⁵² Clause 7 Statement, p.9. See also Appendix 2.

⁵³ Other factors can be relevant, such as temporal considerations and whether it is a retail or wholesale product (see Policy Statement, p.15). But for the purposes of this assessment, the factors being considered are geographic region and the product/services.

⁵⁴ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

⁵⁵ The complainant (24fit) cites both Anytime Fitness Port Lincoln and Maisha Fitness Port Lincoln as fully supportive of the complaint.

Gym and Fitness Centre, Williams Boxing Gym and Funfit Health Club.⁵⁶ It also notes that there are gyms in nearby towns (for example, Tumby Bay, Cummins and Coffin Bay).⁵⁷

The geographic reach of the market relates to identifying the boundary beyond which customers are generally unwilling to travel to use the Council-run PLLC services associated with the relevant product mix (discussed below). In this context, gyms within Port Lincoln are likely to be within the geographic region because it is credible that there will be substitution between them and the PLLC's facilities as the travel distances are low.⁵⁸ However, the extent to which nearby towns that range from 47 to 67 kilometres from Port Lincoln and are 36-45 minutes travel by car⁵⁹ should be within the relevant geographic region would require supporting evidence of substitutability.

4.3.1.2 What are the products/services, what products/services is the Council offering, and who are their competitors?

The Council states that:⁶⁰

'... the offering between the Port Lincoln Leisure Centre and other gym providers is very comparable. Most other gyms, including those in Port Lincoln, offer gym access, group fitness, and personalised programs.'

While the basic gym services provided by the Council at its PLLC are comparable with other gym operators based in Port Lincoln, the Council's overall product offering through its PLLC that is competing directly with them is not. The Council-run PLLC only provides gym services bundled with other services, for example recreational pool access. The services within the council's bundled product mix are not currently replicable by the small to medium sized private sector gym operators in Port Lincoln. In essence, the Council's PLLC-bundled product provides more services, which may be attractive to some customers. This is demonstrated by comparing the services provided in Table 4.1 (Council-PLLC) and Table 4.2 (private gym operators).

Overall, the Council's PLLC advertises three types of membership, as summarised below:

- ▶ All Access 16Y+, which has two discount types from the Standard membership, being Concession⁶¹ and Mates Rates⁶²
- ▶ Active Adults 60Y+,⁶³ and
- ▶ Active Youth (Youth 13Y-15Y).⁶⁴

The prices and services provided for these three PLLC membership types are summarised in Table 4.1. The colour coding is blue for where the service is available to the relevant membership type and grey where not (see Table 4.1).

⁵⁶ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

⁵⁷ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

⁵⁸ The distance from the PLLC to: 24fit is 3.6 kilometres, 7 minutes; Anytime Fitness is 4.0 kilometres, 7 minutes; and Maisha Fitness 3.0 kilometres, 6 minutes. Google search dated 17 June 2019.

⁵⁹ Google search dated 7 June 2019: Coffin Bay to Port Lincoln 46.9 kilometres, 36 minutes; Tumby Bay to Port Lincoln 50.1 kilometres, 38 minutes; Cummins to Port Lincoln 67 kilometres, 45 minutes.

⁶⁰ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.2..

⁶¹ The Council-run PLLC accepts the following concession cards for a discount on its All Access Membership: full-time students, Pensioner Concession Card, health care card, Commonwealth Seniors Health Card, DVA Health Card. Senior Cards are not accepted. PLLC website viewed 5 June 2019.

⁶² A discount offered when family or friends join. Up to five individuals can join together to receive the Mates Rates' discounts, but all debits must come from one set of payment details. If a 'mate' cancels their membership then membership for remaining customers reverts to the Standard, non-discounted price. PLLC website viewed 5 June 2019.

⁶³ Tailored to improving the fitness, strength and balance for those aged over 60 years. PLLC website viewed 5 June 2019.

⁶⁴ Tailored to encouraging and enabling youth to live healthy and active lifestyles. PLLC website viewed 5 June 2019.

Table 4.1: Council-PLLC membership prices and services⁶⁵

Price and Service	All Access 16Y+	Active Adults 60Y+	Youth 13Y – 15Y
Price			
Standard	\$18.00 per week	\$12.80 per week	\$12.80 per week
Mates Rates and Concession ⁶⁶	\$14.40 per week		
Joining fee	\$49	\$49	\$49
Upfront membership - Standard	\$455 per six months	\$325 per six months	\$325 per six months
Upfront membership - Concession	\$364 per six months		
Services - Opening Hours: Mon.-Fri. 6am-8pm, Sat. 8am – 4pm and Sun. 9am-4pm			
Gym ⁶⁷	Unlimited access	Access: Mon.–Fri.: 9.00am-4.00pm Weekends: All day	Unlimited access
Gym consultation and Personal training ⁶⁸			
Pool Aquatic facilities ⁶⁹	Unlimited access to all aquatic areas including spa, sauna, slides & inflatable	Unlimited access to all aquatic areas including spa & sauna	Unlimited access to all aquatic areas including slide & inflatable
Lane swimming	Access during all open hours	Access during all open hours	Access during all open hours
Slide	Access during slide open hours ⁷⁰	Access during slide open hours	Access during slide open hours
Group Fitness	Unlimited access to all instructor-led classes	Access to Active Adult instructor-led classes	Access to all age appropriate group fitness
Aqua Fit, Deep Water Aqua, Flex & Bend, Stadium Bootcamp, and Cardio Blast ⁷¹			
Swim Fit and Mums 'n' Bubs ⁷²			
Workout of the Day ⁷³			
Strength for life 50+ ⁷⁴			
Stadium Sports Drop-in for sports like basketball, netball & soccer ⁷⁵	Access subject to availability		
Personal Training ⁷⁶			

Source: PLLC website and evidence provided to the Commission.

⁶⁵ PLLC website viewed 18 June 2019 (see <https://pllc.ymca.org.au/membership-admissions/memberships>).

⁶⁶ Concession discounts are applicable to All Access Membership and some casual entry fees (see <https://pllc.ymca.org.au/membership-admissions/memberships/promo-discounts>)

⁶⁷ Full range of quality cardio machines, full range of Pinloaded strength machines, full range of free weights, stretch areas, small reception and showers and toilets. Source: advice received from Daniel Weeks, 24fit, email dated 8 March 2019.

⁶⁸ Gym consultation – inductions (mandatory for youth), personalised programs, technique cues and check-ins. Program covers: Week 1: planning; Week 2: program run through; and every 3-6 months: ongoing review & update. Personal training - Customised strength and conditioning program.

⁶⁹ Aquatic facilities include: 25m, heated 6 lane lap swimming pool; leisure beach entry pool; hydrotherapy pool; waterslide; water play features & water toys; spa; sauna; party room; and disability access

⁷⁰ Slide open hours: Saturday and Sunday 12pm-3pm; and Public holidays 12pm-2pm.

⁷¹ Aqua Fit - water resistance training, low-impact aerobic exercise. Deep Water Aqua - water resistance training down the deep end of the pool, focusing on core control, cardio & strength. Flex & Bend - strengthen & stretch in this class combining breath, balance, body weight moves and flexibility. Stadium Bootcamp – indoor workout using a variety of equipment and body weight exercises. Cardio Blast – freestyle aerobics class to music.

⁷² Swim Fit - DIY lap swimming fitness program. Mums 'n' Bubs – a circuit designed using free weights & body weight, under personal trainer guidance.

⁷³ Workout of the Day – program specially designed by qualified instructors.

⁷⁴ Strength for life 50+ – supervised strength & balance training.

⁷⁵ That is, members are welcome to use the stadium courts when not booked, on a 'bring your own' equipment basis. A customer service telephone number is provided to confirm drop-in availability. PLLC website viewed 3 June 2019.

⁷⁶ The PLLC offers personal training services separate to memberships. Discounts available not according to membership types, but according to number of people involved in the session (up to three people) and bulk purchase (first time offer: 3X PT sessions and Ongoing: 5X and 10X PT sessions). See PLLC website viewed 4 July 2019, available at <https://pllc.ymca.org.au/gym/pt>.

By contrast, Table 4.2 summarises the services provided by private gyms in Port Lincoln, which shows a much smaller range of services on offer.

Table 4.2: Private gym membership prices and services

Price and Service	24fit ⁷⁷	Anytime Fitness ⁷⁸	Maisha ⁷⁹
Price			
Annual	\$595 p.a. (paid upfront) (\$11.44 per week)	\$60.45 per month (\$13.95 per week)	
Flexi – billed fortnightly (Full) No lock in contract	\$15.95 per week	\$15.95 per week ⁸⁰	\$20.00 per week ⁸¹ -(Gym+Group Fitness classes) \$15.00 per week-(Gym only)
Flexi – billed fortnightly (Discount) No lock in contract			\$15 per week-(corporate, 60Y+ & concession cardholders) \$10.00 per week-(high school)
Results - billed fortnightly 12 month commitment	\$13.95 per week		
Fitness services			Body composition analysis - \$20 Fitness assessment - \$40
Personal training	n.a.	n.a.	Various ⁸²
Joining fee	\$0 (usually \$79)	\$49.50	\$0
Key tag	\$59	\$99	
Services – Opening hours:	24 hour ⁸³	24 hour ⁸⁴	Mon.-Fri. 6am – 8pm, Sat. 7am – 1pm, Sun. 9am – 12pm
Gym ⁸⁵	Unlimited access	Unlimited access	Unlimited access
Group Fitness	Unlimited access to all instructor-led classes ⁸⁶		
Personalised fitness programs ⁸⁷			
Health services – naturopathic, body composition analysis and fitness assessment			
Access to other gyms	Access to all 24Fit gyms	Access to all Anytime Fitness gyms	

Source: private gym operators' websites and evidence provided to the Commission.

⁷⁷ 24fit website viewed 18 June 2019 (see <https://24fit.com.au/sa/port-lincoln/>).

⁷⁸ Anytime Fitness website https://www.anytimefitness.com.au/gyms/au-1370/port-lincoln-sa-5606/?utm_source=google&utm_medium=organic&utm_campaign=gmb.

⁷⁹ Maisha Fitness website (http://maishafitness.com.au/?page_id=74) viewed 18 June 2019.

⁸⁰ Source: advice received from Daniel Weeks, 24fit, email dated 8 March 2019. Anytime Fitness does not publish its prices and the \$60.45 per month was the only offer presented in a mystery buy exercise. Anytime Fitness website viewed 18 June 2019.

⁸¹ Can also be billed monthly by direct debit. There is 10 visit pass available for \$100 paid up front, entitling access to gym and/or 1 group fitness class per visit. Casual visit \$15.00 per visit (paid upfront), entitling access to gym and/or 1 group fitness class per visit.

⁸² Single 1 hour - \$65, Single 0.5 hour - \$40; Pairs 1 hour - \$45 each, Pairs 0.5 hour - \$35 each, and Single 45 minutes - \$60, Pairs 45 minutes - \$40 each.

⁸³ Staffed hours: Monday – 7:30am to 10:30am & 4:00pm to 7:00pm; Tuesday to Thursday – 12:30pm to 3:30pm & 4:00pm to 7:00pm; Friday – 7:30am to 10:30am; Saturday – 9am to 12pm; and Sunday not staffed. 24fit website viewed 18 June 2019.

⁸⁴ Staffed hours: Monday to Thursday – 10:30am to 6:30pm; Friday – 10:30am to 3:00pm; and Saturday – 9:00am to 1:00pm. Anytime Fitness website viewed 18 June 2019 (see https://www.anytimefitness.com.au/gyms/au-1370/port-lincoln-sa-5606/?utm_source=google&utm_medium=organic&utm_campaign=gmb).

⁸⁵ Full range of quality cardio machines, full range of Pinloaded strength machines, full range of free weights, stretch areas, small reception and showers and toilets. Source: advice received from Daniel Weeks, 24fit, email dated 8 March 2019.

⁸⁶ In the case of 24fit, this covers: Machine Circuit/ Body weight training; AMRAP/ Arms & Abs/ Box Fit; Circuit training/ ABT/ Pump; ABT Abs, Bum, Thighs/ TABATA; and Pilates/ Functional Fitness. In the case of Maisha, Classes include: pump/step; nifty n Over 50's; Abs, Bum & Thighs; Functional training; Boxing. Spin; Kettleball and Step. Maisha website viewed 18 June 2019.

⁸⁷ Free PT Consult. 24fit website viewed 18 June 2019.

This means that the Council's PLLC pricing structure is highly relevant to whether its PLLC's activities are likely to have more than a nominal or trivial impact on other market participants, and be classified a significant business activity. Particularly relevant is the extent to which the pricing structure reflects private sector-equivalent costs for the product mix offered, not just the gym services.

4.3.1.3 Has the Council properly applied competitive neutrality principles in determining the status of a business activity?

The Council may not have properly applied competitive neutrality principles in determining that its PLLC-activities do not have the characteristics of a Category 2 significant business activity (see Appendix 2). This is because, in the absence of evidence to the contrary, the Council's bundled product offering at its PLLC, which provides more services than private sector competitors can deliver, is being provided at prices (\$12.80 to \$18.00 per week) comparable to private sector operators gym-only services offering (\$15 to \$16 per week), comparing Table 4.1 with Table 4.2. In the absence of evidence to the contrary, this would be expected to have a competitive impact that is not trivial or nominal, given the strength of the Council-run PLLC's market offerings (that is, given the range of additional services provided by the PLLC for a comparable price).

It would be reasonable to assume that, from the outset, the Council could have anticipated that the pricing of the PLLC's bundled product would have more than a trivial or nominal impact on the gym services market. The Council would have known it was entering the market with potentially the best offering available within the market. This would lead to substitution to the PLLC; that is, the PLLC would attract members away from the private gym operators.

In response, private sector competitors would have little choice but to lower prices or change the services offered in order to try and maintain their customer base (see Box 4.1). It might also lead private gym operators to question whether:

- ▶ The price they are having to respond to reflects the costs of providing the service from a private sector perspective.
- ▶ The PLLC pricing structure could be maintained without making substantive losses.
- ▶ The cost of supplying and operating the significant infrastructure supporting the additional pool and stadia services was included within the bundled price.

Given the Council's current PLLC pricing, the cheapest adult casual recreational swimming price is \$6.30 per session, unless eligible for a concession in which case it is \$5.05 per session.⁸⁸ This represents 35 percent of the weekly cost of the full gym and concession membership prices⁸⁹ and 44 percent for Mates Rates (see Table 4.1).⁹⁰ The only way the Council's PLLC pricing for recreational pool access could be included within the bundled product is if the PLLC is demonstrably more efficient than its private sector counterparts in providing gym-only services or some form of cross-subsidy exists. The Council has provided no evidence to demonstrate this is the case. The absence of evidence raises concerns regarding the extent to which the Council might be leveraging infrastructure that has been financed through grants and rates to compete on an unfair basis. Such an outcome would conflict with the economic intent of National Competition Policy (see Appendix 2).

Overall, the competitive neutrality principles and guidance materials anticipate that the Council would robustly assess the extent to which the Council's PLLC activities are, or are not, a significant business activity. To date, the Council has not provided substantive evidence suggesting such an assessment has been undertaken, or is regularly undertaken (see section 3.5 regarding the need for frequent

⁸⁸ Adult 16Y+ 20 times (20X) aquatic access price is \$126, equivalent to \$6.30 per session (compared with single access price of \$7.00). Concession 20 times (20X) aquatic access price is \$101, equivalent to \$5.05 per session (compared with single access price of \$5.60). PLLC website viewed 24 May 2019.

⁸⁹ Based on Adult 16Y+ Standard and Concession weekly gym access price of \$18.00 per week and \$14.40 per week respectively. PLLC website viewed 24 May 2019.

⁹⁰ Based on Mates Rates price of \$14.40 per week. PLLC website viewed 24 May 2019.

assessments). Also, while some arguments put forward relate to market assessment in very general terms, the majority of the arguments and evidence put forward by the Council to support its position that it is not engaging in a significant business activity are not directly relevant. Appendix 4 provides a more detailed assessment of this.

Given the lack of evidence provided by the Council, the influence of the Council's PLLC product/pricing mix is illustrated in the case study in Box 4.1. This outlines the complainant's experience since the PLLC's refurbishment, reopening, and the YMCA managing the centre (see section 2.1).

Box 4.1 Case study - Impact of the PLLC on 24fit

This case study has been developed based on consultation with 24fit and its accountants. It seeks to illustrate the impact that the Council-run PLLC has had on a standard type of small to medium sized gym operation. 24fit has been operating gyms throughout South Australia for approximately a decade. In addition to Port Lincoln, 24fit operates facilities in Port Pirie, Stirling, Norwood, Mount Gambier, Mount Barker and Firlie.

24fit opened its Port Lincoln operation in March 2013. Anytime Fitness also opened around this time. The other main operators in the market were Maisha Fitness, Executive Fitness Management (EFM) and PFM. Crossfit services were provided by Crossfit Port Lincoln.⁹¹ There were various other small niche operators providing services such as yoga and boxing. EFM operated out of the PLLC, which at this time was not owned by the Council.

Over the 2013-14 to 2014-15 period, 24fit's membership exhibited considerable variance as it sought to establish its market presence and brand in competition with other service providers. In July 2015, the Council repurchased the PLLC. The process of refurbishment started. This led to the closure of services including the indoor aquatic facilities. As part of the repositioning of the PLLC, the YMCA won the contract to manage the newly refurbished facility, EFM was closed, and it was replaced with new gym facilities (also managed by the YMCA).

From July 2015 24fit saw relatively stable membership numbers and was posting a modest operating profit, although after depreciation the business was loss making. However, with membership numbers stable future prospects appeared reasonable. This was despite the non-payment of membership fees remaining problematic and the consequent deflating of membership income yields relative to price.

In March 2017, the newly refurbished PLLC reopened. Just prior to this, the Council's PLLC started marketing Foundation memberships and its bundled gym-recreational pool-stadia access product. This product offering provides more services to that of existing market participants but priced to compete with their market offering.

Since the PLLC reopened, 24fit's membership has declined sharply, as shown in the graph below.⁹² The subsequent table illustrates the impact on financial performance.

⁹¹ According to 24fit, PFM and Crossfit Port Lincoln are no longer in operation.

⁹² In responding to a request from the Commission, 24fit submitted that the initial surge and then decline in membership over 2014-15 reflected the opening of the new 24fit centre in March 2014 being accompanied by heavy discounting. The cheap annual membership attracted a lot of members, but many were not active and stopped using the gym early. The subsequent decline in membership results from these annual memberships expiring and not being renewed. Source: email from Daniel Weeks, 24fit, dated 20 June 2019.



	2014/15	2015/16	2016/17	2017/18	2018/19 ⁹³
Average membership	543	491	458	390	349
Average weekly membership income	\$7.19	\$8.63	\$9.20	\$8.45	\$8.25 ⁹⁴
Membership income	\$203,133	\$220,180	\$218,897	\$171,510	\$114,930
Total income	\$217,648	\$237,503	\$231,157	\$171,975	\$118,267
Total expenses	\$214,655	\$228,480	\$220,070	\$196,196	\$159,127
PBITDA	\$2,993	\$9,023	\$11,807	-\$24,221	-\$40,860
Depreciation	\$23,000	\$23,000	\$23,000	\$23,000	\$17,250
PBIT	-\$20,007	-\$13,977	-\$11,913	-\$47,221	-\$58,110

24fit has submitted to the Commission that it has sought to compete with the PLLC through improving its services by introducing new equipment, improved the fit-out of its facilities, and added a functional training area. 24fit submits that this has allowed it to introduce group fitness which is offered free of charge to members and that it also experiments with staffing hours and has developed an agreement with a local Exercise Physiologist who uses 24fit's facility exclusively for their own clients.

However, 24fit cannot fully compete with the product range provided by the Council at its PLLC at the price provided. This is unlikely to be because 24fit lacks the capability to operate efficiently, given its extensive experience in this sector. It primarily appears to be because the basis of competition with the PLLC is not on an even footing.

Finally, since the introduction of the PLLC, the main new facilities in Port Lincoln have primarily been for Crossfit-type services.⁹⁵ According to 24fit, in 2017, F45 and Crossfit Eyre started operating in Port Lincoln. The Commission's understanding is the PLLC does not currently provide Crossfit-type services. By contrast, only the Council at its PLLC appears to have entered the market for more standard gym services. It has done so at the expense of EFM. The Commission's understanding is that 24fit's reasons for maintaining its Port Lincoln operation, at least in the short term, is for strategic reasons.

⁹³ The membership figures relate to the period to 10 June 2019, the financial figures are for the first 9 months of the financial year.

⁹⁴ The average membership number used for this calculation is the average for the first 9 months of the financial year.

⁹⁵ The Commission understands CrossFit to be a branded fitness regimen and a registered trademark of CrossFit Inc. (see www.crossfit.com). However, the Council-run PLLC does provide weekly group fitness sessions (see Table 4.1).

4.3.2 Cost-benefit assessment

The Council notes that the Clause 7 Statement only requires competitive neutrality principles to be implemented where appropriate and the benefits from implementation outweigh the costs (see also, section 3.5.2).⁹⁶

In terms of the Council undertaking such an assessment, the Council goes on to state that:⁹⁷

- ▶ the pricing at its PLLC is reflective of the pricing in the market (that is, there is no predatory pricing), and
- ▶ pricing gym memberships at an uncompetitive rate would inevitably result in a significant decline in memberships and a consequential reduction in use of the gym and visits to the PLLC, which the Council argues would be contrary to the community service objectives associated with the PLLC.

In making an assessment of the costs and benefits of implementing competitive neutrality, the Clause 7 Statement requires local government agencies to take into account a number of factors, as summarised in Table 3.1. Having regard to the full range of cost-benefit factors that a local government agency needs to take into account, the Commission's view is that the Council's assessment is too narrow, and does not suitably address the full socio-economic context. For example, the Commission considers that the Council has not had appropriate regard to the following key Clause 7 Statement cost-benefit factors:

- ▶ Impact on actual/potential competitors of the relevant local government business activity
- ▶ Local policies relating to:
 - economic and business development
 - local employment
 - quality of supply of goods and services, including timeliness of supply
- ▶ Impact on the local community
- ▶ Competitiveness of Australian businesses
- ▶ Increased market contestability
- ▶ Economic and regional development, including employment and investment growth, and
- ▶ Efficient allocation of resources

Regarding the first bullet point, the Council has not provided any indication of what it considers the private sector-equivalent cost-reflective price of its bundled product to be. Absent this, making any conclusion about predatory pricing is difficult. Also, if the Council's pricing strategy at its PLLC is below the private sector-equivalent costs of the bundled product, rather than reflecting the pricing of the market, the Council's pricing strategy likely defines a pricing benchmark for the market. From the perspective of private sector operators, pricing above the Council's PLLC bundled price, risks losing memberships because members could credibly threaten to switch to the PLLC, as the actual product offering includes more services. Pricing in line or below the Council-run PLLC to maintain memberships simply places further pressure on financial viability, if they are competing against an artificially low price. This, however, is unknown unless there is transparency regarding private sector-equivalent cost-reflective prices.

The second bullet point simply emphasises that the Council is undertaking a significant business activity through its PLLC and that, in part, the intent of the pricing structure and policy is to incentivise existing customers of other gym-service providers to switch to the PLLC. This is not directly a community service objective, it is a business objective, with the aim of moving revenue streams from other providers to itself in order to cover a proportion of the PLLC's costs. It is possible that differing pricing structures and policies could meet community service objective goals and assist in covering the

⁹⁶ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.2.

⁹⁷ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.2.

PLLC's costs – but without impacting upon existing gym services providers. The Council has provided no evidence suggesting that it has explored this.

The Council also notes that the Implementation Guide sets out the following factors when considering the application of cost-reflective pricing (Implementation Guide factors in brackets):⁹⁸

- ▶ The gym facilities represent a very small element of the use of the PLLC (costing and pricing where there are non-commercial outputs⁹⁹).
- ▶ The gym market in Port Lincoln and surrounding areas is very competitive (pricing in a competitive market¹⁰⁰).
- ▶ Lower than full cost pricing is justified given there is unused capacity within the PLLC during off-peak periods (departure from full costs – unused capacity¹⁰¹).
- ▶ Full cost pricing is not warranted for off-peak customers (pricing for peak periods of consumption¹⁰²).

In relation to this last set of bullet points, they only repeat what the guidelines state. However, the Council would need to determine private sector-equivalent costs before it could be confident as to the applicability of these factors for deriving cost-reflective prices for the PLLC.

A further observation is that, when undertaking cost-benefit assessments, account needs to be taken of the relative scale of private sector gym operators to that of the PLLC, which is supported by the Council.¹⁰³ While, for the Council, its activities in the gym services market may represent a small percentage of its overall operations, private sector gyms are generally small/medium sized businesses. This is the case for the complainant, which was operating in the area well before the government-owned refurbished PLLC opened.

Finally, there is a temporal dimension to considering the costs and benefits of implementing competitive neutrality policy. While the Council may wish to maximise the use of the PLLC as quickly as possible, the approach adopted may risk reducing community choice in the medium to long term, and negatively impact on small to medium sized businesses in the region. This may not be in the community's interests, nor the Council's.

As the case study in Box 4.1 demonstrates, because of its access to finance and product scope, the Council with its PLLC can act as a price leader, and likely has the capacity to absorb heavy discounting for some time, in a manner that would not be sustainable for a private sector operator. If the Council is pricing below private sector-equivalent cost-reflective pricing at its PLLC in the Port Lincoln gym market, and the Council continues to permit this, then it is possible that private sector competitors will exit the market at an opportune moment¹⁰⁴ and new entry will be deterred. Such an outcome should be

⁹⁸ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, pp.2-3.

⁹⁹ Implementation Guide, section 6.7, p.29.

¹⁰⁰ Implementation Guide, section 6.8, p.29.

¹⁰¹ Implementation Guide, section 6.9.2, p.30.

¹⁰² Implementation Guide, section 6.9.4, p.31.

¹⁰³ From an operational perspective, while the PLLC's accounts are not separated from those of the Council's, based on the available evidence the Commission understands that there is an annual operating subsidy of around \$0.8 million. Refer, for example, the Council's draft annual business plan for 2019-20, which appears to show a budgeted net operating expense of \$837,048 for 2019-20, for the Leisure Centre/Indoor facility (source: City of Port Lincoln, *Draft Annual Business Plan for the year ended 20 June 2020*, p.44, available at https://www.portlincoln.sa.gov.au/_data/assets/pdf_file/0044/98999/18.20.1.2-N2019402-DRAFT-ABP-19-20-Adopted-for-Consultation-UPDATED.pdf.)

In the case of infrastructure costs, the 2016-17 Annual Report (p.74) notes that the PLLC refurbishment benefited from a successful grant funding application for the National Stronger Regions Fund and, as a result, the amenity of the indoor aquatic centre was improved with the inclusion of the following: fully tiling and largely levelling the concourse, installing water features for the younger children in the shallow water of the Learners Pool, constructing the kiosk and fitting out a gymnasium on the upper level of the Stadium (annual reports available at <http://www.portlincoln.sa.gov.au/page.aspx?u=786>).

¹⁰⁴ This is most likely to occur when property leases expire or owned premises can be put to an alternative use or sold.

avoided, so that both the PLLC and private sector operators can enjoy an equality of opportunity to compete.

4.3.3 Findings

The Council at its PLLC is bundling a range of services (for example, pool and stadium access) with gym services. This bundled service is competing directly with private sector gym service providers in the Port Lincoln market. The Council is of the view the activities that constitute its services within the Port Lincoln gym services market are not significant business activities, so the principles of competitive neutrality do not apply.

The Commission finds that the Council has failed to properly apply the competitive neutrality principles in coming to that position. In addition, based on the available evidence, the Commission considers that the Council's PLLC-activities (gym services, or gym services bundled with other products) constitute a Category 2 significant business activity (see Appendix 2).

4.4 Recommendations for possible remedies

This failure might be corrected by the Council assessing the implications of the Council's PLLC-activities in the Port Lincoln gym services market more robustly by having proper regard to the Clause 7 Statement, and the guidelines provided.

To the extent permissible under the GBE Act, the Commission also recommends that, if the Commission's advice outlined above is accepted, the Council must commit to a specified timeframe in the very near future within which to undertake this assessment. In order to provide transparency and confidence to the assessment, it should be subject to public consultation and publication in some form. This spans all cost-benefit assessments undertaken by the Council to support its proposed position.

Overall, if the outcome of this process is that the Council, or the Competition Commissioner, determines the gym services (or gym services bundled with other products) to be a significant business activity, the Council should implement some form of competitive neutrality approach. Should that prove to be the case, then the Commission further advises that the approach should include the development of private sector-equivalent cost-reflective prices, and that the Council should consider:

- ▶ Providing both a gym-only and bundled gym services-other services product.
- ▶ Developing and implementing a cost-reflective price that accurately reflects the private sector-equivalent cost of providing a gym-only service.
- ▶ Ensuring the price charged for a bundled service accurately reflects the costs associated with providing the other services within the bundle.

An alternative is for all members of gyms in the Port Lincoln region to have access to the services, other than gym access, included within the bundled product on the same terms as members of the Council's PLLC, net of any transaction costs involved.

Appendix 1 – Treasurer’s referral letter

The Hon Rob Lucas MLC

TRS19D0070

Mr Brett Rowse
Chairperson
Essential Services Commission of South Australia
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Dear Mr Rowse

In my capacity as Treasurer I seek advice from the Essential Services Commission of South Australia (Commission) in accordance with section 5(f) of the *Essential Services Commission Act 2002* (ESC Act), to assist in the investigation of competitive neutrality complaints under the *Government Business Enterprises (Competition) Act 1996* (GBE Act).

Background

1. Principles of competitive neutrality are designed to neutralise any net competitive advantage that a government or local government agency engaged in significant business activities would otherwise have, by virtue of its control by the government or local government, over private business operating in the same market.
2. Under Part 4 of the GBE Act, an appointed Competition Commissioner may be assigned to investigate, and prepare a report on, complaints of infringements of the principles of competitive neutrality.
3. Cabinet approved your appointment as a Competition Commissioner under section 5 of the GBE Act on 17 December 2018.
4. Further to this appointment, I seek advice from the Commission in relation to competitive neutrality complaints submitted to the Department of the Premier and Cabinet.

Referral

Subject to the requirements set out in this request for advice, I, Rob Lucas, Treasurer, request the Commission to provide advice to me pursuant to section 5(f) of the ESC Act in relation to any competitive neutrality complaints made under Part 4 of the GBE Act and referred to it by the Department of the Premier and Cabinet.

Requirements for the advice

In providing its advice, the Commission must:

1. have regard to the objectives of the GBE Act, the requirements of Part 4 and Part 5 of the GBE Act and the principles of competitive neutrality issued under the GBE Act
2. work collaboratively with the Department of the Premier and Cabinet to obtain any relevant information or data required to inform the advice, and
3. consult with, and seek any information from, any other relevant parties as required.

I am advised that in order to provide the advice, arrangements will be made between the Commission and the Department of the Premier and Cabinet to provide funding to cover all staff time, resources and materials to ensure no cross subsidy occurs with other statutory functions or powers undertaken by the Commission.

If the Commission requires further information in relation to this request for advice, please contact Graham Cooper, Manager, Cabinet Office, Department of the Premier and Cabinet on 8429 5113.

Yours sincerely



Hon Rob Lucas MLC
Treasurer

16 January 2019

Appendix 2 - Definition of significant business activity

As outlined in the Clause 7 Statement, in this context of competitive neutrality, a business activity in this context is defined as any activity undertaken:

- (a) which falls within the Australian Bureau of Statistics classification of 'Public Trading Enterprise' and 'Public Financial Enterprise'; or
- (b) where:
 - (i) the activity is primarily involved in producing goods and services for sale in the market; and
 - (ii) the activity has a commercial or profit-making focus; and
 - (iii) there is user charging for goods and/or services; and
 - (iv) the activity is not primarily funded from rate or grant revenue; or
- (c) where the local government agency submits a tender as part of a tendering process in competition with the private sector.

An activity will not be a business activity if:

- (d) it provides goods or services to the local government agency and for reasons of policy or law there is no competition with alternative suppliers; or
- (e) it is clear that the intention of the local government organisation is that the activity's predominant role is regulatory or policy-making, or where the achievement of the community benefits is the main priority of the activity.

Whether an activity is a significant business activity to which competitive neutrality principles should be applied is a matter for each local government agency to determine. This determination should be made taking into account:

- ▶ The intent of National Competition Policy.
- ▶ Whether the business activity possess sufficient market power to create a competitive impact that is more than nominal or trivial.
- ▶ Whether the size of the business activity relative to the size of the market as a whole is more than nominal or trivial.

Significant business activities are categorised as follows:

- ▶ Category 1 being a business activity with an annual revenue in excess of \$2 million or employing assets in excess of \$20 million.
- ▶ Category 2 relates to all other significant business activities.

Source: Clause 7 Statement, page 9.

Appendix 3 – Implementing competitive neutrality

Section 3.5.1 sets out the factors for determining if a business activity is a significant business activity. However, the principles of competitive neutrality only need to be applied where they are appropriate and only to the extent that the benefits from implementation exceed the costs, which is discussed in section 3.5.2. This appendix steps out the remaining requirements for implementing competitive neutrality.

A3.1 Implementing competitive neutrality

The three mechanisms outlined in the Clause 7 Statement for implementing competitive neutrality principles are: corporatisation, commercialisation and cost-reflective pricing.¹⁰⁵ These require different levels of business and accounting separation. Which to adopt is a matter for the local government agency,¹⁰⁶ having regard to a number of factors including: the costs and benefits of applying the principles of competitive neutrality to a significant business activity; the organisational context of the activities exposed to competition; the level of resources used in the supply of the good or service; and any special requirement such as increased accountability or a greater emphasis on efficiency.¹⁰⁷

Table A3.1: Mechanisms for implementing competitive neutrality

Mechanisms	Description
Corporatisation	<p>Corporatisation is the preferred path to competitive neutrality under the Competition Principles Agreement. It represents the strongest form of private sector equivalence and is the most costly to implement.</p> <p>Corporatisation creates a legally separate business entity that has many characteristics of a private sector operator. It will have a board, charter, business plan, and publish an annual report and accounts.</p> <p>Corporatisation explicitly isolates public policy products/services provided by the created corporate, such as CSOs, from those products/service competing with the private sector.</p>
Commercialisation	<p>Commercialisation involves the structural reform of an entity, but does not require legal separation and is not as costly to implement as corporatisation. Commercialisation can take various forms that trend more towards corporatisation or cost-reflective pricing, depending on the degree of private sector equivalence adopted.</p> <p>Similarly to corporatisation, commercialisation seeks to split out and account for the products/services competing directly with private sector operators and those with a public policy dimension, such as CSOs.</p>
Cost-reflective pricing	<p>Cost-reflective pricing is an accounting approach. It does not require any form of structural separation within the entity. It is considered the least costly to implement because of this.</p> <p>It seeks to isolate the costs of supplying the significant business activities from the local government agency's overall product/service portfolio. Thereafter, the approach makes adjustments to account for any net competitive advantage of public sector ownership, and then assesses what pricing policy to adopt based upon private sector-equivalent costs (costs adjusted to account for any net competitive advantage/disadvantage of public sector ownership).</p> <p>Cost-reflective pricing can be introduced by ring-fencing the significant business activity from the other activities of the local government agency.</p>

Source: Commission, drawing on the Implementation Guide, pp.2-3 and Clause 7 Statement, pp.7-8.

¹⁰⁵ Clause 7 Statement, p.6.

¹⁰⁶ Noting that the relevant Minister's approval is required under section 43(3) of the Local Government Act 1999 before two or more councils can establish a regional subsidiary.

¹⁰⁷ Clause 7 Statement, p.7.

Each mechanism provides a differing degree of 'private sector equivalence'.¹⁰⁸ Private sector equivalence relates to the measures undertaken to make the public sector provision of the significant business activity more equivalent to that when it is provided by the private sector. The most basic mechanism available to implement competitive neutrality principles is cost-reflective pricing, with the most complex being corporatisation.

An objective of all three mechanisms is to provide transparency in the pricing of significant business activities and that the costs of supplying these products/services is split from the costs associated with public policy objectives, particularly CSOs.¹⁰⁹

Thereafter, actual pricing may differ from this private sector-equivalent cost-reflective price, provided the relevant local government agency assesses that the benefits outweigh the costs.¹¹⁰ This allows for the actual pricing for significant business activities to account for the market place and the level of competition, pricing strategies and technological advantages/disadvantages of competitors.¹¹¹

However, over the medium to long term, the price for significant business activities should reflect competitively neutral private sector-equivalent costs.¹¹² This means that pricing strategies can be loss-leading in the short term, but cannot be sustained for an undue period of time. What constitutes short, medium or long term is not defined in the competitive neutrality documents and, in the Commission's view, must be determined in the context of the market in which the significant business activities are being provided.

In effect, the implementation of the competitive neutrality principles requires a two-part process involving the assessment of the costs and benefits of: (i) the mechanism to adopt; and (ii) setting an appropriate price for the significant business activity. The latter is dependent on establishing private sector-equivalent costs.

A3.1.1 Competitive neutrality mechanisms

The Clause 7 Statement and the Implementation Guide identify the following factors relating to the nature and circumstances of the significant business activity in question to assist the local government agency in selecting an appropriate mechanism (Table A3.2).

¹⁰⁸ Implementation Guide, p.7.

¹⁰⁹ Implementation Guide, pp.10-11.

¹¹⁰ Clause 7 Statement, p.8.

¹¹¹ Clause 7 Statement, p.8

¹¹² Clause 7 Statement, p.8.

Table A3.2: Characteristics of the significant business activity to account for

Characteristics	Description
Organisational context of the activity	<p>Corporatisation: Where commercial activities are the principal activity and occupy most or all of the entity, corporatisation and the full range of additional private sector equivalence measures. This requires that commercial and non-commercial activities be separated and CSOs explicitly identified, separately costed and directly funded by the local government agency.</p> <p>Commercialisation: Where the significant business activity is only a part of the broader functions of the entity undertaking the activity, has several objectives to achieve and occupies only part of the entity. Separation of commercial and non-commercial will be required, at least as a separate business unit. In principle, the treatment of the CSO activities will require their identification, costing and separate funding as under corporatisation.</p>
Size of resource employed	<p>Corporatisation: 'Large' business activities can more easily offset the transaction costs associated with incorporation, new or amended legislation/regulations, administration of private sector equivalence practices and the expenses of a Board structure.</p> <p>Commercialisation: 'Medium' sized business activities are more suited to this less costly process.</p>
Efficiency objectives	<p>Corporatisation: 'Large' business activities where there are particular concerns about the efficiency of a business activity and the need for greater private sector equivalence.</p> <p>Commercialisation: 'Medium' sized activities where there are particular concerns about the efficiency of a business activity and the need for greater private sector equivalence.</p>
Accountability objectives	<p>Corporatisation: Where there are particular concerns in relation to the performance of the activities in question and/or external confidence in the existence of competitive neutrality is needed. Provides enhanced transparency through the formalisation of reporting requirements regarding the Board and management.</p> <p>Commercialisation: Where the additional benefits of enhanced transparency through corporatisation do not outweigh the costs imposed.</p>

Source: Commission drawing from Implementation Guide and Clause 7 Statement

A3.1.2 Developing private sector-equivalent cost-reflective pricing

Developing private sector-equivalent cost-reflective pricing is not straightforward. Private sector-equivalent cost-reflective pricing for significant business activities will generally require costs to be allocated between significant business activities and other business activities undertaken by the local government authority. It might also require adjustments to the local government authority's cost base to account for private sector equivalence. Further, the development of private sector-equivalent cost-reflective pricing can be complicated by the bundling of a CSO and a significant business activity or activities.

Regarding cost allocation, the costing methods that can be employed are fully attributed cost or avoidable cost. These can be used separately or in combination with each other.

A3.1.2.1 Fully attributed costs

Fully attributed costs requires the full attribution of all costs incurred in the production of a good or service output. For the purposes of calculating private sector-equivalent cost-reflective prices, the attribution of costs should take full account of all relevant costs, such as (non-exhaustive):¹¹³

¹¹³ Implementation Guide, p.24.

- ▶ all direct costs such as labour, materials and premises
- ▶ indirect costs (overheads) such as personnel, IT support and administration,¹¹⁴ and
- ▶ depreciation of physical assets utilised.

The approach is best illustrated by way of an example. If a local government authority provides both a CSO and a significant business activity using the same facility, the full costs of providing that facility would be allocated between the CSO and significant business activity. This requires the development of approaches to apportion costs. In turn, this requires an assessment of what is causing the cost to be incurred and the identification of 'cost drivers'. Cost apportionment methodologies can then be developed based on the cost drivers identified.

So far, the costs allocated to the CSO and the significant business activity represent the local government authority cost base. The next stage is to apply private sector equivalence measures to the costs attributed to the significant business activity. This seeks to ensure the costs attributable to the significant business activity align with those that private sector operators might face. This requires the local government authority to identify any differences between it and a private sector provider supplying the significant business activity, and to make any relevant adjustments to the costs of supplying the significant business activity to reflect this. Examples might include (not exhaustive):

- ▶ Adding the cost of any identified advantages as a result of ownership, such as:¹¹⁵
 - Commonwealth and State taxes
 - debt guarantee fees
 - rate of return on capital employed
- ▶ Deducting the cost of any identified disadvantages as a result of ownership, such as:¹¹⁶
 - additional cost of employment and HR functions¹¹⁷
 - additional accountability, reporting requirements and less flexibility in managing operations.

Once private sector-equivalent costs for the significant business activity have been calculated, a price based on these costs can also be calculated. Based upon the example used, the outcomes of this exercise would be a private sector-equivalent cost-reflective price for the significant business activity based on fully attributed costs. The costs of the CSO activity based on the local government agency's cost base would also be identified on a fully attributed basis (for this example), but a price need not be identified. That is not to say that the local government authority does not price access to the CSO, but that the price need not be explicitly identified through this process.

A3.1.2.2 Avoidable cost

By contrast, avoidable cost is the sum of all the costs that could be avoided if the product or service were not provided. In this case if the same local government authority provided both a CSO and a significant business activity using the same facility, the avoidable costs of providing the CSO would be the costs avoided if the CSO was not provided. The remaining costs would be allocated to the significant business activity. This might result in a different cost allocation to the full attribution method.

Thereafter, the costs associated with the significant business activity would also be adjusted to reflect private sector equivalence. However, the precise nature and magnitude of the adjustments might differ from those if the fully attributed cost allocation approach has initially been used. This is because the

¹¹⁴ Choosing an appropriate cost driver for allocating overheads is important.

¹¹⁵ Implementation Guide, pp.24-27.

¹¹⁶ Implementation Guide, p.28.

¹¹⁷ An agency seeking to incorporate such cost reductions into the derived private sector-equivalent costs would be required to calculate the costs associated with any additional HR functions, supported by evidence of the process that is not applicable to the private sector.

starting point from which any relevant private sector-equivalent adjustments are made is likely to be different.

The outcomes of this exercise would be a private sector-equivalent cost-reflective price for the significant business activity based on avoidable costs. The costs of the CSO activity based on the local government's cost base are also identified on an avoidable cost basis, but a price need not be identified. Again, this does not mean the local government authority does not price access to the CSO; rather, it means that price need not be explicitly identified through this process.

The above illustrates that any private sector-equivalent cost-reflective prices calculated is situation specific and methodologically dependent. This means that understanding the methodologies adopted for developing private sector-equivalent cost-reflective pricing for significant business activities are important to the assessment of a local government authority's application of the competitively neutrality principles.

A3.1.2.2 Bundling CSO and significant business activities

A further point to note is that a local government authority might bundle both its CSO activity with a significant business activity and use this bundled product to compete with private sector operators in the market for the significant business activity. The critical aspect to account for in these circumstances is that private sector operators would generally not supply CSOs. A CSO is generally made available by a local government authority because the private sector is unable to provide the service profitably (implying that there is no competitive market for the services).

The implication of this is that the product mix that the local government authority is using to compete with private sector providers in the relevant market differs from that the private sector operators can provide. Further, a characteristic of the outcomes of using either the fully attributed or avoidable cost allocation approach to establishing private sector-equivalent cost-reflective prices for significant business activities in this context is that these prices need not necessarily directly account for any costs attributable to the CSO activity.

So, if the CSO is bundled with the significant business activity, how the methodological approach adopted by a local government authority accounts for this in calculating a private sector-equivalent cost-reflective price and how this translates into the actual pricing strategy adopted is relevant. This is because it may have implications with respect to the underlying economic intent of the competitive neutrality policy (that is, that significant government business activities should not enjoy any net competitive advantage over private sector businesses operating in the same market simply as a result of their public ownership¹¹⁸).

¹¹⁸ Policy Statement, p.4.

Appendix 4 – The Council’s position

The Council has provided the following substantive responses relating to the competitive neutrality complaint.

- ▶ Letter to the Secretariat from Mr. Stephen Rufus, Chief Executive Officer, City of Port Lincoln, dated 9 March 2018.
- ▶ Letter to Commission from Mr. David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, dated 22 March 2019.
- ▶ Letter to the Commission from Mr. Stephen Rufus, Chief Executive Officer, City of Port Lincoln, dated 9 May 2019.
- ▶ Email to the Commission from Mr. Stephen Rufus, Chief Executive Officer, City of Port Lincoln, dated 31 May 2019.

As noted in section 2.3, the Council has not provided any more than the correspondence outlined above, nor has it indicated it has anything further.

Throughout, the Council claims it has no significant business activities. Further, its letter of 22 March 2019 requests the Commission confirm that the complaint will be dismissed.¹¹⁹

The Council’s correspondence provides the arguments and evidence supporting its position. The correspondence does not include any substantive material suggesting that the Council has undertaken any meaningful market study assessing the potential influence its participation in the Port Lincoln gym services market will have under various product/price options. Rather, it relies on factors outside those contemplated by the competitive neutrality documents. The main arguments and evidence put forward and the Commission’s response is summarised in Table A4.1.

Table A4.1: Council-PLLC significant business activity- Council position and Commission response

Council position	Commission response
Geographic region (section 4.3.1.1)	
The Council refers to Port Lincoln as being the relevant local market. ¹²⁰	Adopting Port Lincoln as the geographic region is a reasonable working assumption.
Products/services (section 4.3.1.2)	
YMCA provided advice to the Council that: ¹²¹ <ul style="list-style-type: none"> ▶ The Mates Rates is a standard membership offer available across the state.¹²² ▶ The pricing of the Mates Rates package differs to reflect costs and the relative pricing in the market in which the facility operates.¹²³ 	While the basic gym services provided by the Council at its PLLC are comparable with other gym operators based in Port Lincoln, the Council’s overall PLLC product offering that is competing directly with them is not. The Council–run PLLC only provides gym services bundled with other services, for example recreational pool access. The services within its bundled product mix are not replicable by the small to medium sized private sector gym operators in Port Lincoln. In essence, the Council’s bundled product offers many more services.

¹¹⁹ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.7.

¹²⁰ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

¹²¹ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.2.

¹²² Also, David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.3.

¹²³ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.4.

Council position	Commission response
<ul style="list-style-type: none"> ▶ Mates Rates is a built-in pricing incentive and referral marketing initiative. Comparing Mates Rates to a standard advertised price at another gym is equivalent to comparing a lock-in (one-year contract) membership gym price to a flexible no lock-in contract gym membership which is an inaccurate comparison.¹²⁴ ▶ Mates Rates was previously called 'Family Discount'. Affordable pricing is a key component towards the Council's approach in operating a community-driven, accessible facility.¹²⁵ ▶ In setting the membership price, the YMCA took into consideration local competitor pricing, like-facility pricing, and the age and quality of facilities.¹²⁶ ▶ The complainant does not mention that the Council's PLLC membership price is \$17.50 per week, compared to the complainant's \$14-\$15. The current PLLC price is \$18.00 per week.¹²⁷ ▶ The complainant's gym offered membership packages at the time of the complaint ranging from \$12.95 to \$14.95 per week, with an annual subscription offer of \$395 which equates to \$7.60 per week; current packages range from \$13.95 to \$15.95 per week, with an annual subscription offer of \$595 which equates to \$11.44 per week.¹²⁸ ▶ It is important to compare 'apples to apples' when comparing prices across competitors - that the Mates Rates price is only available to those who join together with the membership fee coming from one account.¹²⁹ <p>The YMCA has publically displayed pricing with no lock-in contracts.¹³⁰</p>	

¹²⁴ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.4.

¹²⁵ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

¹²⁶ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.7.

¹²⁷ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.7.

¹²⁸ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.7.

¹²⁹ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.7. Repeated in Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.2.

¹³⁰ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6. Repeated in Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.2.

Council position	Commission response
<p>National Competition Policy and whether capable of having more than nominal or trivial implications for the market (section 4.3.1.3)</p>	
<p>There are a number of gyms in Port Lincoln and surrounding areas. The market must be considered to include substitutes such as personal trainers and sport clubs. There are low barriers to entry so the market is not confined to existing operators. Accordingly, there can be no serious suggestion that the PLLC gym satisfies a Category 2 significant business activity:</p> <ul style="list-style-type: none"> ▶ It does not possess sufficient market power to create a competitive impact that is more than nominal or trivial ▶ Its size relative to the size of the market as a whole cannot be considered as being more than nominal or trivial.¹³¹ <p>In the circumstances, the PLLC gym cannot be classified as a 'significant business activity'. Competitive neutrality principles do not apply and the complaint may be dismissed on this threshold issue alone.¹³²</p> <p>The gym of itself and as a stand-alone operation would not possess sufficient market power to create a competitive impact that is more than nominal or trivial. But what is being suggested that when bundled with other parts of the Centre, market power is created.¹³³</p>	<p>The presence of the gym of itself is not pertinent, the product-price mix offered to the market is. As the Council at its PLLC does not offer gym-only services, the Commission's advice focuses upon the implications of the bundled product.</p> <p>However, if the Council did provide a gym-only service it is entirely possible for this to be classified as a Category 2 significant business activity. What matters is the likely customer reaction and competitive ramifications to the product-price mix offered.</p> <p>For instance, if the Council chose to offer a gym-only product similar to that available within the market, but at a price substantially lower, this will lead to changes in the market to the PLLC's advantage. This can result in the PLLC's presence being more than trivial or nominal in terms of market power and/or size.</p> <p>This would be a significant business activity and be subject to competitive neutrality. How a substantially lower price could be offered, and whether it was due to leveraging advantages associated with local government ownership, would be highly relevant to the competitive neutrality assessment.</p> <p>The bundled product offered by the Council at its PLLC is simply an extension of the product-price mix and happens to be the market offering provided by the Council. Similar issues regarding leveraging and the potential for pricing below costs would apply if this constituted a significant business activity. This is discussed in Chapter 4.</p>
<p>YMCA states:¹³⁴</p> <ul style="list-style-type: none"> ▶ It is important to note that the offering between the PLLC and other gym providers is very comparable. ▶ Most other gyms, including in Port Lincoln, offer gym access, group fitness, and personalised programs. ▶ Stadium access is provided to members of the PLLC, however this is on a 'drop-in' basis with no-programming, and limited to 'off-peak' times outside of group bookings. <p>The Council has checked on the Port Lincoln 24fit website and confirms 24fit offers membership packages ranging from \$12.95 to \$14.95 per week,</p>	<p>Chapter 4 considers the impact the Council might have on existing and potential competition through its PLLC, and barriers to entry if its current market behaviour persists.</p> <p>There is no recognition in the YMCA statement that the Council at its PLLC offers recreational pool access in its bundled product.</p>

¹³¹ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

¹³² David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

¹³³ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.1.

¹³⁴ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.2.

Council position	Commission response
<p>with an annual subscription offer of \$365, which equates to \$7.60 per week.¹³⁵</p> <p>Members do not have access to all programs and services at the PLLC. Programs such as swimming lessons, structured stadium sports, fitness camps and personal training are separate 'fee for service' offerings.¹³⁶</p>	
<p>The various packages and the pricing of those packages is unexceptional and is of a nature that would be expected between competitors in a market.¹³⁷</p> <p>It is apparent that the Centre does not enjoy any net competitive advantage simply as a result of its public sector ownership. The Council asked the Commission if it could confirm that the complaint would be dismissed.¹³⁸</p>	<p>Chapter 4 considers the impact the Council might have on existing and potential competition through its PLLC, and barriers to entry if its current market behaviour persists.</p> <p>The Council appears to accept that its PLLC is in competition with other gyms. This leaves the assessment to determine if this competition is more than nominal or trivial (see Appendix 2).</p>
<p>There is competition with other businesses in relation to some aspects of the operations but there is no unfair competitive advantage.¹³⁹</p> <p>The Council believes that pricing is undertaken in a commercially responsible manner. At no time has pricing been designed to obtain an unfair competitive advantage over other gym operators.¹⁴⁰</p> <p>The PLLC (YMCA) pricing is reflective of pricing in the market (i.e., there is no predatory pricing).¹⁴¹</p>	<p>An unfair competitive advantage is not a pre-requisite. For a business activity to be a significant business activity, it must possess sufficient influence to create a competitive impact that is more than nominal or trivial. This might occur with or without a competitive advantage.</p> <p>However, it is acknowledged that the economic intent of competitive neutrality, as applied to significant business activities, is to neutralise net advantage relating to public ownership (see section 3.1).</p> <p>In this regard, the Council has not provided evidence to suggest that it does not have an unfair competitive advantage, and that it assesses this on a regular basis. The guidelines provide examples of factors that can provide a local government authority with a competitive advantage. A local government authority is expected to account for these for all significant business activities, particularly with respect to deriving private sector-equivalent cost-reflective pricing for these activities.</p>
<p>The Council suggests that the Commission might believe that when gym services are bundled with other parts of the PLLC, market power is created.¹⁴²</p> <p>The Council does not necessarily accept such an argument, given there are no gym programs that make</p>	<p>Chapter 4 considers the impact the Council might have on existing and potential competition through its PLLC, and barriers to entry if its current market behaviour persists.</p>

¹³⁵ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.2.

¹³⁶ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.7.

¹³⁷ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.7.

¹³⁸ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.7.

¹³⁹ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.2.

¹⁴⁰ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.3.

¹⁴¹ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.2.

¹⁴² Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.1.

Council position	Commission response
<p>use of any other part of the PLLC and given facilitating public access to the PLLC is consistent with the Council's CSO.¹⁴³</p> <p>However, the Council acknowledges that there is an argument that there is a level of market power arising from the gym's co-location and the consequent ability to bundle services.¹⁴⁴</p>	<p>There is no gym-only product. The gym programs are part of a bundled product, which includes access to other PLLC services to varying degrees (see Table 4.1).</p> <p>It is not a question of market power as such, but rather what is done with this freedom to act relatively unconstrained.</p>
<p>There are numerous other non-YMCA managed examples of equivalent recreation centres which combine pool and gym access into one membership at similar price points (examples provided). The YMCA-PLLC pricing structure is directly comparable to these other 'like activities'.¹⁴⁵</p>	<p>Whether or not the PLLC operator (YMCA) employs similar pricing structures at other centres is not directly relevant to whether the Council is engaged in a significant business activity.</p>
<p>The YMCA has opted for a simple and transparent approach to membership pricing. In contrast to competitors, all YMCA membership prices are publically advertised, flexible (no lock in contracts) and do not fluctuate based on sales/promotions.¹⁴⁶</p>	<p>Whether or not the PLLC operator (YMCA) adopts transparent pricing structures is not directly relevant to whether the Council is engaged in a significant business activity.</p>
<p>The gym is but one small part of the PLLC. Any consideration of the operations of the gym (for competitive neutrality purposes) must distinguish other parts of the Centre's operation from those which are the subject of the complaint. For example, the use of the aquatic facilities by non-gym member residents is significant.¹⁴⁷</p> <p>Costing & pricing where there are non-commercial outputs.¹⁴⁸</p> <ul style="list-style-type: none"> ► Facilities at the PLLC are provided and operated as part of the non-commercial activities involved in the CSO performed by the Council ► Limited access to those facilities as part of the bundled product represents a very small element of the use of the PLLC. 	<p>The size of the gym relative to size of the Council-run PLLC is not directly relevant. What is relevant to competitive neutrality is whether a significant business activity exists.</p>
<p>The PLLC is not in a position of market power. It is essentially a community facility which incorporates a gym. The gym is a small part of the overall operations of the PLLC. The membership component of total PLLC revenue is only \$385,005 (approximately 31% of total revenue).¹⁴⁹</p> <p>The size of the gym business activity relative to the size of the market as a whole is not more than nominal or trivial. The gym is not a substantial</p>	<p>The Council appears to focus on the physical size of the gym, which is not relevant to determining whether the business activity is having a competitive impact that is more than nominal or trivial</p> <p>Arguably the ownership of the pool and stadium would be expected to provide the Council with a degree of market power, when used to compete against private sector gym operators that appear unable to provide such services on a commercial footing.</p>

¹⁴³ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.1.

¹⁴⁴ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, pp.1-2.

¹⁴⁵ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.4.

¹⁴⁶ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.4.

¹⁴⁷ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.2.

¹⁴⁸ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.2.

¹⁴⁹ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.5.

Council position	Commission response
business and is merely one of a number of other gyms and similar operations in Port Lincoln and surrounding areas. ¹⁵⁰	Membership income is potentially relevant, but only with respect to the significant business activity and to the extent it can be accurately measured.
<p>Pricing in a competitive market:¹⁵¹</p> <ul style="list-style-type: none"> ▶ The gym market in the Port Lincoln region is a very competitive market ▶ There are pricing pressures involved in operating within that market which do not permit significant price increases. 	<p>Chapter 4 considers the impact the Council might have on existing and potential competition through its PLLC, and barriers to entry if its current market behaviour persists.</p> <p>A subsidised operation such as the PLLC is likely to have more impact in a market as characterised by the Council. That is, private gyms operating in a market with tight margins and no ability to increase prices significantly would be more vulnerable to competing against a publicly owned entity with access to significant financial resources.</p>
<p>Implementation Guide pricing factors:</p> <ul style="list-style-type: none"> ▶ Departure from full costs – unused capacity:¹⁵² <ul style="list-style-type: none"> - There is unused capacity within the PLLC during off-peak periods - Lower than full cost pricing is justified given how access to the PLLC is incorporated in the bundled product. ▶ Pricing for peak periods of consumption:¹⁵³ <ul style="list-style-type: none"> - The guidelines recognise that full cost pricing is not warranted for ‘off-peak’ customers, and this should be recognised in the application of cost-reflective pricing. <p>Even if competitive neutrality principles did apply, there has been no breach of those principles. The pricing of the Mates Rates package is not artificially low. It is within the range of rates that is appropriate for a package containing the features of the Mates Rates package.¹⁵⁴</p> <p>The Council submits that the current pricing of the bundled product is not inappropriate in the circumstances.¹⁵⁵</p>	<p>The Council would need to develop private sector-equivalent costs before it could be confident it was applying cost-reflective prices.</p>
The PLLC could not be a Category 1 significant business activity as it does not have an annual revenue in excess of \$2 million and does not employ assets with a value in excess of \$20 million. The revenue figure in the operating budget for the entire PLLC for 2018-19 is \$1,172,742. ¹⁵⁶	Useful information, but categorisation does not affect the requirement, or not, to apply competitive neutrality principles.
Ultimately, there can be no genuine contention that the Council has acted in a manner that gives rise to	It is the Commission’s view, based on the Commission’s assessment (see section 4.3.1.3), that

¹⁵⁰ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.1.

¹⁵¹ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.2.

¹⁵² Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.2.

¹⁵³ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.3.

¹⁵⁴ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.6.

¹⁵⁵ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.3.

¹⁵⁶ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.5.

Council position	Commission response
any competitive neutrality concerns or warrants any action. ¹⁵⁷	<p>the Council at its PLLC is engaging in a Category 2 significant business activity. This is based on an assessment of the influence the Council-run PLLC can have on the market, given its behaviour, which is encompassed in its product-price offering in the market.</p> <p>If classified as a significant business activity, competitive neutrality is, by definition, a concern. The extent to which it may warrant action is a subsequent issue and is assessed and based upon evidence and its implications.</p> <p>The Council has not provided substantive evidence to suggest it is not engaging in a significant business activity or that this does not warrant further action.</p>
Cost-benefit assessment (section 4.3.2)	
<p>The PLLC is a community facility that needs to be operated to ensure certain services are made available to residents.¹⁵⁸</p> <p>The YMCA Community Impact Report 2017-18 demonstrates the important role played by the PLLC in the wellbeing of Port Lincoln residents.¹⁵⁹</p>	<p>How the Council defines the PLLC is not directly relevant to whether the Council is engaged in a significant business activity.</p> <p>Its role as a community facility is, along with many other factors, a component within the cost-benefit assessment when considering whether and how to implement competitive neutrality principles (see section 3.5.2). The Council's view that the PLLC is a community facility does not have primacy over other factors.</p>
<p>The Council understands there is a view that cost-reflective pricing would mean that the bundled product price would be much higher. The Council argues that pricing gym memberships at an uncompetitive rate would inevitably result in a significant decline in memberships and a consequential reduction in use of gym and visits to the PLLC. That would be contrary to the community service objectives associated with the PLLC.¹⁶⁰</p> <p>The Council considers that the pricing of the gym package by the PLLC-operator (YMCA) is reasonable in the circumstances and that an increase in price or a reduction in services would be contrary to the public interest in encouraging use of the PLLC.¹⁶¹</p> <p>Given the non-business activities and the community service elements of the PLLC, and the obvious impact of cost-reflective pricing on the operation of the gym, there must be an assessment of what public benefits arise, how the interests of the public are to be</p>	<p>The factors a local government agency has to consider as part of its cost-benefit assessment are broad from an economic, policy and social perspective. They extend beyond the specific business interests and objectives the local government agency may have for the significant business activities. The full set of cost-benefit factors a local government agency should account for are provided in Table 3.1.</p>

¹⁵⁷ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.2.

¹⁵⁸ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.2.

¹⁵⁹ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.2.

¹⁶⁰ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.2.

¹⁶¹ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, email to Commission dated 31 May 2019, p.2.

Council position	Commission response
protected and the balance to be achieved in this situation. ¹⁶²	
Other	
The PLLC was in private hands for 15 years until July 2015, when the Council re-purchased it. Even then, an upper level gym space was leased to EFM who ran a commercial gym until it chose to relocate. ¹⁶³	The history of gym ownership is not relevant to whether the now local government authority owned and operated PLLC gym activity possesses sufficient market power to create a competitive impact that is more than nominal or trivial.
<p>Although a gym has always been part of the PLLC, the Council did not direct in their tender for management services that a gym be part of the facility.¹⁶⁴</p> <p>Two tenderers proposed inclusion of a gym, as gyms are part of their standard offerings when operating similar facilities. The Council believed this would be acceptable as a gym had always been a part of the Centre.¹⁶⁵</p> <p>The YMCA was appointed manager as part of a competitive tender process.¹⁶⁶</p> <p>The Council lists the main tender evaluation criteria.¹⁶⁷</p> <p>YMCA South Australia is one of Australia's oldest and most respected community organisations.¹⁶⁸</p> <p>The successful tender by YMCA South Australia was based on a commitment to develop a community partnership in Port Lincoln coupled with the potential for outreach programs and active promotion of access and inclusion of all community members.¹⁶⁹</p>	<p>Whether a gym has always been part of the PLLC or not, or whether the Council required a gym or not, is not relevant to whether the now local government authority owned and operated PLLC gym activity possesses sufficient market presence to create a competitive impact that is more than nominal or trivial.</p> <p>The appointment process of the operator is not relevant for competitive neutrality.</p>
<p>YMCA operates the PLLC on the same basis as other facilities under their management across the state.¹⁷⁰</p> <p>The PLLC management arrangements are on arms-length, commercial terms with a reputable operator who is offering packages and pricing offered at other facilities which reflect the costs involved and other market constraints.¹⁷¹</p>	This is referring to a management agreement, which is not relevant to whether the Council is engaged in a significant business activity.
The Council and YMCA scrutinise each figure in the draft operating budget to reach an agreed final budget. YMCA does not have discretion to merely set whatever fees or operating expenses they want. Although the Management Agreement allows the	This is referring to a management agreement, which is not relevant to whether the Council is engaged in a significant business activity.

¹⁶² Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.3.

¹⁶³ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.1.

¹⁶⁴ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.1.

¹⁶⁵ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.1.

¹⁶⁶ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.1.

¹⁶⁷ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, pp.2-3.

¹⁶⁸ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.2.

¹⁶⁹ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.3.

¹⁷⁰ Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to the Secretariat dated 9 March 2018, p.1. Repeated in Stephen Rufus, Chief Executive Officer, City of Port Lincoln, letter to Commission dated 9 May 2019, p.2.

¹⁷¹ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.1.

Council position	Commission response
<p>Manager to determine their own prices, this has to be agreed within the budget process.¹⁷²</p> <p>Accordingly, the Council is satisfied that the fee structure would be fair and reasonable and be in line with other regional centres.</p>	
<p>The Gyms and Fitness Centres Industry in Australia has grown strongly over the past five years while undergoing considerable structural change.¹⁷³</p>	<p>This is not relevant to whether the Council is engaging in a significant business activity.</p>

Source: Council correspondence as referenced within the table

¹⁷² David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.3.

¹⁷³ David Levey, Business Manager Corporate & Community Services, City of Port Lincoln, letter to Commission dated 22 March 2019, p.5.



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Our Ref: O20199689

Confidential

10 October 2019

Brett Rowse
Competition Commissioner
BY EMAIL
Brett.Rowse@escosa.sa.gov.au

Dear Mr Rowse

RE: COMPETITIVE NEUTRALITY COMPLAINT

Thank you for your letter dated 27 September 2019, the investigation report prepared by ESCOSA and for the opportunity to comment on the report.

We have outlined our position regarding the issues raised with us in our previous correspondence. We do not propose to repeat the matters from our letters but would request that, in preparing your draft report, you have regard to those letters in their original form rather than the selected extracts appearing in the investigation report.

We would also like to make the following comments:

- We take our legal and regulatory obligations very seriously. We are mindful of the competitive neutrality principles and have sought to ensure that we are fully compliant with all relevant requirements at all times. As part of that compliance, we not only had regard to the Clause 7 Statement but also:
 - approached the Local Government Association in November 2016 for guidance on whether the gym at the Port Lincoln Leisure Centre (**Centre**) constituted a "significant business activity". On the basis of the information available to them, they expressed a view that it was unlikely the gym would be considered a significant business activity. This view was consistent with our assessment. The gym plainly does not exceed the financial thresholds in category 1. Further, there is no evidence that it possesses any relevant degree of market power or that it is of a size which is relevant when considered in the context of the size of the market as a whole;
 - a professional operator was engaged to ensure that the gym was operated in a proper and commercial manner which reflected the market in which the gym operated. Pricing and packages were formulated by the operator (and were consistent with pricing and packages offered by that operator at other similar facilities).
- We have sought to respond to the issues raised with us quickly and cooperatively throughout this matter. When concerns were first raised in February 2018, we responded promptly. We received

no further communication for almost 12 months and naturally assumed no further steps were required. Since we were contacted again earlier this year, we have provided further responses and hosted a meeting with the ESCOSA representative. To the extent the investigation report may suggest that the Council is in any way responsible for any delay in dealing with the complaint is inaccurate.

- The investigation report characterises much of what is contained in the responses we have provided to ESCOSA as irrelevant to the question of whether there is a substantial business activity. With respect, that characterisation is not apposite. Most of the material in question had nothing to do with the question of substantial business activity. It was supplied (in an effort to be helpful and to provide context) by way of background and/or went to the question of whether the pricing was appropriate in the circumstances.
- We understand that ESCOSA takes the view that the gym is a significant business activity. However, on the argument contained in the investigation report, virtually any business activity would have to be treated as a significant business activity. That is clearly not the intention underlying the competitive neutrality principles. The word "significant" must have some meaning and purpose. This is borne out by the financial thresholds in category 1 and by requiring something which is more than nominal or trivial in category 2. The investigation report asserts that the gym is of a size (relative to the market) or possesses such a degree of market power that the gym must be considered a significant business activity. We are unaware of evidence to support that assertion.
- We note there is reference to the complainant experiencing a loss of membership. This membership loss seems to be relied upon as evidence that the gym is being operated in a way which offends competitive neutrality principles. There is no evidence to suggest this is the case. Any number of factors may have contributed to that situation, particularly given the loss of membership appears to be continuing. It is a dynamic market with increasing competition.
- While we were of the belief and understanding that the gym would not be considered a significant business activity, we were nevertheless conscious of ensuring that any pricing was fair and appropriate. The factors surrounding pricing of packages have been outlined in our previous correspondence. We have also attempted to illustrate that some of the price comparisons in this matter do not fairly reflect differences in products and terms in the market.
- We have previously pointed to the factors relevant to the implementation of cost reflective pricing (as contained in the Guide to the Implementation of Competitive Neutrality Policy) and how those factors apply to the gym, including:
 - Costing and pricing where there are non-commercial outputs.
 - Pricing in a competitive market.
 - Departure from full cost - unused capacity.
 - Pricing for peak periods consumption (ie, lower prices for "off peak" use).

We assume you would accept those factors are relevant to a consideration of the appropriateness of the pricing. We cannot see that the investigation report has addressed those matters in any meaningful way.

- The charter for the Centre involves promoting use of the facilities of the Centre for the benefit of the health and wellbeing of the Port Lincoln community. Those non-commercial outputs mean that the cost of operating the Centre exceeds the revenue which is generated. The approach to pricing

adopted by the investigation report would see gym prices increase substantially. This would result in a loss of membership, a reduction in revenue and a greater operating loss. It would also mean a decrease in use of the facilities at the Centre. This is plainly counter-productive on a number of levels. We have indicated to ESCOSA on several occasions that we will naturally take whatever steps are appropriate to address any issues but requiring pricing which is out of step with the competitive market which exists and causes collateral damage to the delivery of non-commercial outputs is inconsistent with the application of competitive neutrality principles.

- We accept that, for the purposes of this complaint, you are only interested in the specific market in which the business activity occurs. However, the situation at the Centre is replicated many times over in other Local Government owned or operated centres, some of which are managed by the same manager responsible for the Centre. All of those centres try to achieve a balance between the commercial and non-commercial activities to ensure they deliver the greatest possible benefit to the local communities in which they are located. The approach adopted in this case will presumably have significant implications throughout South Australia.
- As mentioned in our earlier correspondence, we are mindful that the Clause 7 Statement says "the principles of competitive neutrality only need to be implemented where they are appropriate and only to the extent that the benefits to be realised from the implementation outweigh the costs". We trust that, in recommending how this matter should proceed, you will give consideration to whether the implications of applying cost reflective pricing (or, at least, full cost reflective pricing) will be of net public benefit to the Port Lincoln community. Given the non-commercial activities and the community service elements of the Centre, and the obvious detrimental impact that uncompetitive pricing would have on the ability of the Centre operator to deliver the public benefit outcomes of the Centre, serious consideration must be given to how the interests of the public are to be protected and the balance to be achieved in this situation.

We remain committed to complying with all relevant and applicable obligations. We are happy to discuss any of these issues with you if that would assist.

Yours sincerely



David Levey
ACTING CHIEF EXECUTIVE OFFICER