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Medibank Private Sale Bill 2006

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Medibank Private Sale Bill 2006

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Purpose

The purpose of the Bill is to make amendments and introduce provisions necessary to give effect to the Government's decision to sell Medibank Private in 2008.

Background

In April this year the Commonwealth Government announced its intention to sell Medibank Private, the health fund that has been government-controlled since its inception in 1976. As with many proposals for privatisation of publicly owned or controlled entities, the proposal to sell Medibank Private has met with much controversy. On 1 September this year, the Parliamentary Library released a Research Brief titled 'The proposed sale of Medibank Private: Historical, legal and policy perspectives' (the Research Brief).[1] The release of that document coincided with a public debate over the sale, culminating in the government announcing that the sale would not occur before 2008, but that it would proceed with the introduction of this Bill, in order to lay the groundwork for the sale. The Minister for Finance has denied that there has been any deferment of the sale.[2]

Rights of members of Medibank Private

One of the issues canvassed in the Research Brief was that of members' rights in the Medibank Private fund. One conclusion reached was that it was arguable that members had the right to the benefit of the existing surplus assets of the fund, and that a sale of Medibank Private, if it was to adversely affect those rights, could give rise to a claim against the Commonwealth for compensation.[3] Contrary to some media reports of the contents of the Research Brief, it did not suggest that the members own the fund. Nor did it suggest that the members could 'block the sale'. Rather, it concluded that any action was likely to come in the form of a claim by members for compensation.

After the release of the Research Brief, the *Sydney Morning Herald* reported that the board of Medibank Private Limited had received legal advice some years earlier that:

> … raised questions about whether the Commonwealth was the sole owner or its 2.8million members also had ownership rights.[4]

Other parties raised the issue of members' rights from a moral, rather than legal perspective. Notably, the Australian Medical Association (AMA) called for the fund to be mutualised, stating:

> The AMA, while not wishing to comment on the legality of the situation, doubts the morality of the sale given that much of the value of Medibank Private is in its financial reserves which were not contributed by the government but rather, extracted from the members in compliance with regulatory requirements. This does not imply any criticism of the regulatory requirements. Reserves are necessary for proper prudential management of private health funds.
>
> If the Government no longer wishes to be involved as an operator of a private health fund, there is a strong case for mutualising Medibank Private and retaining the equity with those who have contributed it, namely the members.[5]

The conclusions expressed in the Research Brief on the issue of members' rights prompted the Department of Finance and Administration to seek legal advice, which was tabled in Parliament by the Minister, Senator Minchin, on the 4th of September 2006. The advice obtained was prepared by lawyers Blake Dawson and Waldron.[6] The authors of that advice conclude, in relation to the central point canvassed in the Brief, that 'the Commonwealth will not be liable to pay compensation'.[7] The Blake Dawson Waldron advice appears to form the basis of the conclusions on this issue in the Explanatory Memorandum to the Bill. These conclusions unambiguously reject any suggestion that the members of Medibank Private could be entitled to compensation upon any sale, or that the members have rights in excess of those of, for instance, purchasers of car or house insurance.

Despite the stance taken on the legal issues involved, the government has, contrary to earlier indications,[8] now committed itself to including some entitlement for existing members in the eventual sale plan.[9] This may be in the form of a special entitlement to, or discount on, shares in any initial public offering. That the government recognises that its expressed legal conclusions may not be absolute is also demonstrated by the inclusion, in this Bill, of a number of 'safety-net' clauses, including one allowing an express right to compensation for members in the event that the kind of arguments highlighted in the Research Brief prove to be correct.[10]

Given that the details of any benefit to members to be included in a scheme for the sale of Medibank Private have not been made public, the issue of members' rights remains a live one, and, accordingly, will be revisited below. The legal issues involved are complex, and it cannot be said with certainty that the conclusions expressed in the Explanatory Memorandum and the Blake Dawson Waldron advice would not ultimately prevail. The reasoning offered in support of those conclusions is, however, open to question, and the conclusions expressed in the Research Brief–including that it is arguable that the

Commonwealth could be liable to compensate members of Medibank Private–remain valid.

In essence, the problem with the position that has been adopted by the Government is that it seeks to conceptualise the issues narrowly—characterising the status of members of Medibank Private as equivalent to of those of purchasers of contracts of insurance. This approach ignores or overlooks aspects of the legislative regime that support a different view. Successive Parliaments have fostered a regime for private health insurance in Australia that gives to members of private health insurance funds a status higher than that contended for by the Government. This broad problem can be seen in specific arguments raised by the Department of Finance and its advisers, as shown below.

Blake Dawson Waldron advice

As mentioned above, on Monday 4 September 2006, Senator Minchin, Minister for Finance and Administration, tabled in the Senate, an advice by solicitors Blake Dawson Waldron (the BDW advice). The substantive conclusions expressed in the BDW advice rely on three main premises:

- that membership of the Medibank Private fund entails primarily a contractual relationship that can be terminated on 2 months notice at Medibank Private Limited's discretion
- that members have no enforceable rights to benefit from the general assets of the fund otherwise than through claims under their insurance policies, and
- that Medibank Private Limited is the beneficial, as well as the legal owner of the fund assets.

The nature of membership of Medibank Private

Continuity of membership

According to the BDW advice, membership of Medibank Private entails primarily a contractual relationship that can be terminated on 2 months notice at Medibank Private Limited's discretion, and can only be secured in advance for a period of 12 months at most:

> Membership of the Fund is, under the Rules, dependent on payment of the premium in advance. MPL [Medibank Private Limited] may refuse to accept more than 12 months worth of advance premiums. In addition, MPL may terminate a membership on 2 months notice. It must give a reason for doing so, but termination would appear to be at MPL's discretion.[11]

It is worth taking a moment to absorb exactly what this proposition means. A person who had been a member of Medibank Private for many years, paid their contributions as they

became due, and acted within the rules of Medibank Private and the law could, according to the BDW advice, have their membership terminated arbitrarily, at any time, by Medibank Private Limited, provided it 'gives a reason for doing so.' The existing members of Medibank Private might well find this proposition alarming. They might wonder, for instance, about the integrity of the Government's 'Lifetime Health Cover' program, in respect of which Medibank Private's own website explains:

> About Lifetime Health Cover
>
> This Federal Government initiative rewards those who take out hospital cover early in life and maintain it, by allowing them to pay lower premiums throughout their life compared with others who take out hospital cover when they're older, or who allow their cover to lapse for long periods.

From a legal perspective, the proposition might, if true, have been a strong point in favour of the conclusions expressed in the BDW advice. This is because it would mean that members could scarcely claim entitlement to future long term benefits from fund assets as their memberships could be terminated at any time at the whim of Medibank Private Limited – they would have no right to *continuity* of membership.

In fact, the assertion made in the BDW advice is quite clearly incorrect. It is an error brought about by a narrow focus on the rules and constitution of Medibank private at the expense of a broader consideration of the regulatory regime for health insurance. The fund rules, cited in the BDW advice as the basis for the contract between the fund and members, are required, if they are to be of any effect, to be consistent with the *National Health Act 1953* and regulations, including any conditions of registration.[12] Private health insurers are subject, as a condition of their registration, to a number of requirements.[13] Included amongst those is the principle of 'community rating'. This principle has been described, by a former Coalition Government Health Minister, as a 'keystone' of the Australian private health insurance system.[14]

An organisation must ensure that its constitution, rules and actions, are at all times consistent with the principles of community rating.[15] There is a community rating principle in respect of the refusal or cancellation of memberships.[16] An organisation must not refuse or cancel a membership if such refusal or cancellation amounts to improper discrimination.[17] Improper discrimination is defined in section 66(1) of the National Health Act:

> 66(1) improper discrimination means a discrimination that is related to all or any of the following matters:
>
> (a) the suffering by a person from a chronic disease, illness or other medical condition or from a disease, illness or medical condition of a particular kind;
>
> (b) the gender, race, sexual orientation or religious belief of a person;

> (ba) the age of a person, except to the extent that the person's age may be taken into account under section 73BAAA and Schedule 2;
>
> (baa) the place of residence of a person, except to the extent that the person's place of residence may be taken into account under section 73AAL;
>
> (bb) any other characteristic of a person (including but not limited to matters such as occupation or leisure pursuits) that is likely to result in an increased requirement for professional services;
>
> (c) the frequency of the rendering of professional services to a person;
>
> (d) the amount, or extent, of the benefits to which a person becomes, or has become, entitled during a period;
>
> (e) any matter prescribed for the purposes of this paragraph.

As the Explanatory Memorandum accompanying the Bill that introduced the provisions quoted above explains:

> Community rating prohibits RHBOs [registered health benefits organisations] from discriminating against contributors in relation to access to private health insurance and the use of private health insurance products, except in specified circumstances.[18]

Even in cases of non-payment of contributions, registered organisations are effectively required to give members two months to bring their payments up-to-date.[19] The clear intent is to ensure free, fair and continuing access to health insurance. It is difficult to conceive of a situation in which a registered organisation, purporting to terminate membership without good reason, could convince an arbiter that it was not in breach of the community rating principle. The view that community rating affords protection for continuity of membership is one shared by the Department of Health and Ageing, which has advised that:

> Members are currently provided with the right of continuity of membership through the principle of community rating.[20]

The effect of these provisions is that, far from being liable to have their memberships terminated on two months' notice at Medibank Private Limited's discretion, members of the fund are entitled to retain their status as such, so long as they pay their dues and comply with the law (and any *lawful* fund rules). To the extent that any of the fund rules were inconsistent with that, they would be of no effect. The Medibank Private rule relating to two months notice, would, in the circumstances, be likely to be read down to mean that members who were not financial must be given two months notice to remedy, as is required under the Act. Any inquiry into the rights of members should begin, therefore, from the premise that continuity of membership is more a matter of the members' discretion than that of Medibank Private Limited.

Right to benefit of fund assets in not-for-profit funds

As pointed out in the Research Brief, the not-for-profit status of a registered health benefits organisation has consequences under the Act, including that such an organisation may not distribute profits and that all income of the fund must be credited to the fund, including income that is not *immediately* required for the payment of benefits.[21] Funds *not immediately required* for payment to members are nevertheless to be credited to the fund and not distributed as profits. When that requirement is read together with the express requirement to give priority to the interests of members in any dealing with fund assets,[22] it is difficult to conceive of what the legislative intent could possibly be other than that, in the case of not-for-profit funds, such income be retained for the ultimate benefit of members. The BDW advice tries to avoid this consequence by arguing that:

> It is clear that a payment of surplus to shareholders in a "for profit" registered health benefits organisation can be made while still giving priority to the interests of contributors. This is confirmed by section 73AAD(2)(d), which expressly allows for "for profit" registered organisations to make such payments.[23]

That argument is not convincing. The effect of subsection 73AAD(2)(d) is to make an exception to the principle that funds must give priority to members in dealing with assets, so that for-profit funds can distribute profits. It has no relevance for organisations that are not *established for profit*, as is the case with Medibank Private Limited. This serves to introduce another issue, that is, the change of status from not-for-profit to for-profit.

Not-for-profit and for-profit status

The BDW advice accepts that, at present, Medibank Private is a not-for-profit fund and that members could take action restraining Medibank Private Limited from distributing profits and even recover loss for a breach of the requirement (subject to being able to demonstrate such loss).[24] The BDW advice implies, however, that this could be avoided simply by Medibank Private Limited changing the provision of its constitution that makes it a not-for-profit company.[25] The effect of the BDW advice in this regard is that, an organisation might establish itself as a not-for-profit, register as such and hold itself out to members as being an organisation which is subject to all the applicable restrictions under the Act such as non-distribution of profits, and that its assets are to be managed with priority to members' interests, establish reserves on that basis over a period of years and then, without reference to members, unilaterally change its status and freely distribute its reserves as profit. If this were correct, the effect of the restrictions on not-for-profits under the Act could, in some circumstances, be entirely undermined. [On this point also see discussion below under schedule 2, Part 3, 'Profit status of Medibank Private']

In fact, the position is, to say the least, far more complex than the BDW advice contends. As the industry regulator, the Private Health Insurance Administration Council (PHIAC) acknowledges, the National Health Act is not entirely clear on the process of changing status.[26] The word 'profit' appears in only two subsections of the Act, and nowhere in the

regulations. In one subsection, it is used to clarify that 'an organization *established for profit*' may become registered as a health benefits organization, despite limits in place on profit distributions in not-for-profits.[27] In another, it is used to make clear that, 'if the registered organization has been *established for profit*' it may distribute profits to shareholders.[28] It is noteworthy that the phrase used on both occasions is 'established for profit'. On a literal interpretation, an organisation that was not established for profit cannot become so merely by changing its constitution or its rules. This point appears to have been grasped by those drafting the Bill, who have added a provision amending the National Health Act so that the phrase 'an organisation established for profit' is replaced with 'an organisation that is, or is to be, conducted for profit', and so that an organisation that is 'conducted for profit' may distribute profits and return capital to shareholders.[29] Indeed, this argument is expressly recognised in the Explanatory Memorandum.[30] These changes do not, however, affect the question of the current status of members' rights, which is central to a determination of the question of compensation.

On the current wording of the Act it is arguable that an organisation established as a not-for-profit could not alter that status by changing its constitution and would in fact be in breach of the Act if it distributed profits, despite anything in its constitution. A change of status could come about only by winding up the organisation and establishing a new organisation that was 'for profit'. This would hardly be a surprising result, given that historically, the industry ethos has been largely a not-for-profit one and its regulatory regime has been framed accordingly, with some recent and minimal exceptions in respect of organisations that are established for profit.

It should also be noted that PHIAC does not treat changes of status as being a simple matter of unilateral change of an organisation's constitution or rules. PHIAC has advised that there have been six occasions where organisations have changed their status to for-profit.[31] Where there has been a request to change status, the Department and PHIAC have convened registration committees to consider the issues. In making its decision, PHIAC has considered the interests of contributors and the financial position of the fund.[32] The latter is important because, in the case of a fund in a poor financial position, there may be no issue of loss of members' rights to benefit from fund assets. There may be no surplus asset position to enjoy. In the case of a fund in a good financial position, however, such as Medibank Private, it seems hard to make the case that a change of status that resulted in members losing their right to the benefit of the fund's financial position would be in their interests.

Relevance of repealed section 82ZGA

Another point made in the BDW advice in relation to members' rights that warrants a response is that relating to repealed section 82ZGA of the National Health Act. The Research Brief drew attention to the section and explained that:

> This section provided for the winding up of funds conducted by organisations which had not, by 1 February 1984, applied for registration as a combined 'health benefits'

> organisation (in that year the scheme of the Act changed from one registering separate 'medical benefits' and 'hospital benefits' organisations to one registering only 'health benefits' organisations). An interesting provision appeared in the form of subsection 82ZGA(3), which provided that, where a fund was to be wound up as a result of failure to apply for registration under the new regime, the scheme for the winding up of the fund must make provision:
>
> for the refunding to each person who was a relevant contributor to the fund, in respect of the contributions paid to the fund by him, of an amount equal to so much of the excess as bears to the amount of the excess the same proportion as the sum of the contributions made by the relevant contributor in respect of the relevant period bears to the sum of the contributions made by all relevant contributors in respect of the relevant period.[33]

The Research Brief notes that the section was repealed in 1992 but asserts that it remains of some interest. The BDW advice, on the contrary, asserts that:

> Those provisions are clearly irrelevant; indeed, their repeal demonstrates that Parliament intends that contributors as such *not* have such an interest in Fund assets.[34]

The first part of that assertion is debatable, and the second part is quite plainly wrong. The relevance of the section is that it provides support for the propositions that:

- the scheme of the legislation has always contemplated that the members have the ultimate entitlement to benefit from the fund assets, and
- the Health Insurance Commission did not hold beneficial ownership of the fund and its assets before Medibank Private Limited and hence that ownership could not have been transferred to the latter in 1998 (see below).

The repeal of the section does not have the effect contended for in the BDW advice. This is confirmed by reference to the Explanatory Memorandum to the Bill repealing the section, which explains that the intent was to 'repeal a number of redundant provisions relating to medical and hospital benefits funds which have been replaced by registered health benefits organisations'.[35] That is, the motivating factor for the repeal was simply the redundancy of the provision and the repeal does not evince any Parliamentary intention that contributors not have such interests in funds.

Rights of membership summarised

For the reasons outlined above, members of the Medibank Private fund have rights:

- to health insurance on the terms provided for in the organisation's rules and under the Act
- to continuity of membership (subject to acting lawfully and paying their contributions), and

- to have fund income credited to the fund and applied, ultimately, for their benefit.

Enforcement of members' rights

The second of the substantial points argued for in the BDW advice is that it cannot be said that members have any *enforceable* rights in the fund assets, apart from their rights to be paid health benefits under the rules. This is so, it is said, because:

> … there is no procedure under which a contributor could compel [Medibank Private Limited] to apply any Fund assets in a particular way.[36]

Medibank Private Limited could, the advice contends, 'simply "sit on" any surplus and contributors would have no recourse'.[37] The implication of this is that, without an enforceable right to benefit from the fund's asset position, members could not show they suffered by loss of the entitlement.

These conclusions are, to say the least, debatable. If Medibank Private Limited indefinitely 'sat on' surplus profits, it would almost certainly be in breach of the requirement in section 73AAC of the National Health Act that priority be given to the members' interests in the management of fund assets—unless it could demonstrate that, by doing so, it was somehow acting in the interest of members. It cannot be said with certainty that members could not enforce their rights under section 73AAC. Firstly, the National Health Act itself provides for a very broad enforcement scheme in respect of failures to conduct funds in accordance with its provisions. Under section 73BEM the Minister may apply to the Court for orders redressing breaches of the Act including orders for the *payment of compensation* to any individual for loss sustained as a result of the breach, and *any other order considered appropriate* by the Minister and the Court.[38] There is no reason why this could not be an order compelling a registered organisation to apply certain of its funds in a particular way. There is no also no reason why the Minister could not act bring such an application at the behest of a member or members. Hence, it is possible that a health fund could indeed be compelled to apply surplus income in a particular way, such as through lowered contribution rates.

Secondly, it is at least arguable that, quite apart from section 73BEM, members could, where a registered organisation unreasonably refused to apply surplus funds to their benefit, bring an action in their own right seeking compensation for breach of statutory duty, or for an order compelling the organisation to comply with the Act, perhaps by applying funds in a particular manner.

Beneficial ownership

The BDW advice argues that Medibank Private Limited is the beneficial, as well as the legal owner of 'the assets comprising the Fund'.[39] Beneficial ownership is equated with 'real' or 'true' ownership.[40] In *Commissioner of Taxation v Linter Textiles Australia Ltd*

(in liquidation) [2003] FCAFC 63, in considering the meaning of beneficial ownership, the Federal Court referred to the English Court of Appeal decision in *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077. The judges in that case considered that the term 'beneficial ownership' involved the ability to appropriate to oneself the benefits of ownership (per Lord Donovan at 1096) or the right to deal with the property as your own (per Harman LJ at 1097).[41]

Medibank Private Limited could not 'appropriate to itself' the fund assets nor does it have the right to deal with such assets as its own. It may have the right to deal with fund assets but it is required, under the National Health Act, to conduct such dealings in the interest of members of the fund.[42] The assertion is made in the BDW advice that 'it cannot be the case that "not for profit" status of an entity implies that the entity does not hold beneficial title to its assets'. That is not however, an accurate statement of the argument it seeks to refute. It was not argued in the Research Brief that not-for-profit health funds are incapable of having beneficial ownership in assets. It was pointed out, however, that fund assets are given special treatment in the National Health Act. The Act clearly distinguishes between funds and registered organisations and, equally clearly, between *assets of funds* and *assets of registered organisations*. There are many examples of this, perhaps the most significant of which is that there are separate regimes, under the Act, for the winding up of funds and the winding up of registered organisations, and those provisions distinguish between assets of funds and assets of registered organisations.[43] It is not that registered organisations cannot hold beneficial title to assets, but that they do not hold beneficial title to *fund assets*, the ultimate benefit of which is intended for the members.

Not-for-profit private health insurers are subject to requirements under the National Health Act that make them unique in many respects. One such respect, argued for in the Research Brief, is that assets comprising the health benefits fund are not beneficially owned by the organisation. The Act imposes certain rights and duties in respect of fund assets that have the effect that the fund assets are without beneficial owners. That is, without entities who can, at least while the fund operates, appropriate to themselves the usual benefits of ownership. The result is that a strong case can be made for the proposition put in the Research Brief that Medibank Private Limited is not properly described as the beneficial owner of the Medibank Private fund assets.

The BDW advice makes two further objections to this reasoning, being that:

- There is no canon of statutory interpretation that would lead to the conclusion that the Parliament intended by section 73AAC(1) to deprive registered health insurance organisations of the beneficial title to assets comprising the funds they operate. There is a long standing presumption that, without clear words, legislation is not to be interpreted as alienating or interfering with vested property rights; and
- if section 73AAC(1) were to have the effect that the Brief suggests, it would be invalid by virtue of the Constitution section 51(xxxi), as it would have amounted to an acquisition of MPL's property without compensation.[44]

Both of these arguments miss a critical point. Namely, what is being suggested in the Research brief and here is that Medibank Private Limited has *never* held the beneficial title to the fund and its assets. Hence, there is no question of the legislation taking anything away from the company. There are at least two reasons for this conclusion.

Firstly, transfer of assets from the Health Insurance Commission (HIC) to Medibank Private Limited was effected in 1998, by instrument made by the Minister's delegate under the *Health Insurance Commission (Reform and Separation of Functions) Act 1997*.[45] That instrument transferred various assets *owned by the Commission*. For the same reasons as outlined above, the HIC did not hold the beneficial ownership in fund assets and accordingly, the beneficial interest in those assets did not come within the class of things to which the instrument was expressed to apply (ie. assets owned by the HIC).

In addition, the Health Insurance Commission (Reform and Separation of Functions) Act defines the term 'asset' broadly to include beneficial interests, and hence gives a broad discretion to the Minister to make declarations vesting assets in Medibank Private Limited. It is notable, however, that the actual instrument effecting the transfer of the assets of the Commission and the fund to the company does not purport to transfer the beneficial interest in the fund or its assets to the company.[46] This can be contrasted with the instrument declaring the transfer of shares in Medibank Private Limited from the Commission to the Commonwealth, which expressly transfers the 'legal and beneficial interests' in the shares.[47]

Conclusion on members' rights

As expressed in the Research Brief, it is arguable that members of Medibank Private could be entitled to compensation if the terms of any sale do not adequately account for their right to the benefit of fund assets. It was not asserted in the Research Brief, and is not asserted here, that this means that Medibank Private is owned by its members, or that members could block the sale. Additionally, the argument made in the Research Brief and here is that members may have rights over the existing assets of the fund. The Research Brief refers to Medibank Private's 2005 annual report which cites a net asset figure of $653.3 million.[48] It is this figure in respect of which members' entitlement is discussed (account would also need to be taken of the Commonwealth's $85 million equity). It is not argued, for instance, that there is an entitlement to any premium that Medibank Private as a business would attract on sale. If any entitlement to be offered to members upon a sale is of a value that reflects the net asset position, then the question of compensation may not arise.

Policy arguments for the sale

The two main policy arguments made by the Government in relation to this Bill are essentially the same as those made in April 2006 when it announced its intention to sell Medibank Private.

The first of these relates to the implications of the sale for *competition* in the private health insurance sector. The Government's argument is that:

- a scoping study by Carnegie Wylie has found that privatisation will enable Medibank Private to operate more efficiently, through lower management expenses and expansion into new business areas, and
- this would lead to greater competition in the private health insurance industry as a whole (and hence place 'downward pressure' on premiums).

The other argument made by the Government is that selling Medibank Private will remove the Government's 'conflict of interest' in being both the industry regulator and owner of the largest player in the industry.

Competition issues

The Research Brief examined the Government's competition-based arguments for the sale and found that there was 'little evidence to support assertions that a privatised Medibank Private would be more efficient, competitive and less expensive for consumers'.[49] Since the Research Brief was published, the Government has announced that it intends to sell Medibank Private through a share market float in 2008. The Bill seeks to authorise and facilitate this process. An important feature of the proposed changes, from a policy, as well as a legal, perspective, is the conversion of Medibank Private from a not-for-profit to a for-profit business.

To what extent does the additional information about the mode of sale assist with understanding its likely impact? Does this information lead to the conclusion that a privatised Medibank Private will be more competitive?

It can be reasonably assumed that greater competition would be a likely outcome of the sale if the following were the case:

- conversion of Medibank Private to a private, for-profit health fund would enable it to overcome any significant constraints on competitiveness imposed under current regulatory arrangements, and/or
- some other opportunity(ies) for enhanced competitiveness (not related to regulatory constraints) became available to Medibank Private as a result of its conversion to a private, not-for-profit health fund.

Regulatory burden and competition

A publicly listed Medibank Private would not have any more freedom under the Act and regulations than it has under its current ownership arrangements. The only exception to this is in relation to the probable change in status to 'for-profit'. If such a status change is achieved, then Medibank Private Limited will be able to distribute profits. This in itself would not necessarily allow Medibank Private to operate more efficiently or effectively. Indeed, some argue that it may simply have the effect of adding an additional layer of cost to the business. As Medibank Private argued in its 1996 submission to the Productivity Commission's inquiry into private health insurance:

> A situation where a for-profit 'middleman' (health insurers) is also involved [in addition to private for-profit healthcare providers] will unnecessarily escalate the premium (price) for private health insurance.[50]

The Government has argued that a privately owned Medibank Private would have lower management expenses than it achieves under current ownership arrangements. Management expenses are the costs of administering the fund and include rent, staff salaries and marketing costs. A privatised Medibank Private could seek to reduce costs in any of these areas. However, from a regulatory point of view, there is nothing that a privatised Medibank Private could do to achieve such efficiencies that it cannot do under its current ownership status.

The Explanatory Memorandum argues that the sale will:

> … reduce the administrative requirements that Medibank Private Limited has because of its status as a Government Business Enterprise [GBE] and enable it to compete on a more equal basis with other major private health insurers, which are not subject to these obligations.

These administrative requirements derive principally from the provisions of the *Commonwealth Authorities and Companies Act 1997* and requirements of the Governance Arrangements for Commonwealth Government Business Enterprises (1997).[51] It is true that these requirements constitute a governance burden that does not apply to other health insurance organisations. However, the Explanatory Memorandum does not make clear whether the removal of the governance burden it faces as a Government Business Enterprise would reduce the management expenses of a privatised Medibank Private in any significant way. There is likely to be some reduction in management costs but this could potentially be balanced out by the additional costs associated with its responsibility to distribute profits to shareholders.

The case made for the sale also suggests that an additional source of competitiveness would be that a privatised Medibank Private would be able to expand into new business areas. However, as noted above, from a regulatory point of view, the only difference between a for-profit and not-for-profit health benefits organisation is that the former is entitled to distribute profits to shareholders. There would be no change to the areas in

which it is entitled to do business. While the government is planning changes to the regulation of the sector (through a forthcoming Private Health Insurance Bill) that would enable funds to expand into new areas of business (for example, out-of-hospital care, financial services, life insurance and other general insurance products) these are intended to apply to *all* registered health funds, not just for-profits.[52]

Other avenues for increased competitiveness

A privatised Medibank Private would be in a better position to raise capital through the issuing of shares. One way that this could potentially improve operational efficiency is through the use of this additional capital to invest in such things as improved information technology systems or organisational restructuring. Such investments could, in theory, lead to the kinds of operational efficiency gains that might make Medibank Private more competitive.

While, as noted in the Research Brief, Medibank Private has traditionally been particularly aggressive in pursuit of expansion, innovation and in competition with other funds, there is also the possibility that Medibank Private could diversify into areas of business other than insurance and that this may provide scope for increased competitiveness. Medibank Private Chief Executive Officer, George Savvides, while arguing that 'there are no constraints [associated with the current ownership arrangements] about being a best practice organisation in the health sector today', has also argued that privatisation could 'possibly' allow the fund to 'achieve greater goals'.[53] It is not clear what goals Mr Savvides had in mind nor why a privatised company would be better placed to achieve them. It *may* be that political imperatives associated with public ownership might constrain Medibank Private from taking advantage of attempts at business diversification that for some reason were electorally unpopular (though there is no evidence that this is currently the case).

One claim about how the sale of Medibank Private might increase competitive pressures in the sector is through inspiring a wave of ownership changes among other funds in the sector. As noted in the Research Brief, Standard and Poor's has recently argued that any sale of Medibank Private is likely to 'materially affect the competitive dynamics of the industry'.[54] While Standard and Poor's did not specify the precise nature of the effect on competitive dynamics, it appears to see the main impetus for change in the possibility that the sale may lead to rationalisation and greater concentration within the industry.[55]

However, the Government's intention to sell by way of share float appears to diminish the possibility that the sale will inspire a wave of industry rationalisation/concentration. This is because Standard and Poor's view appears to be predicated on the possibility that Medibank Private would be sold to another fund. The idea was that this would lead to the creation of a very large health fund and that other funds would seek to increase in size (e.g. through amalgamations) in order to compete. Floating Medibank Private on the share market is unlikely to have this effect (in the short term) because it is likely that this would simply lead to a change of ownership, rather than the creation of a new, larger health fund.

This is made likely by provisions in the Bill that prevent any one person from holding a stake of more than 15% of Medibank Private.[56] These provisions hold for five years from the 'designated sale day'. It is possible that after five years a large fund (for example) could take a larger stake in Medibank Private and that this could set off a wave of additional amalgamations in the sector. The likely impact on competitiveness within the sector of this kind of future scenario is unclear at this stage.

Summary

The Government argues that the sale of Medibank Private will lead to reduced management costs and allow the fund to pursue new areas of business but it is unclear how these improvements will be realised. The proposition is based on the conclusions of a scoping study undertaken by Carnegie Wiley, however detailed information from the study has not been provided. This means that there is very little publicly available information to support such claims.

There would appear to be nothing, from a regulatory point of view (apart from being able to distribute profits to shareholders), to show that the 'new' Medibank Private will be able to do to improve its operations that the current organisation cannot. A privatised Medibank Private would be free from the governance burden that applies to GBEs but it is not clear whether this would significantly reduce the organisation's management expenses. A publicly listed Medibank private could potentially improve operational efficiency through the use of additional capital to invest in improved information technology systems or organisational restructuring. However, it is not clear that any reduction in management costs would be greater than the potential increase in costs associated with Medibank Private's new responsibility to distribute profits to shareholders.

As noted in the Research Brief, in 2005, BUPA (Australia's largest for-profit health fund), had lower management costs and premiums than Medibank Private and than the industry average. However, it had less success in retaining members, received a higher proportion of total complaints compared to market share and returned a lower percentage of benefits to members as a percentage of contributions.[57] This highlights the difficult regulatory and operational environment in which *all* private health funds must operate (regardless of ownership status). Premiums, benefits and levels of service are part of a finely balanced, integrated whole, rather than aspects of performance that can be easily separated and traded-off against one another.

Conflict of interest

The Government has often argued that selling Medibank Private will remove what it describes as its conflict of interest in being both the regulator of the industry and owner of the main health fund. The implication is that under current arrangements, the Government is in a position to regulate the sector in a way that advantages it as a business owner.

In theory, it is possible that the Government could act in such a way, though the Government has not provided any explanation of the likely form/s of any such conflict. Medibank Private receives no obvious regulatory advantages over health benefits organisations. There is no direct financial incentive for the Government to provide such advantages given that it does not receive dividends from Medibank Private. Arguably, there is a potential conflict of interest related to the fact that the Government is both the regulator of the sector and the vendor in any possible sale in that it could conceivably regulate the sector in such a way as to maximise the share price for Medibank Private. However, any such conflict exists simply by virtue of the Government's decision to sell, not in relation to the ordinary operation of the organisation.

Further, it could be argued that the Government sufficiently addressed the conflict of interest issue when it decided in 2003 to make the Minister for Finance and Administration the sole Commonwealth shareholder of Medibank Private, 'to provide a clear distinction between the Commonwealth's roles as industry regulator and business owner'.[58] Previously, the Commonwealth's shareholding in Medibank Private had been administered jointly with the Minister for Health and Ageing.

The assumption that there is an inherent and/or problematic conflict in being both the regulator of an industry and owner of a major player in that industry also requires comment. First, it appears to imply that governments are not capable of dealing with conflicting imperatives in an appropriate manner. Second, there may be particular instances where the advantages associated with any real or perceived conflict might be considered to outweigh the disadvantages associated with its removal. For example, some have argued that a predominately not-for-profit private health insurance sector is more likely to focus on the needs of members and on community objectives such as equity than a predominately for-profit sector.[59] One outcome of the removal of the government's potential conflict of interest through privatisation will be to make the largest single private fund (Medibank Private has 29 per cent of market share) a for-profit fund and hence significantly increase the profile of the for-profit segment of the sector.

While not strictly a conflict of interest issue, some have argued that it is inappropriate that the Government is in a position to subsidise Medibank Private's operations through the provision of capital. As the Liberal Party Senator for Tasmania, Guy Barnett, a prominent advocate for the sale of Medibank Private, has argued:

> How is it that such a large government funded asset is able to draw on taxpayers' funds to bolster its own dominant position, while being of no benefit to a large number of taxpayers who, I might add, either have no private health insurance or have membership with other private health insurers? Such a distortion of the market cannot be and should not be tolerated. It is entirely unfair on other health funds and their members … The fact that from time to time taxpayers are asked to contribute funds to Medibank Private creates an unfair playing field for other private health insurers, given that this fund is the country's biggest player.[60]

The Government has provided capital to Medibank Private on three occasions since 1976. Further, as noted in the Research Brief, when the fund was operated by the HIC, Medibank Private's financial operations were always kept separate from those of the Commission and its other functions—that is, Medibank Standard then Medicare—so that the government did not subsidise the operation of Medibank Private, its administration was paid for from members' contributions.

As can be seen from the table below, the first two of the Government's capital injections were relatively small amounts related to the establishment of the organisation and can be regraded as having been repaid. The third injection (of $85 million) was provided to consolidate Medibank Private's capital structure (not, as is sometimes claimed, to bail the organisation out of debt).

Table 1: Commonwealth capital input into Medibank Private

Year	Amount	Reason	Amount owing	Explanation
1976	$10 million	Commencement of fund	Nil	Entire amount returned to the Commonwealth (a)
1978	$11 million	Establishment grant	Nil	Payment was partial compensation for $13.3 million paid by Medibank Private to Commonwealth for benefits wrongly paid by Medibank Standard. An amount of $9.4 million, which was owed by other private funds and which arose in a similar fashion, was written off. Medibank Private was not compensated for the $2.3 million difference (b)
2005	$85 million	'To consolidate a capital structure more consistent with industry practice. Prior to this, Medibank Private had almost 30 per cent of the health insurance market risk, but only 16 per cent of its capital'.		Commonwealth purchased 85 million $1 shares.

(a) On 4 December 1978 the Government decided to 'capitalise' the original grant of $10 million (that is, change it to capital of the Health Insurance Commission).[61] The $10 million was, however, eventually returned to the Commonwealth by Medibank Private apparently due to an administrative oversight in not giving the Government decision of 1978 appropriate legal standing[62]

(b) Therefore, according to Medibank Private, 'while other funds were relieved of liability for their debt, Medibank Private effectively repaid $2.3 million of the total amount owed'.[63]

It is, therefore, correct to state that the Government has provided some capital funding to Medibank Private. However, the question of whether this can be regarded as inappropriate is not as clear. in any case, as suggested above, the argument can be made that the advantages associated with any real or perceived conflict might be considered to outweigh the disadvantages associated with its removal.

Position of significant interest groups and other commentators

Those to have declared support for the sale of Medibank private include:

- Catholic Health Australia
- MBF Australia Limited (Australia's second largest health fund)
- BUPA (as noted above, Australia's largest for-profit health fund)[64]

Those to have declared opposition to the sale include:

- the Australian Medical Association (AMA)
- the Doctors Reform Society
- the Community and Public Sector Union
- the Health Services Union
- the Save Medibank Alliance (a group including Professor John Deeble, one of the founders of the original Medibank and Ray Williams, former general manager of Medibank Private).[65]

The Australian Consumers Association (ACA), while raising concerns about the impact on premiums, has not directly indicated whether it supports or opposes the sale.[66]

ALP/Australian Democrat/Greens/Family First policy position/commitments

The ALP, Greens and Family First have each declared opposition the sale and can be expected to vote against this Bill.[67] Recent comments by the leader of the Australian Democrats, Senator Lyn Allison, in which she described the sale as 'unnecessary and ill-considered' and raised concerns that the inquiry into the Bill by the Senate Standing Committee on Finance and Public Administration will not be 'full and proper' indicate that the Democrats are also likely to vote against the Bill.[68]

Financial implications

The Explanatory Memorandum suggests that the financial impact of the sale on Medibank Private, the Government and the business sector, is difficult to quantify and will depend on variables such as market conditions, demand for Medibank Private shares, the scale of the proposed capital raising and the impact of regulatory changes for the sector.

Main provisions

Clause 3–Designated sale day

Clause 3 provides for the 'designated sale day' which must be declared when the Minister for Finance is of the opinion that all shares in Medibank Private are held by persons other than the Commonwealth, or a wholly owned Commonwealth company.

Schedule 1

Part 1–Sale of the Commonwealth's equity in Medibank Private Limited

Items 1 to 3 amend the *Health Insurance Commission (Reform and Separation of Functions) Act 1997*. The provisions to be amended have the effect of requiring the Commonwealth to retain ownership of shares in Medibank Private Limited.

Part 2–Amendments regarding distribution of profit and associated compensation scheme

Items 4 and **5** amend the *National Health Act 1953* so as to change the reference in section 68(3) of the Act from 'an organisation established for profit' to 'an organisation that is, or is to be, conducted for profit', and to make a similar amendment to section 73AAD. The amendments also provide expressly for the distribution of profit and return of capital to shareholders in an organisation 'conducted for profit'. These changes are in recognition of the fact that it is arguable that, merely by changing its constitution, or even its registration status, Medibank Private would not become an organisation 'established for profit'. For more on this see above under the heading 'Not-for-profit and for-profit status'.

Item 6 adds **subparagraph (3)** to section 73AAD. This section effectively provides that surplus funds generated whilst Medibank Private Limited (and other registered health organisations) can distribute profits accumulated whilst it was operating as a not-for-profit. This provision is central to the question of compensation for members discussed above, and in the research brief. It effectively undermines the long-standing provisions of the National Health Act preventing distribution of such profits and, as outlined above, could give rise to a claim for compensation on the part of existing members of the Medibank Private fund, depending on the terms of any eventual sale. Item 6 is not confined in its operation to Medibank Private Limited. It will apply to other registered

organisations who change their status from not-for-profit to for-profit, but such changes of status for other organisations will be subject to ministerial scrutiny, and will be disallowable where the Minister is of the opinion that they are unreasonable or inequitable.[69] As a result of this Bill, the Medibank Private change of status will not be subject to the same scrutiny (see below under 'Part 3–Profit status of Medibank Private).

Item 7 provides for a safety-net compensation scheme, in the event that the amendments to section 73AAD do in fact constitute an acquisition of property within the meaning of that phrase in section 51(xxxi) of the Constitution. The effect is that, if the amendments did amount to such an acquisition, they would not be invalid, by reason of non-compliance with section 51(xxxi), because a scheme for compensation would be in place. Although the Explanatory Memorandum describes this outcome as being 'unlikely', the inclusion of this scheme in the Bill amounts to a concession that the kind of propositions put in the Research Brief regarding the question of compensation for members are arguable.

Schedule 2

Schedule 2 provides a number of technical and substantive provisions for the facilitation of the sale of Medibank Private Limited. The more significant provisions are outlined below.

Part 2–Medibank Private sale scheme

Part 2 has provisions which anticipate a broad range of sale schemes that may be chosen to effect the sale of Medibank Private. Provision is made for the transfer of the Commonwealth's equity in Medibank Private Limited to a holding company, prior to a transfer of shares in that company to other parties. The term 'Medibank Private company' is utilised to include both Medibank Private Limited and any holding company.

Many provisions of **Part 2** provide for the payment of expenses involved in the sale to be made from the Medibank Private fund. They expressly provide that such payments do not breach the restrictions in the National Health Act on how the fund can be used or the requirement that fund assets be dealt with giving priority to members' interests.

Further details of the sale scheme provisions are provided in the Explanatory Memorandum.

Part 3–Profit status of Medibank Private

Item 20 is directed at clearing any obstacles to Medibank Private amending its rules and constitution so as to enable it to:

- conduct itself for profit

- distribute profits, and
- return capital to shareholders.

All of which it is prevented from doing at present. Medibank Private members will be required to be notified 60 days before any such change, but this is for information purposes only–the Bill gives does not give members a right to prevent the change.

Paragraph (10) of **item 20** makes section 78 of the National Health Act inapplicable to a change of Medibank Private's rules in the manner specified above. Essentially, section 78 exposes proposed changes to the rules of registered organisations to ministerial scrutiny. It includes this provision:

> (4) Where the Minister is of the opinion that a change:
>
> (b) imposes an unreasonable or inequitable condition affecting the rights of any contributors; or…..
>
> the Minister may, by declaration in writing, declare that the change shall not come into operation.

One result of the inapplicability of section 78, then, will be that the Minister for Health will not be required to consider whether the change of rules to allow the distribution as profit of surplus member's contributions accumulated whilst Medibank Private operated as a not-for-profit, is unreasonable or inequitable.

Paragraphs (11) and (12) of **item 20** indicate that the Government has received advice that a change of profit status might give rise to claims by members for damages for breach of the *Trade Practices Act 1974*, or for breach of contract. This is quite separate from the kind of compensation considerations outlined in the Research Brief. Specifically, paragraph (12) expressly anticipates the possibility of claims that representations were made to the effect that 'Medibank Private is not, or will not be conducted for profit' (and hence that members would be joining a not-for-profit organisation that would be bound by its rules and the National Health Act not to convert surplus funds to profit). The concern appears to be that these such representations could have constituted misleading conduct, or conduct likely to mislead, and hence breach the Trade Practices Act, or that the representations could have formed a term of a contract between Medibank Private and its members. Paragraphs (11) and (12) of **item 20** negate any such result, by providing that representations that Medibank Private is not, or will not, be conducted for profit, do not result in breaches of the Trade Practices Act, breaches of contract, or a breach of another law. In anticipation of the possibility that this extinguishment of any right to claim damages might itself amount to an acquisition of property other than on just terms, a 'safety-net' compensation provision relating to these provisions has been included in the Bill.[70]

Part 4–Restrictions on ownership of Medibank Private companies

This Part has effect for 5 years from the 'designated sale day' (see clause 3 above). It is directed at preventing an 'unacceptable ownership situation' pertaining to Medibank Private. Essentially, this means that one person cannot hold a stake of more than 15% of Medibank Private.[71] The Federal Court is empowered, on the application of the Minister for Finance or the relevant company, to make remedial orders where any unacceptable ownership situation arises.[72]

Item 31 provides that schemes entered into for the purpose of avoiding the restriction on ownership provisions, where they result in increasing a stakeholding, can result in the Minister for Finance directing the relevant stakeholder to cease holding the stake. Such directions are to be reviewable by the Administrative Appeals Tribunal. **Items 33** to **42** provide broad definitions directed at preventing avoidance of the restrictions on ownership.

Part 5–Australian identity of Medibank Private companies

Like **Part 4**, this part operates only for 5 years after the designated sale day. The part provides, essentially, that Medibank Private must:

- ensure that its central management and control is ordinarily exercised in Australia
- ensure that it maintains a substantial business and operational presence in Australia
- ensure that it remains incorporated in Australia, and
- ensure that a majority of its directors are Australian citizens.[73]

Part 8 has miscellaneous provisions including a general safety-net compensation scheme in case the provisions of Part 2 amount to an acquisition of property that would, but for the provision, be other than on just terms.[74]

The Minister for Finance is expressly given the power to delegate powers granted by schedule 2 to either the Secretary or a Senior Executive Service employee of the Department of Finance and Administration.

Concluding comments

This Bill contains provisions necessary to facilitate the sale of Medibank Private. As noted above, and in the Research Brief, a sale that does not adequately account for the interest of members in the Medibank Private fund may result in a liability to pay compensation to members. The Government has indicated that it intends to offer some form of benefit to members, but is yet to specify details. This Bill contains no provisions for such benefits. The Bill contains various 'safety-net' compensation provisions, making it unlikely that it

would be found to be constitutionally invalid in the event that it was found to acquire the property of members. Any redress available to members in such circumstances is likely to be limited to a claim for compensation.

The Bill contains safeguards directed at securing the Australian character of Medibank Private, and at ensuring diversified ownership. It should be noted, however, that these provisions will expire five years after Medibank Private is sold.

The Government's policy arguments in relation to this Bill are essentially the same as those made in April 2006 when it announced its intention to sell Medibank Private. First, it argues that the sale will enable Medibank Private to operate more efficiently, through lower management expenses and expansion into new business areas, and that this will lead to greater competition in the private health insurance industry as a whole. Second, it argues that selling Medibank Private will remove the Government's 'conflict of interest' in being both the industry regulator and owner of the largest player in the industry.

The Research Brief suggested that there was little evidence to support the views about the benefits of selling Medibank Private. Limited further information has been made available about the sale—principally, that it will be through a share float with Medibank Private converted to a for-profit fund. This clarification creates a further problem for the Government's case that a privatised fund will be more efficient, in that Medibank Private will have the additional responsibility of distributing dividends to shareholders.

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22. National Health Act, section 73AAC(1).
23. par. 29.
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Members, Senators and Parliamentary staff can obtain further information from the Parliamentary Library on (02) 6277 2743.