

CHAPTER 7

THE COMMERCIAL OPERATIONS OF UNIVERSITIES

...in an ideal world public assets would not be used to subsidise private arrangements but in the way we have forced universities to go, there has been little choice but for universities to think about how to use their assets.. so that they can gain from commercial activities.¹

Public universities are legally defined as charitable organisations, whose main purpose is the provision of a service or benefit to the public. As such, they are able to enter into ‘commercial’ activities only inasmuch as those activities are relevant to their charitable purposes, and only on the basis that any funds they raise are directed to enhancing their capacity to fulfil those charitable purposes. The term ‘private commercial activities’ of public universities needs to be considered in this context.²

7.1 These comments, from a university vice-chancellor and a state Minister for Education respectively, highlight the tensions surrounding universities’ commercial operations. Universities are public institutions with a primary mission of providing a public good in the form of education and research and their commercial operations should be undertaken within that framework. This is clearly the view of state governments, which retain responsibility for regulation and oversight of universities’ financial and commercial operations. However this notion is noticeably absent from the Commonwealth Government’s current financial and policy settings, with their emphasis on developing private sources of income as a substitute for government funding. Universities have been left to navigate these tensions with little, if any, leadership and support from the Commonwealth.

Overview of universities’ commercial operations

7.2 At last count, thirty-four Australian public universities operate, between them, approximately two hundred and eighty commercial entities.³ These commercial operations cover a wide range of functions including: fully-owned firms that provide catering and accommodation services for students; companies providing educational services on a purely commercial basis; off-shore campuses; commercial arms that act as brokers and manage universities’ consulting and corporate research services; and, most recently, a private university. Increasingly universities are also taking equity shares in spin-off companies established to commercialise the intellectual property of their staff. Some have also entered into financial commitments with international

1 Professor Mary O’Kane (University of Adelaide), *Hansard*, Sydney, 17 July 2001, p.973

2 Submission 339, Queensland Minister for Education, pp.2-13

3 Senate Legislation Committee – Questions on Notice 2000-2001 – Additional Estimates Hearing – DETYA – Question E366

consortia providing educational services and have franchise arrangements with other educational service providers. The proliferation of these arrangements in recent years in response to Government policy and financial settings, and the commitment, in some cases, of large sums of money or valuable university assets to commercial ventures, as well as the large financial losses incurred by some, raise a host of public policy issues. These include universities' role and responsibilities as public institutions, the appropriateness and legality of public assets being used to support or subsidise commercial activities and whether universities' commercial operations give rise to any public liability. Professor Simon Marginson, in evidence to the Committee, in May 2001, noted that:

There are questions to be asked and answered about the degree to which universities are subsidising their commercial operations and the kind of benefit which they, the public and the students derive from the commercial operations of universities.⁴

7.3 A number of state Auditors-General have also identified an apparent 'accountability gap' in which some commercial organisations may operate. Current regulatory frameworks are said to be under pressure from 'the requirements felt by universities to engage in commercial activities, including trading off-shore, establishing and operating wholly-owned companies, entering into joint ventures and out-sourcing components of their traditional business.'⁵ Evidence presented to the Committee indicates that few, if any, state governments have either the resources or the legislative powers necessary to effectively monitor the operations of the plethora of commercial entities.

7.4 Questions have also been raised about whether universities' commercial operations should enjoy the same tax-exempt status as their parent university and whether some operations may be in breach of National Competition Policy. State Auditors-General and staff and student representatives have also criticised the lack of transparency that has characterised the arrangements for the establishment of some commercial entities or arrangements, which is seen to be at odds with universities' character as public institutions. Underlying all of these issues are the broader questions about whether the assets of public universities are always, by definition, public assets, and whether universities can continue to have the 'best of both worlds' by enjoying the benefits of public and charitable status and of commercial arrangements.

7.5 As autonomous institutions, universities are able to generate revenue, including by borrowing funds, and to make expenditures as they see fit, provided they comply with requirements of state legislation, of any relevant Commonwealth legislation and of any requirements that the Commonwealth Government has attached to the grant of Commonwealth funds. In New South Wales, for example, the *Public*

4 Professor Simon Marginson, *Hansard*, Melbourne, 14 May 2001, p.32

5 Submission 339, Queensland Government, pp.2-13

Authorities (Financial Arrangements Act)2000 places some constraints on universities' investment powers and borrowings.⁶ Within this framework, universities are free to pursue commercial activities, including establishing commercial entities.

7.6 While many universities established commercial arms or offshoots from early on in their history, these entities were generally peripheral to their core business activities and had limited budgetary impact in terms of either revenue or expenditure. Typical examples included companies established to manage universities' foundations and self-funding catering operations and, during the last two decades, organisations with responsibility for managing technology transfer and consulting activities. This has changed with the contraction of government funding in the last five years. There has been a marked change in the scale, nature and complexity of universities' commercial operations. Many of the newer commercial operations have serious implications for universities' legal and financial standing and, in some cases, for the reputation of Australia's higher education sector.

7.7 This chapter will examine issues associated with a number of these new commercial arms, with particular emphasis on cases where universities have made large investments in speculative, commercial ventures with no guarantee or likelihood of return in the short-term. It will also examine other commercial operations where universities' focus on generating income has exposed them to serious financial, legal or reputation risk, or where public assets are being used to subsidise private operations. These include: international consortia involving overseas universities and multi-national companies and off-shore campuses or arrangements where universities have 'invested' their reputations without requiring adequate quality assurance arrangements; 'spin-off' companies established to commercialise the results of publicly-funded research, in circumstances where the return to the public university is extremely low and where there are hidden subsidies in the form of access to publicly-funded staff and facilities; franchise arrangements with private educational service providers involving preferential access to university courses; private arms providing educational services for the corporate market; and the establishment of a private university.

7.8 The commercial relationships involved with these new commercial arrangements can be complex and diverse and require commercial and financial expertise,⁷ often not available in public universities. Management of these commercial operations may also make heavy demands on universities' governing boards and management, at the expense of a focus on core teaching and research activities. The changes in governance and management structures which may be dictated by the need to manage commercial entities⁸ can also be at odds with, and potentially undermine, universities' capacities to discharge their public responsibilities. As indicated, the

6 Submission 287, University of Western Sydney, pp.8-9

7 *ibid.*

8 M Gallagher, *The Emergence of Entrepreneurial Public Universities in Australia*, Higher Education Division, Occasional Paper Series 2000E, September 2000, p.45

increasing diversity of commercial entities and arrangements is also highlighting deficiencies in the current regulatory regime.

Use of public assets for commercial operations

7.9 The Committee notes that the formation of commercial entities requiring the investment of large amounts of seed capital and moderate to high degrees of risk, and the injection of equity or support of loans to cover losses of existing commercial arms,⁹ is an increasing feature of the higher education sector. This trend reflects universities' responses to government policy directions, which exhort financial self-reliance, and reduced public funding. The emergence of these more risky, speculative operations raises questions about the probity of using universities' public assets to support or subsidise commercial operations and the legal or financial liability that public universities may bear for the operation of their commercial arms.

7.10 Questions relating to the investment of universities' public assets raise the broader question of whether it is possible to distinguish between universities' public and private assets and whether universities need to be accountable to the public for the use of their private income.

7.11 Universities responding, through DETYA, to a question in the Senate Additional Estimates Hearing 2000-2001, and reporting the injection of equity or the provision of loans to their commercial entities, all reported that 'no Commonwealth funding was provided.'¹⁰ One response elaborated that 'any funding in an emergency would be provided from international student fee income.' DETYA's response included the further explanation that:

Universities derive substantial income from non-government sources, which are much larger than any deficits recorded by those universities. Also, all the universities have confirmed in their written responses.. that no Commonwealth funds have been utilised to fill the gap created by any losses. Apart from assurances of the Vice-Chancellors, the university accounts are audited by state auditors (in the case of the Australian National University and the Australian Maritime College, the Commonwealth Auditor-General) and there has been no report from the auditors about any

9 Senate EWRSBE Legislation Committee, Additional Estimates Hearing, 200-2001, Questions on Notice – DETYA Question E367 indicated that, of the 'Group of Eight' universities, information had been provided on the following provision of financial support to commercial arms: the University of New South Wales had provided \$7 million in equity to its commercial arm Unisearch Limited between 1998-2000 and in 1999 approved a \$10 million interest free loan; Unisearch reported a loss of \$5.2 million in 1999; The University of Melbourne reported a loss of \$1.35 million for Melbourne University Private Limited in 1999; (information on other financial support provided to MUPL is reported elsewhere in this section); the University of Queensland provided a total of \$12.16 million in equity funding and loans to a range of commercial entities over the period 1995-96 to 1999; the University of Adelaide provided loans totalling \$0.9 million over the period 1995-1998 to Camtech (SA) Pty Ltd

10 Senate EWRSBE Legislation Committee, Additional Estimates Hearing, 200-2001, Questions on Notice – DETYA Question E367

university utilising Commonwealth moneys to cover losses of private commercial arms.¹¹

7.12 The Committee believes this explanation to be unsatisfactory. DETYA is, of course, well aware, as some of its other publications indicate, that universities do not 'quarantine' or 'ring-fence' their public and earned revenues and, as a consequence, unable to guarantee that funds extended to their commercial operations are not drawn from the public purse. Nor does the fact that the amounts in question may be equal to or less than the total of an institution's earned income suggest that there is little risk of public funds being used for such purposes. As this report indicates in Chapter 3, earned income is not disposable, discretionary income: it is usually tied to the provision of specific services and, in many cases, must also go to cover the costs incurred in generating it. DETYA's apparent unconcern also contrasts with its recent decision, partly in response to concerns raised by state governments, to review the regulatory framework for universities' commercial activities. This clearly suggests that the Government recognises, albeit belatedly and under duress, that there is a problem.

7.13 In addition, the DETYA position assumes that it is possible to distinguish between universities' public and private assets. This contrasts with the view taken by the Victorian Auditor-General, who has declared that all assets of public universities are public assets, and should be treated accordingly, irrespective of their source, because they have been developed through the public university.¹²

7.14 This question has arisen recently in the case of Melbourne University Private Limited (MUPL). The Committee heard evidence from the chair of the panel that assessed the application for MUPL to be registered as a private university (owned by the University of Melbourne) that the panel had been advised that the University's Council had approved the commitment of certain funds to MUPL 'on the condition that they did not come from the university's government grant.'¹³ The clear implication of such a condition is that the University could separately identify those funds sourced from the Government and other avenues, with the latter presumably not subject to the constraints that might apply to public funds and assets.

7.15 However the Committee heard evidence that it is most unlikely that any university would be able to separate funds received from government and other sources in this way. While universities are required to disclose the main items of expenditure and revenue from public and private sources in their annual reports,¹⁴ it is not common practice to separately track that revenue after receipt.¹⁵ The current requirements are for private revenue to be disaggregated into fees and charges,

11 *ibid.*

12 Dr Julie Wells (NTEU), *Hansard*, Melbourne 15 May 2001, p.480

13 Submission 350, Professor W G (Kit Carson), p.2

14 Senate EWRSBE Legislation Committee, Additional Estimates Hearing, 200-2001, Questions on Notice – DETYA Question E20

15 Mr Simon Kent (NTEU), *Hansard*, Melbourne, 15 May 2001, p.480

investment income, royalties, trademarks and licences and consultancy and contract research. A senior official of DETYA recently acknowledged that most universities have limited understanding of the details of their income and expenditure patterns and that as a result :

Australian universities lacked a basic knowledge of their cost structures and cost drivers for sound financial management and for pricing decisions and negotiations.¹⁶

7.16 The Department also acknowledged that it is ‘unable to dissect the expenditure on the public and private activities of universities...’ and that:

in reporting how much the universities are spending on their commercial activities to generate their surpluses, we cannot tell you that. Neither, we suspect, can the universities because they do not fully know their costs in all these respects.¹⁷

The Committee does not believe this argument is satisfactory. It is evident that the initial capital for commercial and similar ventures is derived from surpluses accruing from activities based on public assets.

7.17 The Department also acknowledged that while across the sector as a whole the commercial arms were generating surpluses, ‘in recent times we have seen some of those surpluses trend downwards and for some institutions there are periods when they have gone into deficit.’ It also acknowledged that, at the same time, there had been some decline in overall operating surpluses.¹⁸

7.18 The NTEU made the point that, in any case, all university resources, whether derived from government grants, donations or ‘earned income’ should properly be regarded as ‘institutional income’ for which the first priority should be university’s core teaching and research functions:

I think we need to stop drawing a distinction between universities’ investment of public money in these enterprises and talk instead about the investment of institutional resources generally. In the current environment where university funding is not tied in particular ways, it is in fact the level of resources that is being committed to commercial arms – some of which may be profitable but many of which are not – that creates the strongest argument for increased accountability provisions, especially when that results in institutional resources being shifted out of the public university,

16 M Gallagher, *The Emergence of Entrepreneurial Public Universities in Australia*, Higher Education Division, Occasional Paper Series 2000E September 2000, p.25

17 Mr M Gallagher (DETYA), *Hansard*, Canberra, 13 August 2001, p.1345

18 *ibid.*

which is where the teaching and research that is in the national interest is taking place, and into the commercial area.¹⁹

7.19 The Committee notes the practical and conceptual difficulties associated with the differentiation between public and private, or ‘earned’ income. It agrees that the most appropriate and workable solution is to adopt the view of the Victorian Auditor-General that all the assets of public universities, including those held by universities’ commercial arms, are, by definition, public assets. This position recognises that universities’ ‘private’ income has invariably been earned through the sale or lease of its publicly funded assets, whether its academic reputation, physical assets or the expertise of its teaching and research staff. It also reflects the view that because universities are public institutions, their commercial activities should support, rather than undermine, their missions to provide public goods in the form of education, research and related functions.

7.20 As a logical extension of this position, universities’ commercial operations should be required, at a minimum, to comply with the accountability and regulatory requirements of public universities. Additional reporting and accountability requirements appropriate to commercial operations should also form part of a sound reporting framework as discussed below.

7.21 There are some significant deficiencies in the current accountability and regulatory requirements for universities’ commercial arms. The New South Wales Auditor-General has reported that, under current legislation, some universities’ commercial operations fall outside his jurisdiction and has recommended legislative action to address this matter.²⁰ The Committee also notes that a joint Commonwealth-State review has been established to examine the need for changes to the current regulatory framework to ensure appropriate coverage of universities’ commercial operations. However, as noted in Chapter 5, it considers that there is a need for a more broad ranging review, involving MCEETYA. Such a review would need to address not simply the details of the accountability framework but the broader public policy issues including the need for a ‘public interest’ test for commercial operations.

Recommendation Twenty-Seven

The Committee recommends that the MCEETYA should formally commission a review addressing the commercial accountability framework as it applies to universities as well as broader public policy issues including the need for a ‘public interest’ test for commercial operations. Such a review should include consideration of universities’ legal liabilities for commercial operations and associated risks.

19 Dr Julie Wells (NTEU), *Hansard*, Melbourne, 15 May 2001, p.478

20 P Lawnham, *Safeguards in a new era of commercialisation*, The Australian, 29 August 2001

Public liability risks

7.22 The Committee is also concerned about the risk that universities' commercial operations may give rise to legal or financial liability on the part of the public university, and ultimately the taxpayer. The AVCC has argued that any liabilities from the operations of established companies are limited to the company and do not flow to the university as a whole: 'universities are thus exposed to the extent that they have committed capital funds to those companies, but not beyond that.'²¹ In practice, however, if universities are not willing to allow their wholly or partly-owned companies to fail, and extend funds from their core revenue to cover expected or actual losses or commercial operations, these statements of limited liability ring rather hollow. The Committee heard evidence of several cases where universities had committed large sums of money to ensure the continued financial viability of commercial operations. Two of these cases, ANUTECH and Melbourne University Private Limited (MUPL) which are examined below, illustrate some of important issues relating to the public liability of universities' commercial arms.

ANUTECH

7.23 ANUTECH was established in 1979 as the technology transfer arm of the Australian National University (ANU). The company is wholly-owned by the University. Questions about ANUTECH's financial situation were raised in Parliament, when, following an operating loss in 1999, the University decided in 2000 to increase its equity in the company by an amount of \$5.2 million and extend a loan facility of \$1.5 million.²² There is a concern that the transfer of these funds to the company would undermine the university's capacity to provide a quality education to its students, particularly in light of reduced funding (or under-funding) of core teaching and research activities by government. The appropriateness of using public funds to support private operations in this way is also at issue.

7.24 The ANU has argued that the injection of funds into ANUTECH in 2000 needs to be seen in context. First, ANUTECH has been profitable for most of its existence and has returned \$3 million to the University since it was established. Second, there are 'off-balance sheet' benefits associated with the company including its role in the facilitation of links with industry. Third, a focus on the short-term financial return is not appropriate in these circumstances as commercialisation of research takes time, with costs often incurred upfront and financial benefits following some years later.²³ In the general context of universities' commercial operations, the AVCC has also expressed the view that there is a need to accept that these sort of commercial activities inherently involve some risk:

21 Submission 315, Australian Vice-Chancellors' Committee (AVCC), p.7

22 Submission, 317, Australian National University, p.5

23 *ibid*

A fair assessment requires examination of the general success or not of such bodies, taking into account that they are operating in an area where not every investment will be a success. Universities are seeking to provide the financial backing for turning research outcomes into commercial products. Only some will succeed.²⁴

7.25 The Committee accepts that there is a level of risk inherent in many such commercial operations and that there is no guarantee that any or all operations will be successful, in financial or other terms. The more speculative the venture, including the commercialisation of research, the greater the risk. However the Committee does not accept that universities should have the right to transfer large amounts of public funds to support their commercial arms without adequate safeguards to ensure protection of the public interest. As indicated, it believes that the MCEETYA should formally address this issue as part of a broad review of the framework relating to universities' commercial operations.

Melbourne University Private Limited

7.26 Melbourne University Private Limited (MUPL) was established in 1998, by the University of Melbourne. The Committee has been advised that the private university was expected to service the market for private higher education, relying on a number of competitive advantages including 'an established brand' and 'access, via the University of Melbourne, to world-class infrastructure and expertise',²⁵ and generate revenue in the order of \$200 million annually for the University.²⁶ The decision to establish MUPL reflects the strongly held view of the Vice-Chancellor, Professor Alan Gilbert, that governments in Australia are unlikely to provide the level of funding needed to sustain universities at an internationally competitive level. Comparing the income of Australian public universities, such as the University of Melbourne, with that of leading international universities such as Harvard, Professor Gilbert concluded that the vast gulf in resources could only be overcome if universities such as Melbourne were able to generate substantial non-government sources of income.²⁷ The decision to establish a private university for this purpose also reflected a view that, based on the experience in the United States, there is a market for certified award courses for executive training that is not being met by universities.²⁸ When the proposal to establish the private university was announced, Professor Gilbert declared that the new university was laying down a template that

24 Submission 315, AVCC, p.7

25 Professor Alan Gilbert, University of Melbourne, Response of 24 July 2001 to Questions on Notice: copy of submission to Victorian Government re Melbourne University Private, p.13

26 Submission 229, Melbourne University Student Union, pp.27-29

27 Submission 232, University of Melbourne, pp.1-3

28 Professor Alan Gilbert (University of Melbourne), *Hansard*, Canberra, 22 June 2001, p.579

others would have to follow, expressing his view that 'it's the only way ahead for Australian higher education.'²⁹

7.27 In the event, the assumptions made about the market for fee-paying undergraduate education in Australia have proven to be seriously flawed. The private university has had difficulty in attracting significant numbers of students and has had to significantly scale down its operation and reduce the planned number of schools from four to two. The private university had also been predicated upon the gradual removal of HECS-liable postgraduate coursework places from public universities and therefore a growing demand for full fee postgraduate coursework programs. The recent decision to introduce the Postgraduate Education Loans Scheme (or PELS) for students undertaking postgraduate coursework at public universities presents a further risk to the viability of the private university.³⁰ The Committee also notes as an aside, that the decision to introduce PELS is in itself a clear indication of the limited market in Australia for postgraduate coursework based on upfront fees, *unless supported by concessional, income contingent loans*. While there may be a significant demand and need for lifelong education, this does not translate into a similar-sized market for courses requiring upfront fee payments. Most Australians do not have access to the funds needed to pay fees at the levels in question and few employers seem willing or able to fund the costs of such education, no matter how beneficial to their interests. The Committee notes that the government has agreed to a two-year review of the PELS program.

7.28 The evidence of the Department of Defence also made it clear that the private university may also have a limited market among international students. It confirmed advice that the Committee had received that many Asian students were unhappy with a proposal that they undertake a degree through an institution named 'Melbourne University Private,' and would prefer to have a 'real degree' from the public university. They perceive a degree from a private university as a 'company degree' rather than a 'university degree' and therefore inherently inferior.³¹

7.29 The limited domestic and international market for fee-paying courses from a private university suggests that the viability of MUPL must be seriously in doubt. If this is the case, there are some clear implications for the public university.

7.30 In 1997 the University Council agreed to commit an initial \$10 million to the project³² and that a further sum of \$15 million could be extended to MUPL if needed, on condition that the funds not come from the government grant.³³ The situation of MUPL became a matter of concern when in the third year of its operation, it had lost

29 News Release. Premier unveils \$250 m development for Melbourne University Private 7 August 1998. Vol 7, No 29. (at <http://www.unimelb.edu.au/ExtRels/Media/UN/archive/1998/326/premierunveils.html>)

30 Professor Alan Gilbert (University of Melbourne), *Hansard*, Canberra 22 June 2001, p.578

31 Rear Admiral Raydon Gates (Department of Defence), *Hansard*, 13 August 2001, p.1278

32 Professor Alan Gilbert (University of Melbourne) *Hansard*, Canberra 22 June 2001, p.578

33 Submission 350, Professor W G (Kit) Carson, p.2

\$2.2 million and revenue was only in the order of \$1.5 million;³⁴ by December 2000 half its starting capital had been eroded and none of the expected private investors who were, it was claimed, to contribute \$100 million in equity, had materialised.³⁵ The University's financial exposure is, however, far greater than this because it had guaranteed a \$150 million loan to develop the University Square precinct that would house both the public and private universities. Therefore, while the loan had been taken out on behalf of the public university to finance its proposals for development of University Square, the buildings proposed had been intended primarily for lease to MUPL. With the need to downscale the plans for MUPL, the buildings will now need to be used for other purposes. It is clear that the loan was intended for the development of University Square (two of the three major buildings were to house the private university) but that the public university is now being required to finance the costs of the loan by 'renting' the buildings originally intended to house the private university. In response to a question on notice about whether the University has indirectly expended Commonwealth funds on behalf of the private university, contrary to assurances it has provided, DETYA simply reported that the University had made it clear that the private university and the University Square project remained distinct projects and that they saw no need for the university's assurance about the use of Commonwealth funding to be qualified.³⁶ The Committee is not satisfied with this response.

7.31 The Committee questioned the Vice-Chancellor about the implications of MUPL's poor financial performance for the operations of the public university. In response, Professor Gilbert stated:

Much public comment has been devoted to the fact that Melbourne University Private Ltd, although still in its infancy, has been the least successful of our strategies. But the private university is a long-term strategy; it never expected to be profitable until year 9, and allegations of its insolvency are simply wrong. The most salient point of all about the Melbourne Agenda is that, for the sum of just under \$50 million, the university has decided to invest in self-reliance strategies, \$10 million of which has been invested in the private university. Melbourne has already recouped far in excess of its investment and it has already reinvested the returns into important public university priorities. These initiatives, will, moreover, pay continuing dividends into the future.³⁷

7.32 The Committee does not believe that this is an adequate or accurate response to its concerns. In particular, arguments that MUPL was not expected to be profitable for its first eight years of operation, raise very real questions how the private university will be funded over that period. The solution adopted by the University is a

34 Senator Kim Carr, *Hansard*, Canberra 22 June 2001, pp.1-82

35 Senator Carr *Hansard*, Canberra, 22 June 2001, p.21

36 Senate Estimates DETYA response to Question on Notice, 3821

37 Professor Alan Gilbert (University of Melbourne), *Hansard*, Canberra, 22 June 2001, p.577

merger of MUPL with Melbourne Enterprises International (MEI), a subsidiary of the University of Melbourne, thereby allowing MUPL access to the significant financial reserves of MEI. These reserves were in turn developed from the privatisation of the public universities' assets in the form of Melbourne IT Limited. (The privatisation of Melbourne IT Ltd raises a host of issues in its own right which are discussed in section commencing para 7.47 below). The bottom line is that public assets - by which we include the assets of another commercial arm, generated from the sale of public assets, and with the stated intention of supporting the public university - are being used to subsidise the operation of a private university, which, on current indications is unlikely to viable in the near future. The use of MEI reserves to rescue the MUPL highlights the unsustainability and opportunistic nature of the strategy underlying the 'Melbourne Agenda' and its poverty as a model for successful commercialisation: it essentially relies on a one-off windfall gain that is not available to other universities and that the University of Melbourne cannot expect to repeat.

7.33 The Committee believes that the formation of MUPL has resulted in the transfer of large sums from the public university to a speculative venture with grave implications for the public university.

Due diligence and transparency

7.34 Arrangements relating to the establishment of MUPL and the University of Melbourne's investment in another commercial venture, *Universitas 21 global* have also been characterised by a significant lack of transparency, at odds with the appropriate arrangements for governance of a public university.

7.35 At its public hearing in Melbourne on 15 May 2001, the Committee heard evidence from a member of the University's finance committee that, since 1999, the full minutes of University Council meetings were no longer being provided on the University's website.³⁸ This restricted access to information, together with the limited discussion of proposals related to MUPL and *Universitas 21 global (U21 global)*, made it extremely difficult for Council and committee members to undertake appropriate scrutiny of university decisions. Following the hearing, the witness advised that the University had re-commenced posting Council minutes on the website, but with the exception of a May 1999 Council meeting that had discussed aspects of commercial operations.³⁹

Universitas 21 global

7.36 *Universitas 21* was originally formed as an international consortium to foster academic exchanges between universities.⁴⁰ More recently, however, the consortium decided to pursue a range of commercial ventures, including the establishment of a

38 Mrs Margaret Kay, *Hansard*, Melbourne, 15 May 2001, p.427

39 Submission 249a, Mrs Margaret Kay, p.1

40 Submission 229, Melbourne University Student Union, pp.27-29

'virtual university', *U21 global*, in conjunction initially with News Limited, Microsoft and subsequently with Thomson Corporation, to provide distance degree and other programs to an international market. The Universities of Melbourne, New South Wales and Queensland, are members of the consortium and have agreed to contribute varying amounts of seed capital for the development of U21 global.⁴¹ If the venture is profitable, they stand to gain income on the basis of their equity stake in the project; they will also receive a share of income based on the pre-assessed contribution of their 'brand name' to the company's profits.⁴² Agreement has now been reached with individual universities and Thomson Learning, the publisher, and the 'e-university', to be known as U21global was launched in Charlottesville in the US. The e-university will begin operating in January 2003.⁴³

7.37 Student associations at the University of Melbourne claim that the University's decision to commit \$US5 million (since increased to \$US6 million) of university funds to *U21 global*, was taken without the appropriate due diligence having been completed.⁴⁴ The NTEU also claims that the decision to invest in *U21 global* was characterised by a significant lack of transparency. The university had failed to discuss the project openly at Council meetings, using the argument that 'commercial-in-confidence' requirements prevented the disclosure of information that is normally subject to review by university's governing boards.⁴⁵ The information that the NTEU had been able to obtain from other sources suggested that the arrangements for the establishment and operation of *U21 global*, raised a series of important questions about quality assurance arrangements and whether consortium members would have a level of control commensurate with the investment of their academic reputation.

7.38 Failure to disclose information and allow full and open scrutiny of proposals for major commercial investments at Council meetings raises serious accountability issues. The requirement to report to, and obtain approval from, university councils or senates, and their delegated committees, is the primary mechanism for ensuring that universities are responsible and accountable to the community. Any restrictions on the access of Council or committee members to information on university operations, including their commercial ventures, seriously compromises the council's capacity to discharge its responsibilities, including its responsibility to ensure that the appropriate due diligence requirements have been undertaken.

7.39 Universities' proposals for commercial investments or undertakings should be subject to full disclosure and scrutiny by councils and associated committees.

41 Submission 229, Melbourne University Student Union, pp.27-29

42 Submission 283, NTEU, p.59

43 J Madden, *Deal opens way for global uni*, The Australian Higher Education Supplement, 12 September 2001, p.38

44 *ibid.*

45 Submission 283, NTEU, p.56

Universities should not be able to hide behind ‘commercial-in-confidence’ arguments to restrict scrutiny and avoid accountability for the commitment of public assets.

Recommendation Twenty-Eight

The Committee recommends that proposals for commercial investments or undertakings should be subject to full disclosure and scrutiny by councils and associated committees and should conform to all relevant legislation and recognised standards of public disclosure.

Legal liability related to commercial operations

7.40 Due diligence and appropriate scrutiny of commercial arrangements can help to minimise the risks of universities entering into commercial arrangements that expose them to legal liabilities, including the risk of litigation. Nevertheless, universities may accrue legal liabilities as a result of the sale or lease of their assets or the operation of their commercial activities. Some universities claim to have developed a sound risk management framework for these arrangements⁴⁶ but it is by no means clear that this is common or uniform practice. In any case, as CPA Australia noted, the more speculative the commercial operation, the greater the risk for litigation:

with respect to the indirect consequences of the myriad commercial activities university departments are undertaking to supplement inadequate Government funding for their normal functioning. .. In most universities internal policy dictates that private commercial activities are conducted through the institutional commercial company, contracts drawn up in compliance with the policies of the university’s commercial company. Academics undertaking the activities generally have public indemnity insurance as part of the services of the commercial company...It would be reasonable to suspect that substantial litigation may eventually occur, to the detriment of the Australian university system, the Government, and the public purse.⁴⁷

7.41 The Committee believes that the review by MCEETYA of the appropriate framework for universities’ commercial operations should include consideration of universities’ legal liabilities for commercial operations with a view to ensuring that commercial operations do not expose public universities to substantial risks associated with litigation. The Committee believes that, in the current environment, there is a very real risk of such exposure.

Reputation risks

7.42 Both *U21 global* and MUPL illustrate another important area of concern with universities’ commercial ventures: that is the sale of the universities’ ‘brand’ or

46 Submission 287, University of Western Sydney, p.10

47 Submission 176, CPA Australia, pp.8-9

'reputation' for profit and associated reputation risks. Academic reputation is, for most if not all universities, their most valuable, if intangible, asset. For public universities, this asset has been developed through many years of large public subsidies and is therefore properly regarded as a public asset.⁴⁸

7.43 The Committee heard evidence about a number of commercial ventures where universities are providing their 'brand' or reputation to commercial organisations providing educational or related services without taking the appropriate steps to guarantee the quality of the educational services to be provided. The establishment of *U21 global* was provided as one example of such an arrangement.

7.44 Student associations and the NTEU advised that the arrangements under which *U21 global* has been established, do not appear to include clear and transparent arrangements for quality assurance to the satisfaction of all participating universities. The NTEU also advised that, in its view, it is not clear that the participating universities that are, in effect 'selling' their brands to the venture (and creating an expectation of an appropriate level of quality control) are in a position to assure the quality of the content. They have also observed that 'little is known' about how the intellectual property of academics from participating institutions will be protected.⁴⁹ These arrangements give rise to serious concerns about the reputation risks for participating universities.

7.45 Of even greater concern, these risks are not limited to participants in the venture but could flow on to the Australian higher education sector as a whole because:

there are 'externality' effects associated with the fact that poor practices in one university may affect the reputation of the university system as a whole.⁵⁰

7.46 Public universities' reputations or brands should be treated like any other publicly-funded university assets. Protocols or guidelines for the privatisation of university assets and other forms of commercialisation, including requirements for due diligence and sound valuations, should also apply to the use of university 'brands'. The need for appropriate protocols and safeguards is even more important than with more tangible assets because of the potential ramifications of any reputational damage for the entire higher education sector and the international standing of domestic and international graduates of our universities. An appropriate protocol would provide that the university providing the use of its brand would remain at all times responsible, under Australian law, for the use of that brand, whether in Australia or overseas.

48 Submission 217, Professor Bruce Chapman, p.9

49 Submission 283, NTEU, p.59

50 Submission 49, Professor John Quiggin, p.16

Privatisation of public assets

7.47 Universities that privatise their public assets are essentially engaged in the transfer of funds from the public to private domains. The privatisation of public assets raises a range of important public policy issues. These are discussed in the context of the privatisation of Melbourne IT Ltd.

Float of Melbourne IT

7.48 A number of submissions raised the 1999 float of Melbourne IT Ltd as an example of the issues associated with the conversion of publicly funded assets into private assets and of the lack of probity and financial accountability that may be associated with such transactions.

7.49 Melbourne IT Ltd is a company formed by the University of Melbourne in 1996 to manage the registration of internet domain names in Australia. The development of the internet in Australia was the result of a co-operative effort by the Australian university sector. In the process, an individual at the University of Melbourne assumed responsibility for registration of the Australian domain names. As the internet grew and, with it the size of the registration task, responsibility for registration passed to Melbourne IT Ltd.

7.50 In 1999 Melbourne IT was floated on the stockmarket. In the booming technology market of the time, the value of shares in Melbourne IT rose rapidly, with the result that the university reaped a windfall profit of \$78.4 million from the sale of 85 per cent of the shares. Fifty million dollars from the profit was returned to Melbourne Enterprises International Limited (a subsidiary of the University of Melbourne and the parent entity of Melbourne IT), presumably for the benefit of the public university.

7.51 The Victorian Auditor-General subsequently identified a range of concerns and problems associated with the float of Melbourne IT. In particular, he noted that, although the float involved the disposal of a major public asset, the University had not consulted the Department of Treasury and Finance, which had substantial privatisation expertise. One result is that shares appeared to have been under-valued, with the result that the public sector obtained a less than fair return on its investment.

7.52 The Auditor-General also identified a range of other problems with float, including the allocation of shares to a number of individuals associated with the university council and Melbourne IT itself:

There is no doubt that the University benefited substantially from the floating of Melbourne IT. Nevertheless there are many considerations for government and public sector entities arising from the float which are outlined in this report. These considerations include risk management principles to be adopted, the need to obtain independent valuations from other parties, avoidance of any conflict of interest when persons employed in the public sector benefit from share allocations and consideration of

alternative methods to floating companies to achieve the best outcome from the privatisation of public sector companies.⁵¹

7.53 There is a need to ensure that these principles should apply to any privatisation of public assets. While, in law, this issue is a matter for state governments, the Commonwealth has a legitimate interest in ensuring that there are appropriate arrangements and processes for the privatisation of assets that it has largely subsidised. The MCEETYA review of commercial operations recommended earlier could include consideration of arrangements for the privatisation of the assets of public universities to ensure that public interest requirements are met and that the probity, transparency and accountability requirements are satisfied.

Competitive neutrality (National Competition Policy)

7.54 The principle of competitive neutrality is a key plank of the Competition Principles Agreement (CPA) between the Commonwealth and state and territory governments. The essence of the principle is that government business enterprises operating in direct competition with private business should not enjoy any regulatory advantages.⁵² All Government activities, including the operation of universities' commercial arms, are required to comply with National Competition Policy.

7.55 The Australian Council for Private Education and Training (ACPET) submitted that universities' commercial activities could be in breach of this principle where they take advantage of the benefits and concessions (such as concessional taxation or more favourable regulatory treatment) attaching to their 'public' status, to compete unfairly with private institutions.⁵³ Any subsidisation of universities' commercial arms by providing the use of universities' staff and facilities, free-of-charge or below full cost, would also result in a breach of National Competition Policy. In an environment where universities have little knowledge of their cost structure, there is a significant risk of universities charging less than the full costs for the use of their public assets.

7.56 Arrangements whereby staff at the John Curtin School of Medical Research at the ANU, who are associated with the spin-off company BIOTRON, are allowed to work for BIOTRON for one day a week on public salary, with salary top-up by BIOTRON⁵⁴ also appear to involve cross-subsidisation of public and private activities and may therefore be in breach of National Competition Policy. The management of universities' commercial arms and activities also appears to account for an increasing amount of the time of senior university managers, including vice-chancellors. During 2000, for example, the Vice-Chancellor of the University of Melbourne was said to

51 Victorian Auditor-General's Office Report on Ministerial Portfolios June 2000 (section 3.1.122). at <http://www.audit.vic.gov.au/mp2000/mp000doe.htm>

52 Submission 177, Australian Council for Private Education and Training, p.4

53 *ibid.*

54 Mr Peter Scott, *Hansard*, Canberra, 13 August 2001, p.1238

have spent several months overseas on business associated with *U21 global*. University managers and academics at all levels are also spending large amounts of time travelling overseas to develop and service the international student market. There is nothing to suggest that these resource costs (which, in view of the salaries of many vice-chancellors and senior managers, are not insignificant) are being attributed to those commercial activities. Assuming this to be the case, these practices provide a further hidden subsidy for universities' commercial operations.

7.57 The unfair competitive advantage that universities obtain by subsidising some of their commercial activities or services in this and other ways was raised in a submission from the director of a private research organisation. The submission from Dr Gourlay argued that, because universities had the capacity to subsidise their commercial activities in such ways, they are able to set artificially low charges for such services and undercut fully commercial operations, such as his own, which had to cover the full costs of the operation. Dr Gourlay cited examples where universities had tendered for contracts at prices far below the commercial value,⁵⁵ effectively undermining the capacity for fully private organisations to compete on price.

7.58 Universities, like all public sector agencies, are subject to the laws and policies governing the public sector, including National Competition Policy. To comply with these requirements, universities need to be in a position to accurately and transparently cost their activities so that all costs associated with commercial activities - including the time of vice-chancellors and senior managers - can be fully and accurately accounted for and included in any pricing. The practical difficulties that universities are likely to face in adhering to this requirement, discussed earlier, do not remove this obligation for compliance.

7.59 When this issue, and the difficulties that it poses for universities, was raised with DETYA at Senate Estimates hearings, the Department's response was that this is a matter for institutions and not for the Department. In the Department's view, universities are autonomous institutions responsible for ensuring their own compliance with national and state laws and policies. The Committee considers that this response is disingenuous and evasive. Since 1996, Government policy has clearly and explicitly pushed universities in the direction of expanding their commercial activities and arrangements to generate private income as a substitute for reduced Government expenditure. The Government therefore has a responsibility to ensure that its policy imperatives do not place universities in the position of being potentially in breach of Commonwealth or state laws and policies.

The taxation status of universities' commercial operations

7.60 To date, the commercial arms of Australia's fully owned commercial operations have generally enjoyed the same exemption from income taxation as their parent institutions. The 'tax exempt' status of public universities derives from their

55 Submission 324, Mr Robert Gourlay, pp.1-2

status as ‘charitable institutions’ providing a public good in the form of education or scientific research.⁵⁶

7.61 This preferential taxation treatment provides public institutions’ commercial operations with a valuable competitive advantage in the marketplace and may, in some cases, be essential to their profitable operation. Evidence presented to the Committee, however, indicates that this tax exempt status is not a given: it depends on commercial arms having the same ‘public good’ focus as their parent institutions. It also requires them to meet any specific requirements laid down by the Australian Taxation Office for charitable institutions, including a prohibition on the distribution of profit or capital to members and a requirement that the organisation pursues their objectives principally in Australia. The greater the commercial focus of commercial arms, the greater the risk that they will fail to meet the requirements for tax exempt status. The Committee notes, in this context, that advice presented to the University of Melbourne indicates that there is some doubt that its partly owned company, Uniseed (jointly owned with, and controlled by, the University of Queensland) may meet the requirements for tax exemption as a charitable institution.⁵⁷ While any ruling to this effect would only apply directly to Uniseed, it would have broader implications for other commercial arms in the University of Melbourne and other universities.

7.62 The taxation status of universities’ commercial arms is also affected by their ownership structure. Wholly-owned companies generally enjoy tax exempt status, presumably on the basis that any profits will be available for the parent university’s use in providing educational services. Once private organisations or individuals share in the ownership of commercial arms, this situation no longer applies. The University of Melbourne has been advised that the Australian Taxation Office ruling on the tax exempt status of MUPL may need to be reviewed in the light of proposals to allow for external investment.⁵⁸

7.63 As discussed in the section on competitive neutrality, when universities’ commercial arms are able to benefit from sharing the tax exempt status of their parent university, this raises questions about their capacity to comply with National Competition Policy.

7.64 The Committee believes that the current ambiguity governing the taxation status of universities’ commercial arms and their compliance with the principles of competitive neutrality needs to be resolved by the Commonwealth Government. The Commonwealth’s policy and financial settings have promoted the proliferation of these commercial arrangements and the Commonwealth should take responsibility for providing leadership in resolving the matter. The Committee does not believe that it

56 Senate Legislation Committee, Questions on Notice, 2001-2002 Budget Estimates hearing, DETYA response to Question E8

57 William Buck, Business Consultants Advice to Mr G Rees, Chairman Melbourne Enterprises International Ltd 10 November 2000, Attachment D, p.30

58 Senator Kim Carr, *Hansard*, Canberra 22 June 2001, p.585

is satisfactory for the Commonwealth to absolve itself from this responsibility by reference to the autonomous status of universities. The problems that identified are nation-wide problems with serious implications for universities. It is in the national interest - and therefore surely in the interests of the Commonwealth – that this issue be resolved before it becomes a matter of litigation.

Recommendation Twenty-Nine

The Committee recommends that the Government address the current ambiguity governing the taxation status of universities' commercial arms and their compliance with the principles of competitive neutrality.

If there are genuine public interest reasons for competitive neutrality principles to be over-ridden, these should be stated explicitly and appropriate legislative steps taken to protect the legal position of universities.

Competition between public universities and the private educational arms of universities

7.65 The submission from the University of New South Wales supported the provision of educational services on a commercial basis, arguing that major universities in the North America and Britain have benefited from this approach for decades:

Some examples are an educational testing system at Princeton University, a highly respected worldwide examination system through Cambridge University and the external and continuing education arm of UCLA...In a globalising world, Australian universities will face serious challenges from offshore and should be encouraged...to offer high quality educational services on a commercial basis, as well as commercially viable, distance delivered degree programs.⁵⁹

7.66 Interestingly, none of the examples provided by Professor Niland include commercial entities offering degree programs other than on a distance-delivery basis. Unlike the examples mentioned above, university-owned commercial entities providing campus-based degree programs operate in direct competition with the parent public university. This in turn can create a conflict of interest for the parent organisation. For example, MUPL has been established to provide university level courses on a fully commercial basis and provide an income stream for the parent, public university. MUPL's viability depends, to a large extent, on the public university being denied the opportunity to meet demand while at the same time staff of the public university are contracted by MUPL to provide its courses. In this context, Professor Gilbert has made it clear that MUPL's viability could be undermined by any

59 Submission 263, University of New England, p.4

Commonwealth decision to convert fee-paying places to Government funded places or places with access to an income contingent loan repayment arrangements.⁶⁰

7.67 In this context, the arrangements under which MUPL operates place the parent university in a interesting, and some may say, invidious position. The public university, through its academic board, has the power to approve courses that the private university intends to offer. As a result, it has the capacity to manipulate the market for MUPL services by restricting the availability in the public university, of those courses that the private university intends to offer. The Committee wishes to make it clear that this observation is not intended to imply that the University of Melbourne has acted, or would act, to manipulate the market in this way. The Committee also notes that the arrangements under which the private university has been established make it clear that it was intended to be 'complementary' to the public university and not operate in competition with it.⁶¹ Nevertheless the current arrangements present the university with a clear conflict of interest between its private, commercial interests and its public responsibilities, and provide both the opportunity and the incentive for such manipulation to occur.

7.68 In the longer term, if U21 global becomes operational in Australia, similar conflicts of interest could also arise with respect to that operation and the public universities' course offerings, although the Committee accepts that there is less likely to be a risk of a direct conflict of interest between campus-based degree programs and internet-delivered programs inasmuch as the global programs are not meant to compete with courses offered by the University of Melbourne.

7.69 There is a need to ensure that public universities' commercial arms comply with national competition policy (and do not benefit from any subsidies or support from the public university) and are consistent with, and subordinate to, the public interest in terms of access to higher education. In most cases this will be best achieved by public universities not establishing private arms that provide higher degree courses. Failing that, public universities should be bound by clear guidelines governing the separation of any such public and private operations. Guidelines could include a requirement that the university clearly identify the range and level of courses that would be provided by the private operation and how these would relate to the courses offered by the public university and a clear demonstration of the lack of any overlap between the two operations. For example, non-degree courses, such as adult education courses, are unlikely to present a conflict of interest. While the parent university can and should be responsible for the academic and other quality of its commercial courses, the operations and offerings of the commercial arm should be agreed by a body that includes a representative of state or Commonwealth Parliament who is not part of the university's governing board.

60 Professor Alan Gilbert (University of Melbourne), *Hansard*, Canberra 22 June 2001, p.578

61 The Committee notes that the Minutes of the Melbourne University Private Committee meeting of 21 June 2001 (appendix A) refer to the fact that the 7 July 1997 meeting of the University Council had made it clear that the private university was not to compete with the public university in terms of programs

Universities' franchise operations

7.70 The University of Canberra Students' Association commenting on the increasing prevalence of universities' commercial in confidence arrangements, stated that:

Increasingly at UC we are finding that the latest overseas trip brings back a collection of already signed MOUs and franchise agreements. Signed and sealed agreements that the Students Association didn't even know were under discussion let alone up for finalisation. Agreements that are not usually co-ordinated and that many student support services are never advised of until something goes wrong.⁶²

7.71 The students association, which clearly took a serious and honourable interest in advocating to protect the interests of students enrolled under franchise arrangements, noted these arrangements often seemed to have been negotiated without adequate planning or arrangements for student support services, including English as a Second Language (ESL) programs and library services. In some cases, franchise arrangements had resulted in students being enrolled in courses that were not approved for teaching in the host country; in other cases students were undertaking courses at a lower level than they had been led to expect. The students association noted that, while in Australia, students would have some recourse under the Trade Practices Act if they had been disadvantaged as a result of incorrect or misleading information, no such protection appeared to be available to students enrolled offshore, in Australian university programs delivered through a franchise agreement.⁶³ The association noted that the university had been sympathetic and responsive to the concerns that it had raised in this area, and is reviewing its appeals process to provide better access for offshore students. The Committee notes that the problems that have been experienced at the University of Canberra are likely to have been repeated across Australia, while it is less likely that all universities have been as responsive as the University of Canberra.

7.72 There is a need to ensure that students enrolled in Australian programs offshore have access to a national appeals, review or grievance process to deal with their complaints. This could be a role for the proposed University Ombudsman recommended in Chapter 4, as the AUQA arrangements outlined below, do not, as the Commonwealth has indicated elsewhere, involve any grievance or complaints mechanisms. This would both help to ensure students had an appropriate right of redress, that any problems in specific arrangements and any systemic problems are identified and can be resolved as early as possible to the benefit of both students and the good standing and integrity of Australia's higher education sector.

7.73 Universities may also enter into a franchise arrangements with commercial education providers in Australia. These arrangements typically involve universities

62 Submission 333, University of Canberra Students Association, p.11

63 *ibid.*

entering into a contract for a private provider to deliver units from the university's degree or diploma programs and, in some cases, deliver university preparatory or bridging programs, whether for overseas or domestic students. This raises questions of the extent to which universities can provide quality assurance for courses delivered under such arrangements.

7.74 In the Senate Estimates Committee, DETYA advised that the National Protocols for Higher Education Approval Processes provide that where universities enter into arrangements with other organisations for the delivery of a course leading to the grant of an academic award from that university, the university must carry full responsibility for all aspects of delivery, including the quality and standards of the course, and the qualifications of teaching staff, resource levels and student support arrangements. Measures taken by the institution to ensure standards comparable to those of other campuses will be subject to audit by the AUQA. The Council or governing body of a university or other self-accrediting institution has primary responsibility for quality assurance under these arrangements, and the direct line of accountability for that council or governing body is to the Minister and Government of the state or territory in which it is established.⁶⁴

7.75 The Queensland Branch of the NTEU raised concerns about the proliferation of this type of franchise arrangement in Queensland in recent years. Leaving aside issues of quality assurance, which, as DETYA have advised in the response outlined above, are catered for under current policy and regulatory settings, there were, in the view of the NTEU Queensland, equity issues associated with students being guaranteed entry to a Commonwealth-funded place at the public university on satisfactory completion of a qualifying course at the franchise operation.⁶⁵ Franchise operations could provide a 'second chance' for those students who do not meet the normal entry requirements, but who can afford to pay for the franchised program, to gain entry to their preferred course. The NTEU cites franchise operations that advertise their courses as 'providing automatic entry' to a HECS place at the university partner.

7.76 The NTEU also noted that the Queensland Auditor-General had raised questions about the transparency of the commercial arrangements, including loan arrangements, between the university and franchisee. In one case, the Auditor-General found that Central Queensland University (CQU) had not obtained the permission of the state Treasury before extending a \$4 million loan to its franchise operations, C-Management Services.⁶⁶ Apart from the serious issues of probity and accountability, raised by this sort of practice, there is also a concern that universities' financial interests in franchise arrangements may compromise their willingness to ensure that the franchise operations meet the quality standards. In this regard, the Committee

64 Senate EWRSBE Legislation Committee, Questions on Notice; 2001 - 2002 budget estimates hearing, Response to QE39

65 Submission 62, Queensland Division of the National Tertiary Education Union, p.5

66 Dr Howard Guille (Queensland Division, NTEU), *Hansard*, Brisbane, 2 March 2001, p.8

notes that it heard independent evidence, in the case of CQU's relationship with C-Management Services, that the university is providing close supervision of academic quality.⁶⁷

7.77 It is inappropriate and inequitable for universities to provide preferential access to Commonwealth-funded places in their institutions to students who complete a preparatory program at a franchise operation. Such students should compete for entry to funded places on the same basis as other 'mature age' or non-school leaver entrants. This would not only promote equity, but also provide a greater incentive for ensuring that franchise operations provided high quality teaching.

Consulting arrangements

7.78 Consulting services provide a significant source of 'earned income' for some academics and universities. Most universities have policies governing private consulting work undertaken by their staff. These are designed to ensure an appropriate return to the university from the use of staff time and facilities (usually by means of a management charge) and to limit the time that can be spent on consultancy (typically on day a week). The implementation of such policies is, however, quite uneven across the sector. In addition, there are significant differences in management arrangements for consultancies, with some universities requiring all such arrangements be negotiated and contracted through their commercial arms, or through the relevant department and others allowing academics to enter directly into contractual arrangements with outside parties.

7.79 Auditors-General have identified the latter arrangements, where academics sell their services directly to another party at market rates, as presenting the greatest financial risk for the university. Direct contractual relationships mean that there is no way for universities to identify and monitor the level and nature of any such outside work and as there is no procedure for monitoring the time that academics spend on university business,⁶⁸ there is scope for abuse and associated loss to the university of staff time and commitment. Where consulting is undertaken through the universities, typical arrangements also allow some portion of the income to be accessible to individual or departmental staff, through special accounts available for conferences or work-related activities.⁶⁹ The Committee heard from one witness that these arrangements can also be subject to abuse with some individuals having free access to funds in those accounts.⁷⁰

67 *ibid.*, p9

68 M Gallagher, *The Emergence of Entrepreneurial Public Universities in Australia*, Higher Education Division, Occasional Paper Series 2000E, September 2000, p.20

69 *ibid.*, p 20

70 Submission 43, Professor Patrick Troy, p 9. Professor Patrick Troy, *Hansard*, Canberra, 13 August 2001, pp.1252-1253

7.80 The Western Australia Auditor-General has recommended that universities move away from time-limit policies, with their inherent problems, to a system of performance management that will ensure that the university has an appropriate return for its staff costs.⁷¹

Recommendation Thirty

The Committee recommends that MCEETYA identify the key elements that should be included in universities' policies and practices concerning academic consultancies and that the AUQA be required to examine these policies and practices as part of its audit of educational institutions.

Commercialisation of research – financial and probity issues

7.81 The Committee discussed the broader policies relating to the commercialisation of university research through the formation of spin-off companies, in the previous chapter on the funding and management of research. This chapter will examine some of the probity, financial and related issues.

7.82 The Committee's attention was drawn to the formation of a spin-off company, BIOTRON, that had been established to commercialise the results of research discoveries in the immunological and related fields from the John Curtin School of Medical Research (JCSMR) at the ANU. Shares in BIOTRON were allocated to a number of research staff at the JCSMR associated with BIOTRON, to the university and to the commercial investors. The University's allocation was 7 per cent while one of the research staff was allocated 15 per cent and others varying amounts. The arrangements under which BIOTRON had been established and operates have been controversial, at least among some of the other research staff at ANU who raised some profound philosophical and other objections to the arrangements.

7.83 Issues of concern in the context of universities' commercial operations included: whether the arrangements for individual researchers to be allocated a greater number of shares in the spin-off company than the university provide an appropriate return for the public sector that funded the original research (and would continue to fund the ongoing basic research); the potential conflict of interest associated with research staff holding shares in a company with a charter to commercialise the research developed and funded by the public university which is their employer; and whether individuals should have legal title (or part title) to intellectual property that they have developed as publicly-funded researchers. There are also issues related to the integrity of research, collaboration and the free exchange of ideas that is so central to the pursuit of knowledge, and scientific inquiry in particular.

7.84 The formation of spin-off companies such as BIOTRON to commercialise the results of research is an important plank of current government policy to promote

71 M Gallagher, *The Emergence of Entrepreneurial Public Universities in Australia*, Higher Education Division Occasional Paper Series 2000E, September 2000, p. 20

innovation and to allow universities to generate private funds to substitute for declining real levels of public. The Committee also noted that the issues relating to arrangements such as BIOTRON were not clear-cut. It had heard arguments that Australia needs to fund intermediate research through spin-off companies along the lines of BIOTRON because this is the only way to ensure that the full commercial potential of research is realised.⁷² It heard of barriers to the commercialisation of research in current university practices, including the lack of funds to enable university research staff to patent (and thus protect and exploit) their discoveries and the failure of universities' commercial arms to identify intellectual property that is being developed within universities.⁷³ Proponents of the BIOTRON model argued that it provides a means of overcoming those barriers.

7.85 It was claimed by some research staff at the JCSMR, claims that were disputed by the ANU and representatives of BIOTRON, that the BIOTRON prospectus contained some misleading information about the prospects of success based on past achievements or the current state of scientific knowledge. Witnesses also claimed that the ANU appeared not to have been open to criticism of the arrangements or proposal, because their share holding gave them a vested interest in the proposal proceeding.⁷⁴ The ANU clearly did not agree that there had been inadequate due diligence or disclosure arrangements associated with the formation of BIOTRON, although it is clearly concerned to ensure that any future spin-off companies did not give rise to similar criticisms.

7.86 The Committee wishes to make it clear that its discussion of BIOTRON in this section was prompted by the discussion raised in submissions and hearings and not by any view that BIOTRON should be singled out as raising particular problems. Nor does it wish make any judgement on the claims of the various parties about the arrangements for BIOTRON – apart from a general observation that the university's 7 per cent shareholding appears to be inadequate to ensure an appropriate return for the public.⁷⁵

7.87 The Committee agrees that spin-off companies can be part of a successful approach to the commercialisation of research, promoting innovation and generating broader economic benefits, as has apparently occurred in Silicon Valley, with its array of start-up firms commercialising research undertaken by Stanford University. Successful Australian examples included companies such as ResMed, Cochlear and Gropep. The fact that spin-off companies *may* generate broader economic benefits (and noting that the evidence suggests that only one in 100 such companies are

72 Mr Peter Scott, *Hansard*, Canberra, 13 August 2001, p.1241

73 *ibid*, pp.1240-1241

74 Dr Graeme Laver, *Hansard*, Canberra, 13 August 2001, pp.1223-4

75 The Committee notes, in this context, that the Deputy Vice-Chancellor of the ANU, Professor John Richards, in his evidence to the inquiry, noted that the ANU was proposing that the ANU and researchers should at least start with a 'fifty-fifty' share of equity in future spin-off companies. (*Professor John Richards* (Australian National University), *Hansard*, Canberra, 13 August 2001, p 1332)

commercially viable in the longer term),⁷⁶ does not, however, mean that such arrangements are, by definition, always in the public interest. Nor does it justify the 'free-for-all,' experimentation with spin-off company arrangements that current Government policy appears to promote.

7.88 The Committee also heard that respected university research institutes such as the Harvard Medical School had strict conflict of interest guidelines governing academic staff's commercial holdings in research companies. In this context, one of the principals of BIOTRON explained that the arrangements for that spin-off had been developed with the clear intention of avoiding or minimising conflicts of interest: university research staff associated with BIOTRON worked four days a week for the university on publicly-funded research and one day a week for BIOTRON on intermediate research. The Committee also heard that the allocation of significant share holdings to the researchers in this case, is necessary and appropriate in light of the fact that the researchers were providing the drive and dedication for the commercial exploitation, a drive that was said to have been, in comparison, lacking from the university.⁷⁷ The Committee is not in a position to form a judgement on whether the claims relating to the university's lack of drive are justified. It is clear from Professor Chubb's evidence that there are good reasons to believe that ANUTECH had become too remote from the university but that remedial action has since restored the position of the company.

7.89 The Committee noted that, in some respects, the allocation of share holdings in spin-off companies could be considered analogous to the float of shares in Melbourne IT Ltd or the privatisation of public assets. In both cases, title, or part title to the intellectual property that had been developed through public subsidies, was effectively assigned to a number of individuals associated with these discoveries. The owners of the intellectual property (including the University) had then sold some of their rights to that property on the share market. On closer examination there are, however, also important differences.

7.90 The commercialisation of research is acknowledged to be high risk. The returns to shareholders, including the university, are uncertain and depend on research findings being able to be translated into commercially viable products (or, at least a perception, in the market, of a likely commercial return). This is the basis for the argument for researchers holding shares in the company, thereby combining the knowledge and incentive needed to achieve commercially viable breakthroughs, as discussed in Chapter 6. There is some merit in that argument but only if there is some restriction on researchers selling their shares - or profit-taking - soon after the float of the company or before there has been any research breakthrough. In the event of an early sell-off of shares by researchers, many of the purported benefits of the spin-off model are less likely to eventuate.

76 Australian Research Council, *Research in the National interest: Commercialising University Research in Australia*, July 2000, p.3

77 Mr Peter Scott, *Hansard*, Canberra, 13 August 2001, p.1237

7.91 Some universities are reviewing or developing policies regarding the formation of spin-off companies in the light of their experience with previous arrangements. These policies will address issues such as conflict of interest and ensuring an appropriate public return from the commercialisation of publicly-funded research and consider the best models for commercialisation.⁷⁸ Professor John Richards from the Australian National University, commenting on this matter, stated that:

There will always be a tension in my mind between the extent to which you are partners in the innovation cycle in this country and therefore what we contribute to national innovation and the rights that you are talking about for the public to expect us to be good custodians of public funding and therefore people who would declare the fruits of our research in the public domain.⁷⁹

7.92 The Committee believes that this matter raises important public interest issues. It therefore believes that Government, in this case MCEETYA, should develop a broad policy framework for commercialisation of research to ensure that public interest and probity considerations are given due weight in universities' individual policies and that there is due diligence and full scrutiny by Councils, of all proposals for commercialisation of research. Consideration could include models such as the Harvard guidelines.

Recommendation Thirty-One

The Committee recommends that the Government, in consultation with MCEETYA, develop a broad policy framework for commercialisation of research to ensure that public interest and probity considerations are given due weight in universities' individual policies and that there is due diligence and full scrutiny by university governing bodies, of all proposals for commercialisation of research.

7.93 In developing a policy framework, MCEETYA should also address the question of whether university-owned companies might provide a more effective investment instrument for commercialising research, as well as one that enables universities to retain a much higher share of any eventual revenue and profits. In this context, the Committee notes that some of the problems or barriers to commercialisation identified by witnesses to the inquiry, such as the lack of funding for patenting discoveries and the lack of knowledge, by university managers, of the IP existing or under development, do not, *in themselves*, justify the need for a different approach to commercialisation. Again, these are areas where the Commonwealth could and should provide financial support and leadership as part of a coherent policy for promoting research commercialisation within a broader public interest framework.

78 Professor John Richards (Australian National University), *Hansard*, Canberra, 13 August 2001, p.1331

79 *ibid.*

7.94 The Committee sees merit in exploring arrangements that address the lack of start up capital in a way which provides better protection for the public interest, including potentially better returns on the publicly-developed intellectual property. The Committee envisages that the arrangements for such a fund could include provision for the repayment of funds in the event that the company is commercially successful. This model could help ensure that universities (and the public) retain a greater share of any revenue from commercialisation and could also provide scope for rewarding outstanding researchers.

Recommendation Thirty-Two

The Committee recommends that the Government, as part of its development of commercialisation policy, consider establishment of an Innovation Grants Program from within existing resources to provide seed funding to university owned (or majority-owned) companies to address the current lack of start up capital.

Accountability and regulatory requirements

7.95 The NSW Department of Education and Training, like the Queensland Government, noted that the increased deregulation of universities had created problems and challenges for state governments charged with legal responsibility for oversight of universities established under state acts.

The refocussing of university resources and efforts towards more commercial areas of activity has been welcomed by the Commonwealth as evidence that less regulation allows institutions greater flexibility in managing their activities in a competitive funding environment. In reality, it has merely shifted the responsibility for many aspects of the sector's operations to the States. The evidence is that greater, rather than less, regulation may be needed, given the sector's increasing take-up of entrepreneurial activities. This situation creates additional and increasingly complex concerns for State legislators and administrators in protecting the public purse.⁸⁰

7.96 The NSW Minister for Education has proposed legislation aimed at strengthening the Auditor-General's powers to investigate universities' commercial arms and requiring universities' governing councils to take more responsibility for commercial operations to ensure that taxpayers funds are not being wasted. He has observed that universities' commercial operations had not always been approved by governing councils. The Committee heard reports that at least three universities in New South Wales are being investigated for commercial impropriety.⁸¹ The Victorian Government is also reviewing the arrangements for scrutiny and accountability of commercial activities of universities within its jurisdiction, in the wake of concerns

80 Submission 358, NSW Department of Education and Training, p.3

81 A Contractor, *Unis warned over bad business*, Sydney Morning Herald, 28 August 2001

such as the Auditor-General's criticism of the float of Melbourne IT and general concerns about the losses of MUPL. The relevant Minister has commented that there has been a perceived lack of transparency in university governance and fears that there has not been the scrutiny and rigour required of the commercial activities of public agencies. She drew attention to the lessons of recent corporate collapses, such as of HIH and One.Tel where scrutiny appeared to have been deficient.⁸² The Committee also understands that at least one other state or territory is considering similar action. These inquiries owe their origin in large part to the work of this Committee.

7.97 Curiously, given that the funds that are at risk are mainly sourced from the Commonwealth rather than the states, and as indicated at the start of this chapter, state governments are far from accepting and adopting the more laissez-faire or hands-off attitude of the Commonwealth to universities commercial operations. Most take their responsibilities seriously. However it is also clear that the capacity of state governments to effectively monitor the operations of the increasing number of commercial arms is sometimes quite limited. In light of this, and the valuable insights that would be gained from having a single authority responsible for oversight of commercial operations, the states and Commonwealth (through MCEETYA) should consider whether there are benefits in the Commonwealth, with its major funding responsibility and greater resource base, assuming responsibility for monitoring universities' financial operations, including the operations of commercial arms. The issue may also be one for referral to an independent higher education advisory body, the re-establishment of which the Committee recommends in Chapter 4.

Recommendation Thirty-Three

The Committee recommends that the states and Commonwealth (through MCEETYA) consider the benefits inherent in the Commonwealth, with its major funding responsibility and greater resource base, assuming responsibility for monitoring universities' financial operations, including the operations of commercial arms.

82 M Ketchell University businesses facing scrutiny, *The Age*, 8 September 2001