



Competitive Neutrality Complaint

**Complaint by a Road Transport
Operator Against Queensland Rail**

Final Report

July 2001

FOREWORD

The Queensland Competition Authority (the Authority) decided on 22 May 2000 to investigate a complaint by a road transport operator alleging a breach of the principle of competitive neutrality by Queensland Rail (QR).

While the definition of competitive neutrality was changed following amendments to the *Queensland Competition Authority Act 1997 (QCA Act 1997)* which were effective from 26 May 2000, the Authority was required to investigate the complaint under the provisions of the *QCA Act 1997* which were in existence at the time the Authority was considering whether to investigate the complaint.

The complaint related to pricing and animal welfare advantages that QR is alleged to have enjoyed over road transport service providers in the transport of livestock in Central Queensland (mainly to the East Coast). In order to expedite investigation of the complaint, the Authority decided to focus on the arrangements between Richmond Shire and Rockhampton, as most evidence was available from the complainant on this route.

Although the Authority did not then examine the extent of competition in the rest of the market nominated by the complainant, the arrangements which form the basis of the complaint were the same as those applying elsewhere in Central Queensland. It is highly likely, therefore, that the same conclusions would apply to the remainder of the Central Queensland market in which the complainant and QR compete.

The Authority has investigated the complaint and concluded that the financial arrangements between QR and the Queensland Government prevailing at the time of the complaint provided QR's *Cattletrain* livestock transport services with a competitive advantage over the complainant in the transport of livestock between Richmond Shire (via Winton) and Rockhampton solely because of the government ownership and control of QR. Accordingly, those arrangements breached the principle of competitive neutrality. The Authority also concluded that on the basis of the available information, the breach of competitive neutrality was not warranted when considered against the matters identified in section 49 of the *QCA Act 1997*.

For the breach to be remedied, the Authority recommends that the open ended financial arrangements between QR and the Queensland Government prevailing at the time of the complaint either cease or be amended to ensure that no competitive advantage is provided to QR unless there exists a demonstrable public benefit in doing so.

However, the Authority has been advised by Queensland Treasury and Queensland Transport that past arrangements which provided open ended funding for QR have ceased, that the Queensland Government currently has no policy intention to provide a direct subsidy to either the rail or road livestock transport industries, and that Queensland Transport and QR are currently developing a Regional Rail Service Agreement (RSA) for the transport of general freight which reflects this. Accordingly, as the source of the past breach relating to the complaint has been removed, no further action is necessary.

The new arrangements did not form part of the complaint and are, therefore, beyond the scope of the Authority's investigation. The Authority, however, has also been advised by Queensland Transport that the transport of livestock by QR may in the future receive limited indirect subsidy as a result of reduced access charges for all rail freight (not relevant to competitive neutrality as it is to be provided to all rail service providers irrespective of ownership), the KOJX livestock wagon project, initiatives to promote the employment of surplus staff in regional areas or, on rare occasions, by the attachment of livestock wagons to scheduled train services. Should these initiatives proceed, clear specification of policy objectives and improved

financial information systems would be needed to ensure that, subject to the public interest, the arrangements are competitively neutral.

Earlier drafts of this report have been circulated to the relevant agencies, the complainant and his representative to ensure that the facts (including those relevant to the complaint, the basis for QR's pricing and government policy positions) underpinning the Authority's conclusions have been accurately represented.

The Authority also concluded that no elements of the complaint breached the definition of the principle of competitive neutrality under the amended provisions of the *QCA Act 1997* as:

- private livestock transport providers are not subject to any procedural or regulatory requirements of the Commonwealth, the State or a local government to price services according to their full cost; and,
- the *Australian Model Code of Practice for the Welfare of Animals – Land Transport of Cattle* cannot be considered to be a regulatory or procedural requirement under s38(c) of the *QCA Act 1997* as it is a voluntary code.

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1. EXECUTIVE SUMMARY

1.1 The Complaint

The Queensland Competition Authority decided on 22 May 2000 to investigate a complaint by a road transport operator who transports livestock alleging a breach of the principle of competitive neutrality by Queensland Rail Corporation (QR). The complainant requested that the complainant's identity be kept confidential, and that the Australian Livestock Transporters' Association (ALTA) act as the complainant's agent. The Authority accepted these requests.

The complainant alleged QR breached the principle of competitive neutrality in Central Queensland by:

- pricing its *Cattletrain* livestock rail transport services below a level which a commercial private sector organisation could attain; and
- enjoying a procedural and operational advantage as a result of animal welfare transport standards.

Specific allegations included that QR:

- offered 'more favourable' prices to selected customers to attract them to use the QR livestock transport service;
- discounted livestock freight rates to particular businesses; and
- influenced the development of the animal welfare standard for livestock transport.

1.2 Legislative Requirements

While the definition of competitive neutrality was changed following amendments to the *Queensland Competition Authority Act 1997 (QCA Act 1997)* which were effective from 26 May 2000, the Authority was required to investigate the complaint under the provisions of the *QCA Act 1997* which were in existence at the time the Authority was considering whether to investigate the complaint.

In this regard, prior to 26 May 2000, section 38 of the *QCA Act 1997* required that, for an agency carrying on a significant business activity to be in breach of the principle of competitive neutrality, it must enjoy a competitive advantage over competitors or potential competitors in a particular market solely because of its government ownership or control.

1.3 The Investigation

The complaint related to pricing and animal welfare advantages that QR is alleged to have enjoyed over road transport service providers in the transport of livestock in Central Queensland (mainly to the East Coast). In order to expedite investigation of the complaint, the Authority decided to focus on the arrangements between Richmond Shire and Rockhampton, as most evidence was available from the complainant on this route.

1.4 Conclusions

Substantiation of Allegations

The Authority has concluded that the financial arrangements between QR and the Queensland Government prevailing at the time of the complaint provided QR's *Cattletrain* livestock

transport services with a competitive advantage over the complainant in the transport of livestock between Richmond Shire (via Winton) and Rockhampton solely because of the government ownership and control of QR. Accordingly, those arrangements breached the principle of competitive neutrality. The complaint, that QR enjoyed a competitive advantage because of its government ownership or control by pricing its *Cattletrain* livestock rail transport services below a level that a commercial private sector organisation could attain in the transport of livestock between Richmond (via Winton) and Rockhampton, is substantiated.

The Authority also determined that on the basis of the available information, the breach of competitive neutrality was not warranted when considered against the matters identified in section 49 of the *QCA Act 1997*.

Although the Authority did not then examine the extent of competition in the rest of the market nominated by the complainant, the arrangements which form the basis of the complaint were the same as those applying elsewhere in Central Queensland. It is highly likely, therefore, that the same conclusions would apply to the remainder of the Central Queensland market in which the complainant and QR compete.

Reason for the Decision

The Authority concluded that:

- QR's livestock transport service was obliged to comply with the principle of competitive neutrality. All of QR's business activities have been declared for this purpose under the *Queensland Competition Authority Act 1997*; and
- the complainant and QR did compete in providing livestock transport services between Richmond Shire and Rockhampton;
 - both the complainant and QR specifically sought to transport livestock and provide services capable of transporting similar load sizes;
 - both provided linehaul cattle transport services;
 - these services were available to graziers in the Richmond Shire and abattoirs in Rockhampton and could be arranged to deliver to Rockhampton;
 - these services were available at, or within, similar times; and
 - customers, the complainant and QR viewed these services as substitutes and in competition with one another.

General Pricing of QR Livestock Services

QR has advised that:

- prices charged for the transport of livestock are historic and did not reflect costs;
- revenues received from customers in respect of livestock freight services did not cover the cost of providing those services in aggregate, and that the Winton to Rockhampton route did not recoup associated costs;
- QR's financial information systems were not able to allocate costs to the *Cattletrain* service subject of the complaint.

On this basis, the Authority concluded that prices for the transport of livestock by QR did not cover QR's cost of providing these services between Winton and Rockhampton. QR thus had a competitive advantage over the complainant, who must cover all the costs of providing a competing service.

Queensland Transport advised that, historically, government funding was provided to QR on a whole of agency basis with no detailed specification of the services that QR was to perform in return. QR has also advised that it was unaware of any direct or indirect community service payments for its livestock services. The Authority has concluded that the nature of the financial arrangements and payments from the Queensland Government to QR followed from QR's government ownership or control. This is evidenced by the open ended nature of the arrangements and the absence of any detailed performance requirements or defined outcomes. It is considered such arrangements would not be available to a private sector operator of rail should such an alternative have been present.

Favourable Treatment of Select Customers

The Authority concluded that QR did provide slightly more favourable prices to certain clients in the form of volume discounts, in the absence of the necessary financial information to support such discounting. Such discounting could only be sustained by an entity which did not cover its costs, in other words one that was government owned or controlled.

Matters Not Substantiated

The Authority concluded that QR's discounts to its customers in exchange for operational efficiencies under commercial agreements with those customers did not result from government ownership or control. Such practices are applied by commercial operators.

The Authority concluded that QR did provide lower prices in the form of discretionary discounts off QR's standard rate schedule but this practice was no longer in effect at the time of the complaint.

The Authority also concluded that the substitution of larger wagons for smaller wagons at the same price arose due to operational requirements rather than as a result of government ownership or control.

The Livestock Code is intended as a guide for people transporting cattle by road or rail. It is not a legally enforceable standard in Queensland. The Authority did not consider that QR enjoyed any advantage from the application or development of the Livestock Code that can be solely attributed to QR's government ownership, as the Livestock Code applied to both public and private rail operators and, in any case, is not mandatory. Furthermore, the Authority did not consider that any influence exerted by QR arose due to its government ownership as the standards were established by an independent body well-removed from any source of undue influence.

Public Benefit Issues

In summary:

- there is insufficient specification in the financial arrangements prevailing at the time of the complaint to allow QR to establish an appropriate competitively neutral and efficient tariff structure for livestock transport, or the incentive to meet these objectives in the most efficient manner;

- pricing was based on historical rather than marginal cost prices necessary to ensure an efficient allocation of resources and consequently did not incorporate any adjustments to ensure desired social or environmental objectives were achieved; and
- available information indicated that most cattle continue to be transported by road rather than rail in the Richmond to Rockhampton sector, and that the employment and regional benefits are no less than those of rail although insufficient reliable information is available to be definitive on this point.

1.5 Recommendations

For the breach to be remedied, the Authority recommends that the open ended financial arrangements between QR and the Queensland Government and prevailing at the time of the complaint cease or be amended to ensure that no competitive advantage is provided to QR unless there exists a demonstrable public benefit in doing so.

However, the Authority has been advised by Queensland Treasury and Queensland Transport that past arrangements which provided open ended funding for QR have ceased, that the Queensland Government currently has no policy intention to provide a direct subsidy to either the rail or road livestock transport industries, and that Queensland Transport and QR are currently developing a Regional Rail Service Agreement (RSA) for the transport of general freight which reflects this. Accordingly, as the source of the past breach relating to the complaint has been removed, no further action is necessary.

Earlier drafts of this report have been circulated to the relevant agencies, the complainant and his representative to ensure that the facts(including those relevant to the complaint, the basis for QR's pricing and government policy positions), underpinning the Authority's conclusions have been accurately represented.

1.6 Amended *QCA Act 1997*

Following amendments to the *QCA Act 1997* which were effective from 26 May 2000, an agency can only be found to be in breach of the principle of competitive neutrality if the agency enjoys a competitive advantage over competitors or potential competitors because the agency's activities are not subject to: (a) full tax equivalent systems; (b) offsetting debt guarantee fees; or (c) government procedural or regulatory requirements on conditions equivalent to the conditions to which a competitor may be subject.

The Authority concluded that no elements of the complaint breached the definition of the principle of competitive neutrality under the amended provisions of the *QCA Act 1997* as:

- private livestock transport providers are not subject to any procedural or regulatory requirements of the Commonwealth, the State or a local government to price services according to their full cost; and
- the *Australian Model Code of Practice for the Welfare of Animals – Land Transport of Cattle* cannot be considered to be a regulatory or procedural requirement under s38(c) of the *QCA Act 1997* as it is a voluntary code.

2. THE COMPLAINT

2.1 The Complainant

The Queensland Competition Authority decided on 22 May 2000 to investigate a complaint by a road transport operator who transports livestock alleging a breach of the principle of competitive neutrality by Queensland Rail (QR). The complainant requested that the complainant's identity be kept confidential, and that the Australian Livestock Transporters' Association (ALTA) act as the complainant's agent. The Authority accepted these requests.

2.2 The Agency

The complaint was directed against Queensland Rail (QR). The relevant business activity of QR against which the complaint was directed is the Regional Freight Division of QR's Metropolitan and Regional Services business unit. It is responsible for the delivery of scheduled and chartered *Cattletrain* livestock rail transport services.

All the business activities of QR were declared on 1 July 1997 as 'significant business activities' for the purposes of the competitive neutrality provisions of the *Queensland Competition Authority Act 1997*.

2.3 The Complaint

The complainant alleged that QR breached the principle of competitive neutrality in Central Queensland by:

- pricing QR *Cattletrain* livestock rail transport services below a level which a commercial private sector organisation could attain; and
- enjoying a procedural and operational advantage as a result of animal welfare transport standards.

Specific allegations included that QR:

- offered 'more favourable' prices to selected customers to attract them to use the QR livestock transport service;
- discounted livestock freight rates to particular businesses; and
- influenced the development of the animal welfare standard for livestock transport.

2.4 Source of Alleged Advantages

It was claimed by the complainant that QR was able to engage in these alleged practices by virtue of the following competitive advantages which allegedly follow from government ownership or control:

- the availability to QR of external subsidies paid by the Queensland Government (including CSO payments);
 - the availability to QR of internal subsidies sourced from other business units within QR; and
 - the ability of QR to influence policy decisions to its advantage, particularly in terms of livestock transport standards.
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3. THE DECISION TO INVESTIGATE

3.1 Requirement to Investigate

Under the provisions of the *QCA Act 1997*, the Authority was required to investigate a complaint about an alleged breach of the principle of competitive neutrality if:

- the activity which was the subject of the complaint in relation to a particular market has been declared to be a significant business activity by the Ministers (the Premier and Treasurer);
- the complainant was, or seeks to be, in competition in a particular market with the significant business activity;
- the complainant was, or may be, adversely affected by the competitive advantage enjoyed by the significant business activity;
- the complainant made a genuine attempt to resolve the matter of its complaint with the government agency; and
- the complainant and the affected agency satisfy certain procedural requirements outlined in the *QCA Act 1997*.

3.2 Rationale for the Decision to Investigate

The Authority decided to investigate the complaint as it considered the essential legislative requirements for an investigation were satisfied, in particular that:

- all of the business activities of QR were declared on 1 July 1997;
- an examination of the market indicated that the complainant could be in competition with QR;
- the complainant could be adversely affected by non-compliance by QR with the principle of competitive neutrality;
- the complainant had attempted to resolve the complaint with QR; and
- the complaint was not frivolous or vexatious, nor had the complainant failed to provide any required information, nor was there any other matter which could preclude investigation of the complaint.

3.3 Basis for the Investigation

While the definition of competitive neutrality was changed following amendments to the *Queensland Competition Authority Act 1997 (QCA Act 1997)* which were effective from 26 May 2000, the Authority was required to investigate the complaint under the provisions of the *QCA Act 1997* which were in existence at the time the Authority was considering whether to investigate the complaint.

In the interests of completeness, the Authority also considered the complaint as if it had been made after the date of the change in the definition of competitive neutrality.

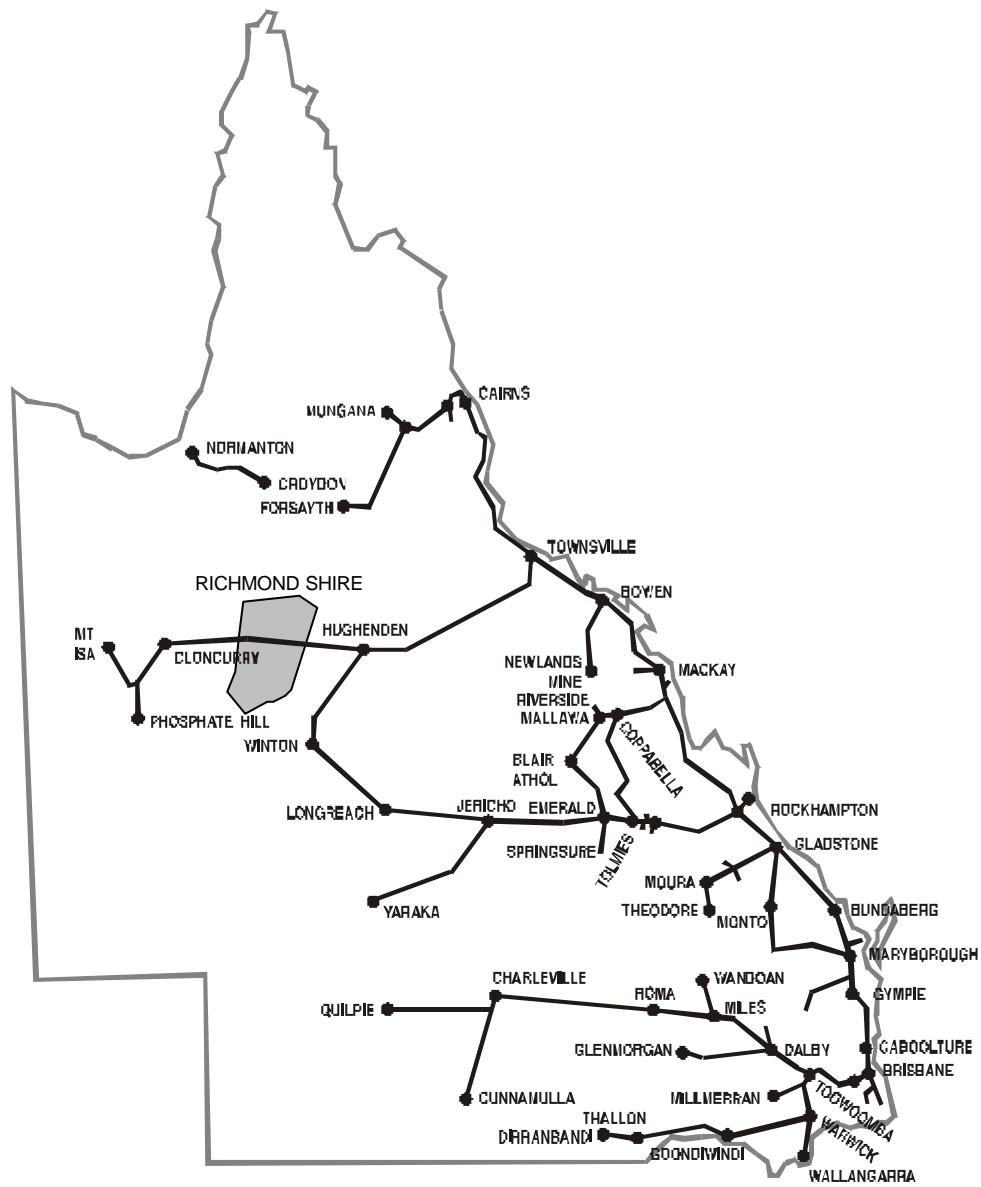
4. THE MARKET

The market for a product or service is an area of close competition between substitute goods or services, and can be defined or distinguished according to the nature of the service being provided, a geographic dimension, the market focus of participants, and time.

The complaint related to pricing and animal welfare advantages that QR is alleged to have enjoyed over road transport service providers in the transport of livestock in Central Queensland (mainly to the East Coast) - in particular from the Richmond, Winton and Flinders Shires to Cloncurry, Mt Isa, Mackay, Rockhampton, and Stuart (Townsville).

The Authority focussed its investigation on the arrangements between Richmond Shire and Rockhampton as, according to the complainant, most evidence was available from the complainant on this route. Furthermore, the arrangements which form the basis of the complaint are similar to those applying elsewhere in Central Queensland. These routes are identified in Figure 4.1.

Figure 4.1 - QR's Rail Network



4.1 The Service

The relevant service involves the transport of livestock.

The complainant provided intrastate livestock road transport services either alone or, where additional capacity was required, by subcontracting the services of other livestock transporters.

The standard unit of measure for the road transport of livestock is a deck of cattle. Around 20 cattle are carried per deck, however this can vary depending on the breed and maturity of the cattle as well as whether or not they are dehorned. The complainant provided livestock transport services from properties to other properties, railheads, abattoirs and seaports across Queensland. Information provided by the complainant shows that between June 1996 and June 1999 the complainant transported between 2,000 and 3,000 decks or between 60,000 and 100,000 head of cattle. During that period 54 per cent of trips were between one property and another, 26 per cent were to transport cattle from properties to QR services and 20 per cent were from properties to abattoirs or seaports.

QR provided for the transport of livestock in the form of its *Cattletrain* livestock transport services, which comprise dedicated scheduled services. QR also provides dedicated chartered services where there are sufficient numbers of livestock to warrant service provision. Unlike the complainant, QR was restricted to operate its services between points on the rail network. However, graziers could deliver their livestock to the railhead using their own vehicles or by using the services of road transport operators.

4.2 The Geographic Dimension

The geographic dimension of a market defines the physical boundaries within which the market exists.

As noted above, the complaint related to pricing and animal welfare advantages that QR is alleged to have enjoyed, over road transport service providers, in the transport of livestock in Central Queensland (mainly to the East Coast) - in particular from the Richmond, Winton and Flinders Shires to Cloncurry, Mt Isa, Mackay, Rockhampton, and Stuart (Townsville).

In order to expedite investigation of the complaint, the Authority decided to focus on the arrangements between Richmond Shire and Rockhampton, as most evidence was available from the complainant on this route.

Both road and rail transport services were available for livestock from Richmond Shire to abattoirs in Rockhampton. Livestock were either transported by road to the abattoirs or to QR railheads in Richmond, or Winton, for *Cattletrain* livestock transport services to Rockhampton.

QR contended that order size was a factor in determining whether there was a market. In QR's view, road transport was generally only interested in orders of 4 decks and above due to the configuration of the road train equipment being operated, particularly in relation to services between Richmond and Rockhampton. Small orders would be refused, priced too high or directed to rail by a road transport operator.

Accordingly, freight logs of the complainant and QR were examined to ascertain whether QR transported consignments of 4 decks or more from Richmond Shire to the Rockhampton area.

Over the last two years, only a very small number of decks of livestock were transported from Richmond to Rockhampton by rail and only 25 per cent of these were for orders of more than 4 decks at a time. That is, only a very small number of consignments comparable in size to those provided by road transporters were provided by *Cattletrain* livestock transport services.

However, QR data for Winton to Rockhampton services for the year to November 2000 and for 1999 shows that a significant number of cattle were moved. An analysis of data for these periods indicates that 86 per cent of orders were for consignments of 4 decks or more at a time.

QR also contended that most of the work in the Richmond Shire was not contestable by rail as cattle were transported from properties to Karumba Port, the Innisfail abattoir and Darwin for live export and movements to southern saleyards. This contention was largely supported by information provided by the complainant.

It is also evident that there may be parts of the geographic catchment for which the two modes may not be effective substitutes because of the cost of transferring livestock from one mode to another. For example, if a cattle station is located a significant distance away from a rail loading point, rail may not be able to place a significant price discipline on road because the added transport and handling costs are relatively large. In this case, the geographic markets may be separate.

It is clear, however, that some road and rail services were provided between Richmond and Rockhampton although a more significant number of services, for orders of similar size, were provided by both QR and the complainant between Winton and Rockhampton.

4.3 Timing of the Provision of Services

The services provided by the complainant were organised on an informal, ad hoc basis, and usually as a result of telephone contact with clients. Clients typically included graziers, abattoirs, live cattle exporters or their agents.

Both services were available within the planning timeframe of graziers and abattoirs.

QR's *Cattletrain* service is a scheduled service but this has not yet been fully implemented with chartered services still being made available. The scheduled service involved 6 services per week from Richmond to Townsville, which could then connect through to Rockhampton on 3 services per week. Scheduled services from Winton to Rockhampton operated throughout most of the year on a fairly regular weekly basis.

There is a strong seasonal element in the transport of livestock. Most livestock transport in the region typically occurs during an eight month period each year from April to November, effectively during the dry season. This seasonal variation was evident in data provided by both QR and the complainant. Neither rail nor road transport operators can provide services to all potential users during the wet season. Road transport operators' capacity is reduced due to the constraints on road traffic and graziers are also reliant on road transport to provide a farmgate to railhead service. Only a very small number of graziers in the Richmond area are able to walk stock to local saleyards for transport by rail.

The Authority concluded that both road and rail transport services were available at, or within, similar times and could thus be considered substitutes for each other. That is, they provided a competitive choice for graziers and abattoirs seeking to transport livestock to Rockhampton.

4.4 The Market Focus

The market focus of customers and competitors is a useful indicator of whether transport operators consider themselves to be, and therefore act as, competitors in a particular market. This provides an important indication of whether the goods or services are indeed substitutes for each other.

Cattle may be sold on a 'weight and grade' basis at meatworks or on a 'liveweight' basis across scales in graziers' local areas. Typically cattle sold on a 'weight and grade' basis are transported at the grazier's expense to the meatworks. Cattle sold 'liveweight' are transported from the local area at the abattoirs' expense and are typically railed to the abattoirs.

Graziers in the Richmond area contacted by the Authority commented that they perceived that road and rail compete to provide livestock transport services. These graziers use both road and rail linehaul services to deliver cattle to Rockhampton abattoirs. Comments from graziers suggested that there was a trade-off between the trip time, the cost of transport and differences in the quality of the service provided, particularly as it related to bruising of stock in transit.

Rockhampton abattoirs receive cattle by both road and rail. They indicated to the Authority that when they purchased cattle in the Richmond area and arranged their own transport they chose the transport service that offered the best combination of price and service quality, which confirmed that they also saw road and rail transport operators offering services that were substitutes.

In general, livestock transport service providers confirm that road and rail operators compete to transport livestock from Richmond Shire to Rockhampton:

- the complainant considered that the complainant and other livestock road transporters were in competition with QR between Richmond Shire and Rockhampton; and
- QR and the complainant have separately indicated that neither rail nor road had the capacity to undertake the entire transport task. However, they both considered that if additional modal capacity were available they would be able to undertake some of the other mode's transport task in the Richmond area.

Further, while not specific to the Richmond to Rockhampton area, the Authority noted the following attitudes, which relate to general road and rail competition and which also apply to this area:

- QR has stated at forums such as the Livestock Consultative Committee that it considered it competed against road transporters to carry livestock;
- QR has indicated in a presentation to the Authority that it considers that competition from road transport operators had increased due to volume loading concessions, B-triple road trains and low cost or cross subsidised access to road infrastructure by heavy vehicle operators; and
- in the context of a Queensland Parliamentary debate about the relative pricing of road and rail services, the Minister for Transport has stated that "the movement of freight by rail should be encouraged where possible" thus recognising that alternatives to rail such as road transport of livestock do exist.

Furthermore :

- the very fact that there is a complaint suggests that the ability to substitute is sufficiently high and directly affects the revenue of both parties; and
- the rail mode would not need to price so aggressively, if it did not experience price competition from the road mode.

Having regard to the views of graziers, abattoir owners, the complainant, the market participants and users of the services the Authority considered that rail and road compete in the provision of substitute services between Richmond Shire (particularly from Winton) and Rockhampton.

The Authority notes submissions from Queensland Transport that there is a difference in the legal liability for the condition in which cattle arrive at the meatworks. Road transporters are liable for the condition of the livestock being transported while rail operators are only responsible for the condition of wagons, ensuring that loading does not affect animal welfare, that drivers are aware that there is livestock on the train, and providing accredited stock care managers enroute. These differences have not, however, been identified by any participants in the market, either users or service providers, as differentiating their services to an extent which precludes them from being regarded as competing services.

4.5 Conclusion

The Authority recognised that there are a number of factors that influence the choice of service. They included the availability of the services, the destination, length of trip and associated condition of the livestock, and the cost of the service. Service choice may also be influenced by the method by which cattle are sold.

Nevertheless, the Authority concluded that the complainant and QR did compete in providing livestock transport services between Richmond Shire and Rockhampton as:

- both the complainant and QR specifically sought to transport livestock and provide services capable of transporting similar load sizes;
- both provided linehaul cattle transport services;
- these were available to graziers in the Richmond Shire and abattoirs in Rockhampton, and could be arranged to deliver to Rockhampton;
- these services were available at, or within, similar times; and
- customers, the complainant and QR viewed these services as substitutes and in competition with one another.

The Authority also recognised that there were some differences in the nature of some services provided by the complainant and QR:

- QR provided scheduled and chartered services on a fixed permanent network through a series of nodal points whereas the complainant offered a door-to-door service;
- QR services required at least 48 hours notice for charter services. In contrast, the complainant could provide some services at relatively short notice on an ad hoc basis; and
- journey times vary considerably between comparable road and rail services, with most road services taking considerably less time.

The Authority considered that while these differences reflected inherent characteristics in these two modes of transport, the differences did not materially preclude effective competition in providing livestock transport services or prevent consumers from substituting one service for another as:

- QR services could be complemented by road transport service operators to provide a door-to-door service;

- road transport operators could also require more than 48 hours to organise the transport of 24 deck and above loads; and
- differences in journey times could be allowed for by graziers and abattoirs when planning the movement of livestock.

As noted above, the Authority chose to focus its inquiries upon the Richmond Shire to Rockhampton route as most evidence was available from the complainant on this route. In this analysis, the extent of competition between QR and the complainant is most extensive on the Winton to Rockhampton service.

5. REGULATORY ENVIRONMENT

5.1 General Regulatory Framework

QR is a statutory government owned corporation (GOC) and was corporatised on 1 July 1995 under regulations contained in the *Government Owned Corporations (Queensland Rail) Regulation 1995*. As a statutory GOC, QR is required to comply with certain legislative, regulatory and policy requirements, including:

- the *Government Owned Corporations Act 1993 (GOC Act 1993)*;
- the Community Service Obligations Policy Framework (CSO Policy);
- the *Financial Administration and Audit Act 1977; (FAA Act 1977)*; and
- the *Financial Management Standard 1997 (FMS 1997)*.

In addition to legislative and regulatory requirements relating to QR's corporate governance, both QR and road transporters of livestock are subject to:

- the *Animal Protection Act 1925*; and
- the *Animals Protection Regulation 1991*.

5.2 Government Owned Corporations Act 1993

The *Government Owned Corporations Act 1993 (GOC Act 1993)* sets out the objectives of corporatisation, including improvement of the State's overall economic performance and to provide an ability for the Government to achieve social objectives by directing an agency to undertake certain non-commercial activities. The key principles of corporatisation are:

- clarity of a GOCs objectives, including clearly identified and costed CSOs;
- management autonomy and authority, including clearly defined roles for the Minister and the Board;
- strict accountability for performance, monitored against the statement of corporate intent; and
- competitive neutrality.

The principle of competitive neutrality requires that the efficiency of overall resource use in the State is promoted and, wherever possible, any special advantages or disadvantages of a GOC, because of its public ownership or market power, are to be minimised, removed or made apparent to ensure that the GOC competes on equal terms with other entities carrying on business.

A GOC's statement of corporate intent (SCI) forms the basis for its accountability in the absence of monitoring by shareholders and markets to which listed corporations are typically subject. Section 132 of the *GOC Act 1993* requires that each GOC's annual SCI provide a definitive statement of the nature and extent of the CSOs and the way in which the GOC is to be compensated for performing these CSOs. A copy of the SCI, excluding certain commercially sensitive information, is tabled before the Queensland Legislative Assembly each year.

Historically, Queensland Transport (QT), on behalf of the Queensland Government, has made annual budget payments to offset the cost to QR of providing rail services. Funding provided to QR was largely on a whole of agency basis with no detailed specification of the services that QR was to perform in return, with some exceptions including the purchase of certain capital items. That is, QT provided QR with an untied operating subsidy.

Subsequently, QR and QT executed a contract for the purchase of specific below rail services effective 1 July 1999. The Transport Services Contract (Rail Infrastructure) is between QR (as the Service Provider) and the Director-General of QT for and on behalf of the State of Queensland (as the Purchaser). The Contract requires QR to:

- manage and make available each Track Section to which the Agreement applies so as to:
 - maintain the Service Standards to at least the Base Service Levels for that Track Section;
 - provide access to Railway Operators; and
- negotiate in good faith with any potential Railway Operators to provide access to the Track Sections consistent with the relevant legislation.

QR and QT have recently entered into discussions to establish contracts for the purchase of other specific rail services that fulfil specific transport outcomes. A regional rail service agreement is yet to be concluded. This will provide for general freight services to be supplied by QR in respect of various lines including the line between Winton and Rockhampton. However, there is no intention to purchase train services on the line between Townsville and Mt Isa. The level of detail is not expected by QT to include specific subsidisation of individual freights, such as livestock freight undertaken by QR's *Cattletrain* services.

5.3 Community Service Obligation Policy Framework

The State Government provides a range of non-commercial products and services to the community mainly through its agencies. The policy document *Community Service Obligations – A Policy Framework (March 1999)* specifies the requirements for applying CSOs to government owned corporations. The key objectives of the Queensland Government's CSO policy guidelines are:

- to ensure that the delivery of CSOs is consistent with the outcomes defined by the Government to support its priorities for meeting the needs of the Queensland community;
- to adopt an 'output' focus in the delivery of CSOs and thereby provide opportunities for innovative service delivery, improvements in the quality and cost of products and services provided, and increased value for money for the community;
- to clarify the Government's different roles and responsibilities as (i) shareholder/owner of the commercial business entity; and (ii) purchaser of services from the commercial business entity; and, (iii) where possible, minimise any conflict between these different roles of Government; and
- to improve the direct accountability of agencies in the delivery of CSOs on behalf of the community.

To qualify as a CSO an activity must satisfy three criteria:

- it must be a non-commercial product or service;
- it must be clearly purchased by the Government; and
- it must be purchased through the relevant Department from an appropriate commercial business entity.

In general a range of activities are not regarded as CSOs, including:

- delivery by commercial business entities of any non-commercial products or services not approved as part of the Budget process;
- any loss of potential revenue resulting from publicly-owned business entities being required to eliminate any excess profits or cross-subsidies and other forms of price discrimination; and
- non-commercial activities that are essentially strategic business decisions which are ultimately in the commercial interest of the business entities, including:
 - lowering prices to attract customers and establish, increase or maintain market share or improve capacity utilisation (eg special deals, customer loyalty programs, early payment discounts, off-peak rates).

Competitive neutrality adjustments are used in many instances to account for advantages and disadvantages that government businesses enjoy because of their public ownership.

5.4 Financial Administration

Of particular note, Part 3 section 46C of the *Financial Administration and Audit Act 1977* includes requirements for each statutory body to:

- ensure that its operations are carried out efficiently, effectively and economically; and
- where services are rendered or goods supplied to any person by the statutory body - take action to ensure that fees and charges are being properly assessed and levied and that the same are adequate having regard to the cost of supplying such goods or services and other relevant matters.

5.5 Animal Welfare

Queensland animal welfare laws are contained in the *Animals Protection Act 1925* and the *Animals Protection Regulation 1991*. The objective of the legislation is to prevent cruelty to animals. The legislation covers all animals and animal conveyance in Queensland and identifies various offences, including:

- ill-treatment of any animal;
- failing to provide sufficient suitable food or drink; and
- conveying any animal in such a manner as to subject the animal to unnecessary pain.

The Queensland Department of Primary Industries (DPI) administers the legislation. The main agencies that enforce it are the Queensland RSPCA and the Queensland Police Service.

In addition to the Queensland legislation, model codes have been established at the national level to provide best practice guides to animal welfare. The *Australian Model Code of Practice for the Welfare of Animals – Land Transport of Cattle* (the Livestock Code) was in place at the time of the decision to investigate the complaint. It was developed by the Standing Committee on Animal and Resource Management (SCARM), which comprises all Department Heads and Chief Executives of Commonwealth, State, Territory and New Zealand government agencies responsible for agriculture, soil, water and rural adjustment policy issues as well as the Commonwealth Scientific and Industrial Research Organisation and the Bureau of Meteorology.

It was endorsed in August 1999 by the Animal and Resource Management Council of Australia and New Zealand (ARMCANZ), which comprises all Commonwealth, State, Territory and New Zealand Ministers responsible for agriculture, soil, water (both rural and urban) and rural adjustment policy issues. The Livestock Code replaced the *Model Code of Practice for the Welfare of Animals – Road Transport of Livestock* and the *Model Code of Practice for the Welfare of Animals – Rail Transport of Livestock* that were previously endorsed by ARMCANZ in 1983.

The Livestock Code is intended as a guide for people involved in transporting cattle by road or rail. It emphasises the responsibilities of the owner of the cattle (and the owner's agent), livestock transporters, livestock transport drivers, attendants and railway officials. The Code applies to the period immediately after mustering for loading including any handling in yards, waiting periods, loading, transit, rest period and unloading at the point of destination.

The Livestock Code is not a legally enforceable standard in Queensland. Breaches of the Livestock Code, in and of themselves, do not automatically constitute a criminal offence. According to the Animal and Plant Health Service (APH) of the Department of Primary Industries, the Livestock Code is neither a rule nor a regulation. Although APH has indicated that the Livestock Code may be submitted as court evidence to determine whether animals have been mistreated in a case under the *Animals Protection Act 1925*, the application of the Livestock Code is not specified in that Act or the Regulation. That is, a breach of the Livestock Code does not necessarily constitute a breach of the *Animals Protection Act 1925*.

The Queensland Government has proposed to replace the current Act with a new *Animal Care and Protection Act*. An important feature of the policy principles is the recognition of national codes of practice in the draft legislation. Although the proposed amendments to the *Animals Protection Act 1925* will refer to certain animal welfare codes, it is unlikely that the Livestock Code will be explicitly mentioned.

QR introduced a livestock quality assurance program called *Stockcare*. *Stockcare* is intended to reflect the requirements of the legislation and codes identified above but is essentially an internal QR quality assurance program with no application to road transport. It does not impose penalties on QR for nonconformance. The *Stockcare* program provides for monitoring and handling of livestock by trained *Stockcare* attendants at strategic points during livestock journeys on QR's network. The program includes a system for reporting on the welfare of livestock. QR has stated that it liaises closely with DPI and the RSPCA and complies with the Livestock Code.

6. ALLEGED COMPETITIVE ADVANTAGES

The objective of this section is to identify whether or not QR enjoyed the alleged competitive advantages in relation to the pricing, and animal welfare standards, of its *Cattletrain* livestock transport services, and to ascertain whether the competitive advantage arose solely as a result of its government ownership or control.

6.1 Pricing

Key Issues

The complainant alleged that QR enjoyed a competitive advantage, and therefore breached the principle of competitive neutrality, by pricing its *Cattletrain* livestock rail transport services below a level that a commercial private sector organisation could attain.

Specific allegations included that QR:

- offered 'more favourable' prices to selected customers to attract them to use the QR livestock transport service; and
- discounted livestock freight rates to particular businesses.

Pricing of Road and Rail Services for Competitive Neutrality

The Authority was provided with details of prices for the transport of livestock by road and rail. An analysis of this information showed that rates charged by QR from the Richmond region to Rockhampton were in the order of 30 per cent less than comparable rates charged by the complainant.

To breach the principle of competitive neutrality, it is not relevant that prices for a particular service are below those of a competing service provider. Each service provider has a different approach to the way in which it conducts its business, the range of services provided, the nature and the size of its asset base.

Rather, from the perspective of competitive neutrality, the issue is whether prices charged are below the cost of those services, and, in this instance, whether any shortfall was due to QR's government ownership or control. A private sector service provider is required to cover all costs including earning a return on capital and return of capital if services are to be provided over the long term. The Authority notes that the complainant has provided road transport services over many years and is continuing to do so.

General Pricing of QR Livestock Services

Assessment

The Authority sought to ascertain whether the charges for livestock transport services reflected the cost of service provision, however, QR was unable to provide financial information at the level of specificity necessary for this purpose. The absence of financial information at the service level was ascribed by QR to the difficulty in ascertaining such costs as a result of the nature of the network service being provided and the difficulty of identifying and allocating with any certainty and unambiguously overhead costs which constitute a major part of the livestock service costs.

QR has advised, however, that prices for QR's livestock transport services are derived from historic charges, the basis of which QR was unable to establish, and which have been altered, over a period of time, sometimes to reflect changes in the consumer price index (rather than

movements in known costs). A table of the freight rates that QR charges customers was provided to the Authority.

Furthermore, QR advised that revenues received from customers in respect of livestock freight services did not cover the cost of providing those services in aggregate, and that the Winton to Rockhampton route did not recoup associated costs (although freight specific information was not available).

The Authority sought to verify this advice on the basis of an assessment of published financial information. However, while an analysis of the Profit and Loss Statements over the past three years confirmed that QR's customer revenues did not cover its total operating expenses and that QR received \$1.00 from the government for every \$2.00 in customer revenue, the information was too aggregated to confirm the information received from QR for the livestock services from Winton to Rockhampton. Table 6.1 refers.

Table 6.1 QR Profit and Loss Statements

	2000	1999	1998(b)
	\$'000	\$'000	\$'000
Operating Revenue			
Sales			
Coal and Mainline Freight	1,034,540	1,006,697	-
Metropolitan & Regional Services	187,343	173,119	-
Traveltrain	56,761	50,147	-
Other (a)	20,628	2,571	-
Total	1,299,272	1,232,534	1,197,373
Government Contributions (GC)			
Metropolitan and Regional Services	346,100	265,862	-
Traveltrain	59,476	63,694	-
Network Access Group	263,011	197,795	-
Other	2,239	6,066	-
Total	670,826	533,417	541,568
Contributions from developers (a)	-	17,681	16,490
Total Sales Revenue	1,970,098	1,783,632	1,755,431
<i>GC as % of Sales Revenue</i>	<i>34%</i>	<i>30%</i>	<i>31%</i>
Other Revenue			
Total	377,194	118,380	140,079
Total Operating Revenue	2,347,292	1,902,012	1,895,510
<i>GC as % of Op. Revenue</i>	<i>29%</i>	<i>28%</i>	<i>29%</i>
Total Operating Expenses	2,165,547	1,734,126	1,590,901

Notes:

(a) QR received amounts from developers by way of non-refundable capital contributions for the provision of necessary infrastructure. This accounts for around 87% of the other category in 2000. The residual is made up of external access fees.

(b) Comparison with 1998 figures not available due to restructuring.

Source: QR Annual Reports 2000, 1999 and 1998.

Nevertheless, on this basis of the submissions received from QR, the Authority has concluded that prices for the transport of livestock by QR did not cover QR's cost of providing these services between Winton and Rockhampton. QR thus had a competitive advantage over the

complainant, who must cover all the costs of providing a competing service if he is to continue to provide services over the longer term.

Government Ownership

The *GOC Act 1993*, QR's public *Statements of Corporate Intent* for the years 1997, 1998 and 1999, and QR's Annual Reports for the years 1998, 1999 and 2000 do not identify any explicit direction from Government in relation to the provision or pricing of QR's *Cattletrain* livestock transport services. Indeed, QR has confirmed that it is not aware of any CSO payments as defined by the *GOC Act 1993* that are specific to *Cattletrain* livestock transport services.

In the past funding was provided to QR largely on a whole of agency basis with no detailed specification of the services that QR was required to perform.

The issue, therefore, arises as to whether such funding was provided solely due to the government's ownership and control of QR.

The Authority considered that CSOs were only made available to QR because of its government ownership or control in that they were open ended and without any detailed performance requirements or defined outcomes. It is not considered such arrangements would be available to a private sector operator of rail should such an alternative have been present.

The complainant also alleged that a source of competitive advantage was the availability to QR of internal subsidies from other areas of QR, such as revenue from its coal operations. QR indicated that no such subsidies existed but stated that, in any case, it was not uncommon to cross-subsidise less profitable parts of a business or treat some businesses as 'loss leaders' to attract customers to the business.

The Authority recognises that commercial entities do price discriminate and may allocate different proportions of fixed and common costs to customers. However, such actions require a detailed understanding of the costs of providing a service and the responsiveness of demand to changes in the price of the service. It is not considered that a commercial entity could sustain the consequent overall losses, of the size of those suffered by QR, without a government subsidy. As noted above, the nature of current arrangements would not be available to a private entity.

However, in the absence of necessary detailed financial information, it was not possible to establish whether any internal cross-subsidy or loss-leading was involved in supporting QR's livestock service. Neither was it considered necessary to pursue this matter further in the light of the above conclusions as related to government contributions in general.

Competitive Neutrality and Payments Received from the Queensland Government

The Authority received submissions from QR which proposed that, in determining whether the principle of competitive neutrality has been breached, the Authority should take into consideration QR's other direct and indirect payments from government in assessing the commerciality of QR's livestock services.

The Authority disagrees with such an approach as the principle of competitive neutrality, as defined under the provisions prevailing at the time the Authority was considering whether to investigate the complaint required that a government agency should not enjoy a competitive advantage, solely because of the government ownership or control of the agency, over competitors or potential competitors in a particular market. A government payment to the agency does not overcome the existence of a competitive advantage.

However, the Authority does accept that a CSO or payment from government, reflecting specific objectives desired by government, may justify any breach of the principle of competitive neutrality.

Therefore, under the legislation prevailing at the time of the complaint, even if the payments were the result of an explicit government policy, it would still be necessary to consider whether they provided a competitive advantage due to government ownership or control and whether, if they did, the breach of the principle of competitive neutrality was justified.

Nevertheless, Queensland Transport advised that, historically, government funding was provided to QR on a whole of agency basis with no detailed specification of the services that QR was to perform in return. QR has also advised that it was unaware of any direct or indirect community service payments for its livestock services and that in relation to other payments and/or subsidies then current information systems were not capable of such detail.

It is evident therefore that prices did not reflect any specific social objectives relevant to the transport of livestock.

Conclusions

QR has advised that:

- prices charged for the transport of livestock are historic and did not reflect costs;
- revenues received from customers in respect of livestock freight services did not cover the cost of providing those services in aggregate, and that the Winton to Rockhampton route did not recoup associated costs;
- QR's financial information systems were not able to allocate costs to the *Cattletrain* service subject of the complaint.

On this basis, the Authority has concluded that prices for the transport of livestock by QR did not cover QR's cost of providing these services between Winton and Rockhampton. QR thus had a competitive advantage over the complainant, who must cover all the costs of providing a competing service.

Queensland Transport advised that, historically, government funding was provided to QR on a whole of agency basis with no detailed specification of the services that QR was to perform in return. QR has also advised that it was unaware of any direct or indirect community service payments for its livestock services. The Authority has concluded that the nature of the financial arrangements and payments from the Queensland Government to QR followed from QR's government ownership or control. This is evidenced by the open ended nature of the arrangements and the absence of any detailed performance requirements or defined outcomes. It is not considered such arrangements would be available to a private sector operator of rail should such an alternative have been present.

Favourable Treatment of Select Customers

Assessment

The complainant alleged that certain customers of QR received "more favourable" prices to use QR's services.

QR confirmed that it did discount prices where users were prepared to agree to changes in practices which provide QR with improved operational efficiencies and that abattoirs were targeted on this basis.

QR provided an example of where it offered such discounts. In the instance cited, it provided deck rebates to an abattoir operator who spent a significant amount of money to improve the rail operations at the abattoir's siding. QR has advised, however, that such discounts are very rare.

QR has also advised that a volume rebate was available for customers who met certain revenue levels, reflecting potential economies of scale. This rebate started at 1 per cent where annual revenue exceeds \$2 million and rose to a rebate of 4 per cent where revenue exceeds \$5 million a year.

Government Ownership

The ability of a government business to offer more favourable prices to select customers as a result of improved operational efficiency does not necessarily arise solely due to government ownership or control. In commercial transactions between privately owned firms efficiency gains are often shared between companies. The Authority confirmed the existence of such arrangements with a leading Australian freight and logistics company. Volume discounts also represent general industry practice.

In instances where specific discounts to reflect improved operational efficiency were provided by QR it was considered possible that the specific cost improvement by QR could be accurately estimated. Consistent with industry practice, these benefits could be shared between the service provider and service user.

However, it is not evident why volume discounts for individual users would be provided by a business entity providing network services when the entity is unable to cover its operating costs and does not have financial information to ascertain the cost of servicing users or the benefits that accrue to it as a result of offering volume discounts. Such a practice could only be undertaken by an entity in receipt of continuous CSO support as is the case with government owned business activities.

Conclusions

The Authority concluded that QR did provide slightly more favourable prices to certain clients in the form of volume discounts, in the absence of the necessary financial information to support such discounting. Such discounting could only be sustained by an entity, which did not cover its costs, that was government owned or controlled.

The Authority, however, concluded that QR's discounts to its customers in exchange for operational efficiencies under commercial agreements with those customers did not result from government ownership or control. Such practices are applied by commercial operators.

Discounting of QR Prices

Assessment

Up until two years ago services were discounted at the discretion of QR's livestock manager. The complainant provided the Authority with examples of quotes that showed that QR had been offering discounts for some specific services of between 29 per cent and 49 per cent off the standard table of rates that QR applies for *Cattletrain* livestock transport services. These related to the period in which QR agreed that such practices were undertaken.

Since then, QR has advised that it ceased such practices and only provided for volume discounts and those related to improved operational efficiency as noted above. No evidence is available to the Authority that could contradict the advices received from QR.

However, the complainant also alleged that QR practises other forms of discounting that continued into 2000. QR allegedly charged customers a rate for smaller wagons than the wagons actually supplied, effectively enabling the customer to transport more livestock. The complainant provided the Authority with examples of quotes which showed that QR had been offering additional capacity of around 12 per cent to certain customers for some specific services at the standard rates that it applies for *Cattletrain* livestock transport services, effectively providing another form of discounting.

QR advised that it revised its ordering procedure to encourage customers to order in decks. QR would then supply whatever equivalent wagons would be required. The older, smaller wagons were restricted to run principally in the South-West where the transits were slower and adequate maintenance facilities were available. The larger wagons were allocated to the North and Central regions of the State. Where QR supplied the larger wagons to cover an order due to operational necessity, more often than not some additional capacity was therefore supplied. Even when the full fleet of deck size wagons is constructed, QR intends that the large wagons will continue in operation.

Government Ownership

Of the above issues, only that relating to wagon size needs to be considered in terms of whether it is due to government ownership or control, as QR has advised that the discounting of services by QR regional managers has been discontinued and no evidence has been received to suggest otherwise.

The Authority accepts that technical requirements regarding the availability of maintenance services for older wagons and operational requirements could result in the diversion of wagons to the area of the complaint. It is considered likely that a private sector operator in a similar position would also allocate wagons on this basis. Depending on the costs of maintaining the older wagons, cost reflective prices may indeed be lower for the larger wagons.

Consequently, additional capacity supplied in the manner described is not considered to be solely due to government ownership or control.

Conclusion

The Authority concluded that QR did provide lower prices in the form of discounts off QR's standard rate schedule but this practice is no longer in effect.

The Authority also concluded that the substitution of larger wagons for smaller wagons at the same price arose due to operational requirements and that any advantage does not arise as a result of government ownership or control of QR.

6.2 Animal Welfare Standards

Assessment

The main concerns of the complainant related to:

- advantages enjoyed by QR as a result of the animal welfare standard; and
- the process by which the standard was established.

The *Animals Protection Act 1925* and the accompanying *Animals Protection Regulation 1991* have not been the subject of any complaint.

The Livestock Code is intended as a guide for people transporting cattle by road and rail. It is not a legally enforceable standard in Queensland. In respect of the Livestock Code which had been developed at the time of the complaint, it was noted that rail staff, unlike road transporters, were exempt from responsibility for the “care and welfare of cattle during transport”.

Furthermore, the Authority was aware that QR made representations to the Animal Welfare Committee regarding the need for shorter transit times and regarding the responsibility of rail staff for animal welfare.

Government Ownership

There is no legal obligation for any party to comply with the Livestock Code. While the Code does distinguish between road and rail, it does not distinguish between government owned and private sector rail services. Hence, neither its coverage nor any non-compliance can be considered to result from government ownership of QR.

The Authority notes that QR did not have representation on any of the bodies responsible for developing the Livestock Code but only made submissions to these bodies.

A wide range of government and industry bodies were consulted during the preparation of the Livestock Code. The NSW Department of Agriculture, as the Code coordinator, sought responses from each jurisdiction, in addition to holding its own consultations with national stakeholder bodies, on behalf of the Animal Welfare Committee. The Animal Welfare Committee members obtained comments from industry and animal welfare bodies in their individual states and territories on later drafts.

Both private and public sector organisations have had significant opportunities at a number of stages to provide submissions to the Animal Welfare Committee and respond to subsequent changes in the draft Code. The NSW Department of Agriculture advised that the draft Code went through several rounds of consultations.

It was therefore considered that QR’s submission to the Animal Welfare Committee during the drafting of the Livestock Code, in the context of an interested industry representative, and the consequent change in one element of that Code, cannot reasonably be considered to have arisen solely because of government ownership or control of QR.

Conclusions

The Livestock Code is intended as a guide for people transporting cattle by road and rail. It is not a legally enforceable standard in Queensland. The Authority did not consider that QR enjoyed any advantage from the application or development of the Livestock Code that can be solely attributed to QR’s government ownership, as the Livestock Code applied to both public and private rail operators and, in any case, is not mandatory. Furthermore, the Authority did not consider that any influence exerted by QR arose due to its government ownership as the standards were established by an independent body well-removed from any source of undue influence.

7. SECTION 49 ISSUES

7.1 Requirements of the *QCA Act 1997*

Section 49 of the *QCA Act 1997* requires the Authority to have regard to a range of matters in relation to the investigation of a complaint.

The need to ensure compliance with the principle of competitive neutrality.

QR was subject to the requirements of the *GOC Act 1993* and the business activities of QR have been declared for the purposes of the *QCA Act 1997*. The Minister for Transport, Queensland Transport and QR have confirmed that the board and management of QR are responsible for complying with the principle of competitive neutrality as defined under the relevant legislation.

The Authority has had regard to the need to ensure compliance with the principle of competitive neutrality in relation to the complaint under the *QCA Act 1997*.

The need for efficient resource allocation.

The Authority noted the Minister for Transport's statement to Queensland Parliament on 26 August 1999 that Queensland's "capacity to move freight efficiently is central to the ongoing success of the Queensland economy."

In general, transport resources will be most efficiently allocated when prices for these services reflect the marginal cost of providing these services. In certain circumstances, the application of such an approach will ensure that total costs are covered and where there exist no externalities, such an approach will maximise net public benefits.

QR, however, offered livestock transport services at prices that did not cover the total cost of their provision.

Where there exists substantial excess capacity as a result of past decisions and those assets cannot be put to another more productive use, the Authority recognises that the total current cost of service provision will not be covered and that the most efficient allocation of resources that can be achieved is one where prices cover the marginal operating cost associated with continued provision of the service. In the absence of the relevant information, however, it is not possible to conclude that current prices cover such marginal operating costs.

Furthermore, it is recognised that pricing based on marginal cost may lead to losses because costs may continue to decline with increases in output, which would prevent full cost recovery. QR is likely to exhibit declining costs in this manner. In such circumstances either subsidies or two-part tariffs (where the fixed component provides a means for recouping the deficit) are typically warranted. The Queensland Government has in the past met this shortfall by a subsidy.

That there has existed insufficient specification in the financial arrangements prevailing at the time of the complaint, has been noted above. The absence of such specificity would not allow QR to establish an appropriate competitively neutral and efficient tariff structure for livestock transport, or the incentive to meet these objectives in the most efficient manner. In part, the extent of any such subsidy should be influenced by other costs associated with the rail and road transport of livestock if an efficient allocation of resources is to be achieved. QR noted that to obtain a complete understanding of the CSO framework for livestock services the impact of the competitive imbalance between road and rail as transport modes for farm-to abattoir/port/railhead services and externalities associated with each transport mode must also be recognised.

The Authority is aware of a 1999 paper by the Bureau of Transport Economics (BTE) *Competitive Neutrality Between Road and Rail (Working Paper 40)* which took into account taxes paid on fuel, road and rail infrastructure use charges, other taxes and government charges, together with linehaul costs of road and rail transport. The report indicates that after consideration of externalities, including the introduction of recent changes to the tax system, intercapital city rail transport charges that are, in general, 13 per cent below those of road transport charges achieve competitive neutrality. The current differential in charges for regional livestock services appears to be 30 per cent, which may indicate that rail transport charges were too low if competitive neutrality and efficiency were to be achieved.

However, the BTE's Working Paper was based on National Road Transport Commission (NRTC) charges which the BTE estimated recover about 66 per cent of the total cost of road wear and road provision of the arterial road network.

On 1 July 2000 subsequent significant increases in heavy vehicle user charges came into effect. Road user charges increased by 18 per cent for B-Doubles, 10 per cent for double road trains and 5 per cent for triple road trains. The NRTC estimated that expenditure recovery from these charges was between 79 per cent and 100 per cent for B Doubles (depending on the axle configuration), 87 per cent for double road trains and 94 per cent for triple road trains. This expenditure recovery was based on the average road user profile for each vehicle type. This would imply a greater than 13 per cent differential may be acceptable if competitive neutrality and efficiency are to be achieved. However, there is insufficient information to estimate the costs of rail and its externalities to assess the differential with any certainty.

While the Authority cannot determine the precise differential that should be applied to account for such factors, it is evident that neither the financial payments from government nor QR's pricing have taken such factors into account and therefore it is highly unlikely that existing prices reflect an efficient allocation of the community's resources

The need to promote competition.

While QR's prices appear to be set on an historical rather than commercial basis, the Authority considered that the presence of private livestock transport service providers in the same market promotes competition at least in the quality of services being provided.

Any government policies or guidelines about the application of the principle of competitive neutrality.

The Authority is not aware of any government policies or guidelines about the application of the principle of competitive neutrality which would alter the requirements of the relevant legislation identified above, or affect its application to the current complaint.

Any directions about the application of the principle of competitive neutrality given to the government agency by the government.

The Authority is not aware of any direction by government that would affect the application of the principle of competitive neutrality relevant to the investigation of the complaint.

Any arrangements between the government and the government agency about a competitive disadvantage suffered by the agency because of the government ownership or control of the agency.

The Authority did not receive advice of, or otherwise identify any arrangements between the government and QR, about any competitive disadvantage suffered by QR because of the government ownership or control of QR.

Any laws about the application of the principle of competitive neutrality.

The relevant legislation affecting the application of the principle of competitive neutrality has been identified above. The Minister for Transport, Queensland Transport and QR advised the Authority that the board and management of QR are responsible for complying with the principle of competitive neutrality as defined under the *Queensland Competition Authority Act 1997*.

Any legislation or government policies relating to ecologically sustainable development.

The *Environmental Protection Act 1994 (EPA Act 1994)* is intended to protect Queensland's environment while allowing ecologically sustainable development in the State, reflecting a desire to balance environmental protection and economic development.

The Authority was advised that the requirements of the *EPA Act 1994* apply on equivalent conditions to both rail and road transporters, and that this legislation and related policies do not affect the application of the principle of competitive neutrality relevant to the investigation of the complaint.

This is consistent with the position put by the Authority in the draft access undertaking by QR. The Authority has taken the view that there is no impact on competitive neutrality where environmental requirements are to be consistent with Queensland's ecologically sustainable development framework. There is no known Queensland Government policy which seeks to allocate livestock transport to rail over road competitors to promote ecologically sustainable development.

The complainant has not identified any such matters in relation to this complaint.

Social welfare and equity considerations including community service obligations and the availability of goods and services to consumers.

The Authority noted that, under the provisions of the *GOC Act 1993*, non-commercial services should only be provided by a GOC on the basis of an explicit service agreement with government (for the payment of a CSO), or on direction by shareholding Ministers. However, no such arrangements existed in relation to the provision of *Cattletrain* livestock transport services. QR has confirmed that it was not in receipt of any community service obligation payment specific to the provision of its *Cattletrain* livestock transport services.

Historically, Queensland Transport, on behalf of the Queensland Government, has made annual budget payments to offset the cost to QR of providing community service obligations. Funding provided to QR was largely on a whole of agency basis with no detailed specification of the services that QR was to perform in return, with some exceptions including the purchase of certain capital items. Accordingly, the pricing arrangements were not supported by any clearly defined Government objectives and it is highly unlikely that past pricing arrangements reflected any specific social objectives relevant to the transport of livestock.

Any legislation or government policies relating to occupational health and safety or industrial relations.

Both road and rail transporters of livestock are required to comply with relevant occupational health and safety and industrial relations legislation and policies. These have been developed to relate, both generally and specifically, to the operations of each mode of transport.

This is consistent with the position put by the Authority in the draft access undertaking by QR. The Authority has taken the view that there is no impact on competitive neutrality where

occupational health and safety requirements are to be consistent with Queensland's occupational health and safety framework. There is no known Queensland Government policy which seeks to allocate livestock transport to rail over road competitors to promote occupational health and safety or industrial relations objectives. The Authority notes comments by the Minister for Transport in Parliament regarding the need to encourage the use of rail to achieve road safety objectives. This matter should be addressed in the context of any CSO framework for livestock transport.

The complainant has not identified any such matters in relation to this complaint.

Economic and regional development issues, including employment and investment growth.

There is no comprehensive data on the regional economic impact of rail and road livestock transport services between the Richmond Shire and Rockhampton. Relevant census data, information from QR and the Livestock Transporters' Association of Queensland (LTAQ) have been examined.

Census data provided by the Office of Economic and Statistical Research shows that in 1996, the most recent year for which data was available, 38 people in the Winton and Richmond Statistical Divisions were employed in the category *6110 Road Freight Transport* while 52 are employed in the category *6200 Rail Transport*.

Road Freight Transport employment is defined as people engaged mainly in the transportation of freight by road including people using rented vehicles. However it does not include people who provide support services to Road Freight Transport. In contrast, Rail Transport consists of people engaged in operating railways for the transportation of freight or passengers, in operating railway terminal or depot facilities for receiving, despatching or transferring rail freight or cargo, or in providing services allied to rail transport not elsewhere classified.

QR advised that its *Cattletrain* livestock transport services are not a major business of QR, either in terms of employment or investment. Consequently, the operation of the service itself does not have a significant impact on employment or investment growth. QR estimated that its livestock business, for services between Richmond Shire and Rockhampton, employs 7 people in Richmond Shire, operates dedicated livestock equipment worth \$2.1 million and turns over \$3.0 million annually, of which \$0.5 million is spent in local communities along these routes.

It is noted that in 1997 the Queensland Government announced a special allocation for the construction of livestock wagons, undertaken at the Townsville Railway Workshops, which represented an investment in capital and supported the current Government's regional employment strategy.

Furthermore, over the five years to 1997 QR spent \$10 million upgrading holding and spelling facilities. It has upgraded 250 wagons for use as livestock transport. The previous Government also committed \$12 million to the construction of new cattle rolling stock for QR, which are to be manufactured at QR's Townsville workshops. QR estimates that 35 people are employed full-time on the cattle wagon project at this workshop.

However, road transporters also typically reside and operate their businesses in regional areas. Indeed the Livestock Transporters Association of Queensland (LTAQ) estimates that there are 42 businesses that operate 162 prime movers based in and around the Richmond Shire that would be capable of providing livestock transport services between that shire and Rockhampton. This figure was based on the number of LTAQ members who operate services along the Townsville-Mt Isa rail line. LTAQ estimated that these businesses employ 243 people, operate equipment worth \$72.9 million, turnover \$32.4 million a year and spend \$25.4 million a year, mostly in their local communities.

While the potential business of these operators may be affected by the arrangements, these estimates, however, also incorporate those road livestock transporters providing services to other markets. Some 18 livestock transport operators have been identified in Richmond, Winton and the surrounding areas by the Authority and these service providers are most likely to be directly affected by competition between Winton and Rockhampton between rail and road transport. It is estimated that these businesses operate 62 prime movers and, with equipment worth \$27.9 million, employ 95 people, produce a turnover of \$12.4 million a year and spend \$9.7 million a year.

Available information also indicates that most cattle continue to be transported by road rather than rail in the Richmond to Rockhampton sector. Accordingly, together with the above data, this would suggest that road transport accounts for a greater share of employment and regional benefits are thus no less than those of rail. However, there is insufficient reliable evidence to be definitive on this point. It is evident, however, that regional employment initiatives based on a preference for one mode of transport need to be cognisant of their impact on employment in the other. Initiatives which enhance the competitiveness of the region are those which provide the most cost effective service for the graziers and minimise the costs to the community overall.

The interests of consumers or any class of consumers

Certain users choosing to transport cattle by rail benefited from the below cost prices offered by QR and the various discounts. However, according to QR, the benefits of discounts are offered on a very limited basis.

About 90 per cent of cattle transported from Richmond to abattoirs in Rockhampton are delivered by road. Having regard to the overwhelming reliance of graziers in the Richmond Shire on road transport, it was not evident to the Authority that the benefits of this approach have been uniformly enjoyed by graziers nor, in the absence of the relevant financial information, is it evident that the public benefit of the approach warranted the costs associated with the service.

It was noted that significant livestock is sold in lots of less than the four decks necessary to justify the use of road transport. While QR is able to accept orders of less than four decks, each *Cattletrain* livestock transport service, which is dedicated to livestock transport, requires a minimum of 24 wagons. Nevertheless, scheduled rail livestock services may be of particular value to graziers who need to move smaller lot sizes and may be worthy recipients of CSOs.

7.2 Summary

In summary:

- there is insufficient specification in the financial arrangements prevailing, at the time of the complaint to allow QR to establish an appropriate competitively neutral and efficient tariff structure for livestock transport, or the incentive to meet these objectives in the most efficient manner;
- pricing was based on historical rather than marginal cost prices necessary to ensure an efficient allocation of resources and consequently did not incorporate any adjustments to ensure desired social or environmental objectives were achieved; and
- available information indicated that most cattle continue to be transported by road rather than rail in the Richmond to Rockhampton sector, and that the employment and regional benefits are no less than those of rail although insufficient reliable information is available to be definitive on this point.

8. CONCLUSIONS AND RECOMMENDATIONS

8.1 Conclusions

Substantiation of Allegations

The Authority has concluded that the financial arrangements between QR and the Queensland Government prevailing at the time of the complaint provided QR's *Cattletrain* livestock transport services with a competitive advantage over the complainant between Richmond Shire (via Winton) and Rockhampton solely because of the government ownership and control of QR. Accordingly, these arrangements breach the principle of competitive neutrality.

The complaint, that QR enjoyed a competitive advantage, because of its government ownership or control, by pricing its *Cattletrain* livestock rail transport services below a level that a commercial private sector organisation could attain in the transport of livestock between Richmond (via Winton) and Rockhampton, is substantiated.

The Authority also determined that on the basis of the available information, the breach of competitive neutrality was not warranted when considered against the matters identified in section 49 of the *QCA Act 1997*.

Although the Authority did not then examine the extent of competition in the rest of the market nominated by the complainant, the arrangements which form the basis of the complaint were the same as those applying elsewhere in Central Queensland. It is highly likely, therefore, that the same conclusions would apply to the remainder of the Central Queensland market in which the complainant and QR compete.

Reason for the Decision

The Authority concluded that:

- QR's livestock transport service was obliged to comply with the principle of competitive neutrality. All of QR's business activities have been declared for this purpose under the *Queensland Competition Authority Act 1997*; and
- the complainant and QR did compete in providing livestock transport services between Richmond Shire and Rockhampton;
 - both the complainant and QR specifically sought to transport livestock and provide services capable of transporting similar load sizes;
 - both provided linehaul cattle transport services;
 - these services were available to graziers in the Richmond Shire and abattoirs in Rockhampton and could be arranged to deliver to Rockhampton;
 - these services were available at, or within, similar times; and
 - customers, the complainant and QR viewed these services as substitutes and in competition with one another.

General Pricing of QR Livestock Services

QR has advised that:

- prices charged for the transport of livestock are historic and did not reflect costs;
- revenues received from customers in respect of livestock freight services did not cover the cost of providing those services in aggregate, and that the Winton to Rockhampton route did not recoup associated costs;
- QR's financial information systems were not able to allocate costs to the *Cattletrain* service subject of the complaint.

On this basis, the Authority has concluded that prices for the transport of livestock by QR did not cover QR's cost of providing these services between Winton and Rockhampton. QR thus had a competitive advantage over the complainant, who must cover all the costs of providing a competing service.

Queensland Transport advised that, historically, government funding was provided to QR on a whole of agency basis with no detailed specification of the services that QR was to perform in return. QR has also advised that it was unaware of any direct or indirect community service payments for its livestock services. The Authority has concluded that the nature of the financial arrangements and payments from the Queensland Government to QR followed from QR's government ownership or control. This is evidenced by the open ended nature of the arrangements and the absence of detailed performance requirements or defined outcomes. It is not considered such arrangements would be available to a private sector operator of rail should such an alternative have been present.

Favourable Treatment of Select Customers

The Authority concluded that QR did provide slightly more favourable prices to certain clients in the form of volume discounts, in the absence of the necessary financial information to support such discounting. Such discounting could only be sustained by an entity which did not cover its costs, in other words one that was government owned or controlled.

Matters Not Substantiated

The Authority concluded that QR's discounts to its customers in exchange for operational efficiencies under commercial agreements with those customers did not result from government ownership or control. Such practices are applied by commercial operators.

The Authority concluded that QR did provide lower prices in the form of discretionary discounts off QR's standard rate schedule but this practice was no longer in effect at the time of the complaint.

The Authority also concluded that the substitution of larger wagons for smaller wagons at the same price arose due to operational requirements rather than as a result of government ownership or control of QR.

The Livestock Code is intended as a guide for people transporting cattle by road and rail. It is not a legally enforceable standard in Queensland. The Authority did not consider that QR enjoyed any advantage from the application or development of the Livestock Code that can be solely attributed to QR's government ownership, as the Livestock Code applied to both public and private rail operators and, in any case, is not mandatory. Furthermore, the Authority did not consider that any influence exerted by QR arose due to its government ownership as the

standards were established by an independent body well removed from any source of undue influence.

Public Benefit Issues

In summary:

- there is insufficient specification in the financial arrangements prevailing at the time of the complaint to allow QR to establish an appropriate competitively neutral and efficient tariff structure for livestock transport, or the incentive to meet these objectives in the most efficient manner;
- pricing was based on historical rather than marginal cost prices necessary to ensure an efficient allocation of resources and consequently did not incorporate any adjustments to ensure desired social or environmental objectives were achieved; and
- available information indicated that most cattle continue to be transported by road rather than rail in the Richmond to Rockhampton sector, and that the employment and regional benefits are no less than those of rail although insufficient reliable information is available to be definitive on this point.

8.2 Recommendations

For the breach to be remedied, the Authority recommends that the open ended financial arrangements between QR and the Queensland Government prevailing at the time of the complaint cease or be amended to ensure that no competitive advantage be provided to QR unless there exists a demonstrable public benefit in doing so.

However, the Authority has been advised by Queensland Treasury and Queensland Transport that past arrangements which provided open ended funding for QR have ceased, that the Queensland Government currently has no policy intention to provide a direct subsidy to either the rail or road livestock transport industries, and that Queensland Transport and QR are currently developing a Regional Rail Service Agreement (RSA) for the transport of general freight which reflects this. Accordingly, as the source of the past breach relating to the complaint has been removed, no further action is necessary.

The new arrangements did not form part of the complaint and are therefore beyond the scope of the Authority's investigation. The Authority, however, has also been advised by Queensland Transport that the transport of livestock by QR may in the future receive limited indirect subsidy as a result of reduced access charges for all rail freight (not relevant to competitive neutrality as it is to be provided to all rail service providers irrespective of ownership), the KOJX livestock wagon project, initiatives to promote the employment of surplus staff in regional areas or, on rare occasions, by the attachment of livestock wagons to scheduled train services. Should these initiatives proceed, clear specification of policy objectives and improved financial information systems would be needed to ensure that, subject to the public interest, the arrangements are competitively neutral.

9. FINDINGS UNDER THE AMENDED *QCA ACT 1997*

9.1 Requirements of the amended *QCA Act 1997*

Following amendments to the *QCA Act 1997* which were effective from 26 May 2000, an agency can only be found to be in breach of the principle of competitive neutrality if the agency enjoys a competitive advantage over competitors or potential competitors because the agency's activities are not subject to: (a) full tax equivalent systems; (b) offsetting debt guarantee fees; or (c) government procedural or regulatory requirements on conditions equivalent to the conditions to which a competitor may be subject.

In the interests of completeness, the Authority decided to consider the complaint as if it had also been made after the date of the change in the definition of competitive neutrality.

As detailed, the alleged competitive advantages involved:

- general pricing of QR livestock services;
- favourable treatment of select customers;
- discounting of QR prices; and
- animal welfare standards.

Each of these was considered in the context of the amended provisions of the *QCA Act 1997*.

General Pricing of QR Livestock Services

It was alleged that QR enjoyed a competitive advantage in breach of the principle of competitive neutrality by pricing QR *Cattletrain* livestock rail transport services below that which a commercial private sector organisation could attain.

There was no suggestion in the complaint that quoting and pricing practices may be attributable to the agency's activities not being subject to requirements to include full tax equivalents or off-setting debt guarantee fees (under s38 (a) and (b)). QR's Annual Reports indicate that the organisation's activities are subject to these financial requirements.

In relation to s38(c), private livestock transport providers are not subject to procedural or regulatory requirements of the Commonwealth, the State or a local government to price services according to their full cost. Accordingly, the alleged competitive advantage arising from the general pricing of QR livestock transport services could not breach the principle of competitive neutrality as defined under the amended provisions of the *QCA Act 1997*.

Favourable Treatment of Select Customers

It was alleged that QR enjoyed a competitive advantage in breach of the principle of competitive neutrality by offering 'more favourable' prices to selected customers to attract them to use QR's livestock transport service. As was the case for the alleged competitive advantage on general pricing, the ability for QR to offer further discounts on below-cost standard prices essentially represents a GOC pricing issue.

There was no suggestion in the complaint that quoting and pricing practices may be attributable to the agency's activities not being subject to requirements to include full tax equivalents or off-setting debt guarantee fees (under s38 (a) and (b)). QR's Annual Report indicates that the organisation's activities are subject to these financial requirements.

As noted above, private livestock transport providers are not subject to a procedural or regulatory requirement of the Commonwealth, the State or a local government to price services according to their full cost.

Accordingly, the alleged competitive advantage arising from the favourable treatment of select customers could not breach the principle of competitive neutrality as defined under the amended provisions of the *QCA Act 1997*.

Discounting of QR Prices

It was alleged that QR enjoyed a competitive advantage in breach of the principle of competitive neutrality by engaging in discounting of livestock freight rates. As was the case for the alleged competitive advantage on general pricing, the ability for QR to offer further discounts on below-cost standard prices essentially represents a pricing issue.

There was no suggestion in the complaint that quoting and pricing practices may be attributable to the agency's activities not being subject to requirements to include full tax equivalents or off-setting debt guarantee fees (under s38 (a) and (b)). QR's Annual Report indicates that the organisation's activities are subject to these financial requirements.

As noted previously in relation to s38(c), private livestock transport providers are not subject to a procedural or regulatory requirement of the Commonwealth, the State or a local government to price services according to their full cost.

Accordingly, the alleged competitive advantage arising from the discounting of QR livestock transport services could not breach the principle of competitive neutrality under the amended provisions of the *QCA Act 1997*.

Animal Welfare Standards

It was alleged that QR enjoyed a competitive advantage in breach of the principle of competitive neutrality by enjoying a procedural and operational advantage as a result of animal welfare transport standards, and further influenced the development of the animal welfare standard for livestock transport.

The Queensland Department of Primary Industries has also advised that the *Australian Model Code of Practice for the Welfare of Animals – Land Transport of Cattle* is voluntary. It therefore cannot be considered to be a regulatory or procedural requirement under s38(c) of the *QCA Act 1997*.

Accordingly, the alleged competitive advantage arising from differential animal welfare standards between rail and road could not breach the principle of competitive neutrality under the amended provisions of the *QCA Act 1997* as the model code does not constitute a regulatory or procedural requirement of the Commonwealth, the State or a local government.

Similarly, there exists no Commonwealth, the State or a local government procedural or regulatory requirement relating to the nature of representations by any party, accordingly this matter falls outside the ambit of the amended provisions of the *QCA Act 1997*.

9.2 Conclusions

The Authority concluded that no elements of the complaint breached the definition of the principle of competitive neutrality under the amended provisions of the *QCA Act 1997* as:

- private livestock transport providers are not subject to any procedural or regulatory requirements of the Commonwealth, the State or a local government to price services according to their full cost; and
- the *Australian Model Code of Practice for the Welfare of Animals – Land Transport of Cattle* cannot be considered to be a regulatory or procedural requirement under s38(c) of the *QCA Act 1997* as it is a voluntary code.