



# Decision

## Australian Rail Track Corporation's application to vary the 2008 Interstate Access Undertaking

28 February 2019

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## Summary

The Australian Competition and Consumer Commission (**ACCC**) decided, on 28 February 2019, to consent to the Australian Rail Track Corporation's (**ARTC's**) 22 February 2019 application (**Revised Application**) to vary its 2008 Interstate Access Undertaking (**2008 IAU**). In making this decision, the ACCC has had regard to the matters in section 44ZZA(3) of the *Competition and Consumer Act 2010* (Cth) (**the Act**). The current IAU is due to expire on 28 February 2019.

### Original and Revised Applications

The Revised Application seeks to:

- extend the term of the 2008 IAU from 28 February 2019 until 29 February 2020, to allow for ARTC to consult with its customers and the ACCC in developing a replacement IAU.
- vary the notice ARTC will give to the ACCC of its intention to submit a replacement undertaking, from 3 months to 6 months prior to the expiry date of the existing undertaking.

The Revised Application replaces ARTC's 29 January 2019 application to vary the 2008 IAU (**Original Application**). The Original Application sought to:

- extend the term of the 2008 IAU to 29 February 2020
- set new Indicative Access Charges to apply from 1 July 2019. These Indicative Access Charges were proposed to be the 2018–19 Indicative Access Charges, escalated by the Consumer Price Index (**CPI**) for all Segments except those between Adelaide and Kalgoorlie, which ARTC proposed to escalate by CPI plus 2 per cent
- include an obligation for ARTC to draft a reconciliation mechanism into any future replacement IAU, or a further extension to the 2008 IAU. This mechanism was proposed to reconcile the charges set out in the Original Application against the charges in any replacement IAU or further extension to the 2008 IAU as accepted by the ACCC. The reconciliation mechanism provided for either a refund to, or recovery from, users of the Interstate network
- vary the Indicative Track Access Agreement (**ITAA**), in accordance with the proposed changes to the IAU.

Following stakeholder submissions that raised a number of concerns, particularly regarding the reconciliation mechanism, ARTC withdrew the Original Application from the ACCC's consideration, and submitted the Revised Application on 22 February 2019.

The 2008 IAU and 2011 Hunter Valley Access Undertaking (**HVAU**) are both entirely voluntary access undertakings submitted by ARTC under Part IIIA of the Act. The ACCC has become increasingly concerned with the appropriateness of this regulatory framework, particularly where ARTC submits applications shortly before the expiry of an existing undertaking.

### Next steps

The ACCC expects that ARTC will commence constructive engagement with industry and the ACCC regarding the development of a replacement IAU shortly after the release of this Decision. In particular, ARTC should engage with the ACCC prior to ARTC lodging a replacement IAU for the ACCC's assessment.

The ACCC's views and requests for information, as set out in the draft decision on the proposed 2018 IAU<sup>1</sup>, should form the basis of this engagement. The ACCC notes that this may include discussions on elements of the Original Application that did not form part of the Revised Application – that is, discussions about the escalation of Indicative Access Charges, and a reconciliation mechanism as part of a compliance regime for a replacement IAU.

As the terms and conditions set out in the IAU have implications for users of the Interstate network, the ACCC expects that industry will also productively engage in these discussions.

In accordance with this variation, ARTC will inform the ACCC of its intention to submit a replacement to the 2008 IAU by 29 August 2019 at the latest, which is 6 months prior to the revised expiry date of the 2008 IAU on 29 February 2020. If ARTC is to submit a replacement undertaking for the ACCC's assessment, the ACCC expects that any extension ARTC submits in accordance with section 2.2(c) and (d) of the 2008 IAU will include a suitable time buffer in its application. This is to ensure that there is more than sufficient time for the development and assessment of a replacement undertaking, and therefore consistent regulatory coverage of the Interstate network while the assessment of the replacement undertaking is underway. The ACCC considers that this would assist in mitigating the regulatory uncertainty, about which ARTC and users have expressed concerns during the assessment of the Original Application.

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<sup>1</sup> ACCC, *Draft Decision – Australian Rail Track Corporation's 2018 Interstate Access Undertaking*, 20 December 2018.

# 1. Background

On 14 November 1997, the Australian, New South Wales, Victorian, Queensland, South Australian and Western Australian Governments signed an intergovernmental agreement establishing ARTC. ARTC was established as a consolidated below-rail owner and operator to create a single avenue for all above-rail operators seeking access to the Interstate network, consistent with the National Rail Summit Heads of Agreement and the Competition Principles Agreement.

ARTC's objectives under the intergovernmental agreement were to provide efficient and seamless access to the Interstate network by:

- operating the business on commercially sound principles
- pursuing a growth strategy for interstate rail
- improving interstate rail infrastructure through better asset management and a program of investment
- promoting operational efficiency and uniformity on the Interstate network.

ARTC has a monopoly over the below-rail infrastructure used to transport bulk freight, intermodal freight and passengers over the Interstate network. In the absence of appropriate regulation, ARTC would have the ability and incentive to exercise its market power to charge higher prices, to operate inefficiently and to undertake unnecessary investment and expenditure. This would be to the detriment of above-rail operators using the Interstate network, as well as participants in upstream and downstream markets, and would ultimately affect the efficiency and productivity of the Australian economy.

The ACCC acknowledges that ARTC and the Australian rail industry face competition from road (especially for shorter non-bulk freight movements) and sea (for bulk freight). However, ARTC remains a monopoly supplier of below-rail services on the Interstate network. As such, the ACCC recognises that all above-rail operators providing intermodal, bulk and passenger services on the Interstate network rely on ARTC to supply an important business input.

## 1.1. The 2008 and 2018 Interstate Access Undertakings

Access to the below-rail infrastructure of the Interstate network is currently regulated through the 2008 IAU. The 2008 IAU sets out the terms and conditions of access for parties seeking to operate trains on ARTC's Interstate network. The 2008 IAU was accepted by the ACCC on 30 July 2008 in accordance with Part IIIA of the *Trade Practices Act 1974 (Cth)*.<sup>2</sup> The term of the 2008 IAU was originally for 10 years, due to expire on 21 August 2018.<sup>3</sup>

The ACCC's role in assessing an IAU application, and ongoing involvement with the IAU, is to ensure that ARTC behaves in a manner that avoids the distortionary outcomes associated with the exercise of monopoly power. This promotes an environment where above-rail operators and associated industries can undertake efficient investment and expenditure.

On 6 March 2018, ARTC submitted the 2018 IAU application to the ACCC for assessment under Part IIIA of the Act. The 2018 IAU was intended to replace the 2008 IAU.

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<sup>2</sup> Division 6 of Part IIIA of the Act provides that the ACCC may accept an undertaking from a person who is, or expects to be, the provider of a service, in connection with provision of access to the service.

<sup>3</sup> Documents relating to the accepted 2008 IAU are available at: <https://www.accc.gov.au/regulation/infrastructure/rail/interstate-rail-access-undertaking-2008>

On 26 March 2018, the ACCC published a consultation paper inviting submissions from stakeholders on the 2018 IAU. Although submissions were initially due on 23 April 2018, several stakeholders requested extensions. The ACCC received the final submission in response to the consultation paper on 19 July 2018.

After considering ARTC's application and stakeholder submissions, the ACCC considered that ARTC's application did not provide the information required to assess the 2018 IAU. An information request was issued to ARTC on 22 May 2018. On 6 July 2018, ARTC claimed its response in its entirety was commercial in confidence.

The ACCC met with ARTC on the claims of blanket confidentiality between July and September 2018. ARTC ultimately provided the ACCC with final versions of its public responses on 13 September 2018, agreeing to make the majority of its response publicly available.

On review of ARTC's response to the ACCC's first information request, the ACCC issued a second information request to ARTC on 20 September 2018. ARTC provided the ACCC with confidential and public versions of its second response on 30 October 2018.

On 20 December 2018, the ACCC issued a draft decision to not accept the 2018 IAU application.<sup>4</sup> In particular, the ACCC had concerns with ARTC's:

- proposed approach to the roll-forward of the Regulatory Asset Base (**RAB**), used to determine the initial Ceiling Limit to be applied from 2018–19
- proposed real pre-tax weighted average cost of capital (**WACC**) of 7.76 per cent, and nominal pre-tax WACC of 10.40 per cent. The ACCC considered a real pre-tax WACC of 5.57 per cent and nominal pre-tax WACC of 8.16 per cent was appropriate
- proposed mechanism for adjusting the Indicative Access Charges Range. The ACCC also sought views from stakeholders regarding whether CPI is the appropriate mechanism for escalation of the Indicative Access Charges Range
- obligations regarding potential regulatory gaps. The ACCC considered the period of notice by which ARTC will notify the ACCC of its intention to submit a replacement undertaking should be longer to reduce regulatory uncertainty for users of the Interstate network and ARTC.

The ACCC also considered that the 2018 IAU should be subject to an annual compliance assessment process for all Segments of the Interstate network.

The decision-making framework that the ACCC uses to assess variations to and replacements of existing undertakings under Part IIIA of the Act, is set out in chapter 5 of this Decision.

On 25 January 2019, ARTC withdrew the 2018 IAU application from the ACCC's consideration.

## 1.2. ARTC's applications to vary the 2008 IAU

Under section 44ZZA(7)(b) of the Act, an access provider (in this instance, ARTC) can vary an undertaking at any time after it has been accepted by the ACCC, but only with the ACCC's consent.

On 29 January 2019, ARTC submitted an application to vary the 2008 IAU pursuant to section 44ZZA(7) of the Act (**Original Application**). Following discussions with the ACCC,

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<sup>4</sup> See ACCC, *Draft Decision – Australian Rail Track Corporation's 2018 Interstate Access Undertaking*, 20 December 2018.

on 22 February 2019 ARTC withdrew the Original Application and submitted the Revised Application. Both applications are discussed below.

### 1.2.1. ARTC's original variation application

The Original Application proposed variations to:

- extend the term of the 2008 IAU by 12 months to 29 February 2020
- set new Indicative Access Charges to apply from 1 July 2019. These Indicative Access Charges were proposed to be the 2018–19 Indicative Access Charges, escalated by CPI for all Segments except those between Adelaide and Kalgoorlie, which ARTC proposed to escalate by CPI plus 2 per cent
- include an obligation for ARTC to draft a reconciliation mechanism into any future replacement IAU, or a further extension to the 2008 IAU. This mechanism was proposed to reconcile the charges set out in the Original Application against the charges in any replacement IAU or further extension to the 2008 IAU accepted by the ACCC. The reconciliation mechanism provided for either a refund to, or recovery from, above-rail operators
- the ITAA, in accordance with the proposed changes to the IAU.

In its Original Application letter, ARTC stated that the Original Application sought to extend the 2008 IAU while ARTC works with the ACCC and industry to lodge a replacement IAU—the 2019 IAU.<sup>5</sup>

ARTC also submitted that:<sup>6</sup>

- *It is in the interests of operators using the interstate network and their customers that an undertaking remains in place and there is regulatory certainty as to access and pricing until the 2019 IAU is accepted by the ACCC.*
- *In the absence of an approved ACCC undertaking, parts of the interstate network will become subject to state based economic regulation which will add complexity and administrative burden for operators and ARTC which is not preferable for an interim period.*
- *The reconciliation mechanism will provide protection for operators and ARTC that the pricing for the period of extension will be reconciled against the approved regulatory positions under the 2019 IAU, once accepted.*

ARTC's Original Application is available at: <https://www.accc.gov.au/regulated-infrastructure/rail/artc-interstate-rail-access-undertaking/january-2019-variation-of-the-2008-interstate-access-undertaking/variation-application>

### 1.2.2. ACCC consultation on ARTC's original variation application

On 30 January 2019, the ACCC invited submissions on ARTC's Original Application pursuant to section 44ZZBD(1) of the Act. Submissions were due on 13 February 2019.

In response, the ACCC received submissions from:

- NSW Trains, 12 February 2019
- Southern Shorthaul Railway (**SSR**), 12 February 2019

<sup>5</sup> ARTC, *RE: 2018 [sic] Interstate Access Undertaking – Extension Request*, 29 January 2019, p. 1.

<sup>6</sup> *Ibid*, pp.1–2.

- SCT, 12 February 2019
- Pacific National, 14 February 2019.

While stakeholders had varying views on the Original Application, the majority raised concerns regarding the proposed reconciliation mechanism. Specific issues raised in stakeholder submissions are discussed in detail in chapters 2 and 3 of this Decision.

Submissions are available at:

<https://www.accc.gov.au/regulated-infrastructure/rail/artc-interstate-rail-access-undertaking/january-2019-variation-of-the-2008-interstate-access-undertaking/consultation-letter>

On 22 February 2019, ARTC withdrew the Original Application from the ACCC's consideration. In the letter withdrawing its Original Application, ARTC stated that:<sup>7</sup>

*In light of discussions with stakeholders and expressed concerns in respect of the certainty associated with the proposed reconciliation process, ARTC withdraws its application for approval by the ACCC of the 2008 IAU Extension...*

### 1.2.3. ARTC's revised variation application

On 22 February 2019, ARTC also submitted the Revised Application to the ACCC for assessment.

The Revised Application proposes variations to:

- extend the term of the 2008 IAU by 12 months to 29 February 2020, consistent with the Original Application
- extend the notice ARTC must provide to the ACCC regarding whether it will submit a replacement undertaking from 3 months to 6 months prior to the expiry date of the IAU. This is largely consistent with Pacific National's submission to the Original Application and the ACCC's views on regulatory gap provisions set out in the draft decision on the 2018 IAU.

In comparison to the Original Application, the Revised Application does not include:

- escalation of Indicative Access Charges for Adelaide to Kalgoorlie Segments by CPI plus 2 per cent
- a reconciliation mechanism for charges between the Original Application and a subsequent IAU.

In its Revised Application, ARTC states that it:<sup>8</sup>

*...recognised customer concerns around the lack of certainty that this [reconciliation] mechanism may provide and accordingly submit this revised extension based on continuance of the CPI indexation from July 1 2019.*

Under section 44ZZBD of the Act, the ACCC may publish a notice inviting public submissions on an access undertaking application if it considers it appropriate and practicable to do so.<sup>9</sup>

<sup>7</sup> ARTC, RE: 2018 [sic] Interstate Access Undertaking – Withdrawal request, 22 February 2019, p. 1.

<sup>8</sup> ARTC, RE: 2008 Interstate Access Undertaking Extension Application to the ACCC, 22 February 2019, p. 1.

<sup>9</sup> If the ACCC does publish such a notice, a minimum of 14 days must be allowed for submissions.



The ACCC did not publish such a notice in relation to the Revised Application, as the Revised Application largely retains the substance of the current 2008 IAU, and stakeholders previously had the opportunity to provide views on the Original Application. In addition, the ACCC notes that publishing a notice for public submissions to the Revised Application would lead to submissions being due after the expiry date of the current 2008 IAU. The ACCC considered that this would not promote the regulatory certainty sought in stakeholders' submissions to the Original Application as well as ARTC's submissions to both Applications.

Having regard to these matters, the ACCC considered that it would not be appropriate and practicable to publish a notice for public submissions to the Revised Application. However, the ACCC has taken into consideration any relevant submissions to the Original Application in its assessment of the Revised Application, as discussed in chapters 2 and 3 of this Decision.

ARTC's Revised Application is available at: <https://www.accc.gov.au/regulated-infrastructure/rail/artc-interstate-rail-access-undertaking/january-2019-variation-of-the-2008-interstate-access-undertaking/revised-application>

## 2. ACCC's views on ARTC's variation application

Having regard to the matters in section 44ZZA(3) of the Act, it is the ACCC's view that it is appropriate to consent to ARTC's 22 February 2019 variation to the 2008 IAU pursuant to section 44ZZA(7) of the Act. The ACCC's reasons for its decision are below.

Further information about the ACCC's decision-making framework under Part IIIA is set out in chapter 5 of this Decision.

### 2.1. Extending the term of the 2008 IAU

In both its Original and Revised Applications, ARTC proposes to vary section 2.3(a) of the 2008 IAU to extend the term of the undertaking by 12 months, with a new expiry date of 29 February 2020.

In its Original Application, ARTC stated that it intends to work with the ACCC and industry to lodge a revised access undertaking to replace the 2008 IAU. However, given the replacement to the 2008 IAU will not be in place prior to 28 February 2019, ARTC submitted that it was:<sup>10</sup>

*...in the interest of operators using the interstate network and their customers that an undertaking remains in place and there is regulatory certainty as to access and pricing until the 2019 IAU is accepted by the ACCC.*

*In the absence of an approve ACCC undertaking, parts of the interstate network will become subject to state based economic regulation which will add complexity and administrative burden for operators and ARTC which is not preferable for an interim period.*

In its Revised Application, ARTC states that:<sup>11</sup>

*[a]greement to the extension will enable ARTC to work with the ACCC and our customers to develop a transparent regulatory framework that will provide for the future recovery of Interstate network efficient operating costs and sustainable commercial returns. As the Interstate Network does not currently earn a commercial rate of return, resetting this framework is essential.*

In response to the Original Application, the majority of stakeholders submitted their support for ARTC's proposed extension:

- NSW Trains considered that the extension provides regulatory certainty while the replacement IAU is being finalised<sup>12</sup>
- SCT stated that the extension will provide industry time to conclude agreements based on a revised IAU and ITAA<sup>13</sup>
- SSR considered that the extension is appropriate, and that past experience shows this timeframe will be necessary.<sup>14</sup>

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<sup>10</sup> ARTC, *Re: 2018 [sic] Interstate Access Undertaking – Extension Request*, 29 January 2019, pp. 1–2.

<sup>11</sup> ARTC, *RE: 2008 Interstate Access Undertaking Extension Application to the ACCC*, 22 February 2019, p. 1.

<sup>12</sup> NSW Trains, *Re: ARTC 2018 [sic] Interstate Access Undertaking*, 12 February 2019, p. 1.

<sup>13</sup> SCT, *Consultation on proposed variation to the Australian Rail Track Corporation Limited (ARTC) 2008 Interstate Access Undertaking*, 12 February 2019, p. 1.

<sup>14</sup> SSR, *January 2019 Variation to the 2008 IAU*, 12 February 2019, p. 1.

In contrast, Pacific National submitted that ARTC's proposed extension does not provide sufficient time for:<sup>15</sup>

- ARTC to consult with all rail operators, end customers, key stakeholders and the ACCC on a replacement IAU prior to ARTC lodging its proposal to the ACCC
- the ACCC to formally assess ARTC's proposal, including additional timeframes in the event the ACCC does not approve the subsequent replacement IAU.

Pacific National considered an extension to 30 December 2020 would be appropriate.

The ACCC considers ARTC's proposal to change the expiry date of the 2008 IAU to 29 February 2020 is appropriate.

The ACCC notes ARTC's submission that it is in the interests of above-rail operators and their customers that an undertaking remain in place with the ACCC, rather than having parts of the Interstate network fall under state-based economic regulation. This position has the support of the majority of stakeholders.

The ACCC considers ARTC's proposed extension provides regulatory certainty over the operation of the Interstate network. The ACCC considers this is in the legitimate business interests of ARTC and the interests of those seeking access to the Interstate network (sections 44ZZA(3)(a) and (c), respectively). Additionally, the ACCC considers such regulatory certainty is likely to promote the efficient operation, use of and investment in the Interstate network while ARTC works with the ACCC and industry to develop a replacement IAU for the ACCC to assess (section 44ZZA(3)(aa)).

The ACCC notes Pacific National's submission that 12 months is not sufficient time for ARTC to consult with all stakeholders and lodge a replacement IAU to the ACCC for assessment. The ACCC considers that in order for ARTC to have a replacement IAU accepted by the ACCC by 29 February 2020, ARTC will have to:

- work with the ACCC to provide the information sought in the ACCC's draft decision on the 2018 IAU application, including providing justification for any information ARTC considers to be confidential<sup>16</sup>
- work with all above-rail operators and other stakeholders to determine the terms and conditions of a replacement IAU application, taking into account the ACCC's views in the draft decision on the 2018 IAU application
- submit the replacement IAU to the ACCC for assessment with sufficient time prior to the expiry date of the 2008 IAU, taking into account the ACCC's assessment timelines set out in the Act. The ACCC notes that at under 2.2(c) of the 2008 IAU, if ARTC intends to submit a replacement undertaking to the ACCC, it must also apply for an extension of the existing IAU. This section remains unchanged in the Revised Application.

## 2.2. Regulatory gap provision

In the Revised Application, ARTC proposes to vary section 2.2(b) of the 2008 IAU to extend the notice that ARTC will give to the ACCC of its intention to submit a new undertaking for assessment, from 3 months to 6 months prior to the expiry date of an existing IAU.

The ACCC notes that ARTC's proposed variation is largely consistent with the ACCC's recommendation in the draft decision on the 2018 IAU.<sup>17</sup> This proposal was additionally

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<sup>15</sup> Pacific National, *Pacific National Submission on ARTC's 2019 Application to Vary the 2008 Access Undertaking (2019 Variation)*, 14 February 2019, p. 3.

<sup>16</sup> The information sought in the ACCC's draft decision on the 2018 IAU is set out in Appendix A of this Decision.

reflected in Pacific National's submission to ARTC's Original Application.<sup>18</sup> Specifically, Pacific National proposed that the period of notice be increased from 3 to 6 months, which is now reflected in ARTC's Revised Application. Pacific National also proposed an amendment to section 2.2(c) of the 2008 IAU that ARTC be required to apply to extend the undertaking at the same time that it submits a new undertaking to the ACCC.<sup>19</sup>

The ACCC considers ARTC's proposed amendment to section 2.2(b) of the 2008 IAU is appropriate. The ACCC considers that increasing the period of notice that ARTC must give to the ACCC promotes regulatory certainty over the operation of the Interstate network, which is in the legitimate business interests of ARTC, and the interests of those seeking access to the Interstate network (sections 44ZZA(3)(a) and (c)).

The ACCC notes NSW Trains' view, set out in its submission to the Original Application, that the proposed extension to the 2008 IAU is appropriate as it provides regulatory certainty while a replacement IAU is finalised.<sup>20</sup> The ACCC considers that ARTC's proposed amendment to 2.2(b) is consistent with NSW Trains submission, in that it provides additional regulatory certainty around the time of the expiry of the IAU.

The ACCC also notes Pacific National's concern that the 12 month extension does not provide sufficient time for the ACCC to assess ARTC's proposal for a replacement undertaking.<sup>21</sup> The ACCC notes ARTC's view that it is preferable for the Interstate network to remain under ACCC regulation, both in the context of the Original Application and 2018 IAU.<sup>22</sup>

As noted previously, if ARTC is to submit a replacement IAU to the ACCC for assessment, it must also apply for an extension of the existing undertaking. Under section 2.2(d), the length of that extension must reasonably estimate the time it would take for ARTC to develop the replacement undertaking and have it take effect following the ACCC's approval.

The ACCC considers that the assessment of variation applications or replacement undertakings shortly before the expiry of an existing undertaking raises regulatory uncertainty for both ARTC and users of the Interstate network. For example, after the ACCC published its draft decision on the 2018 IAU, ARTC withdrew the 2018 IAU and submitted the Original Application for the ACCC's assessment on 29 January 2019, approximately one month before the expiry date of the 2008 IAU.<sup>23</sup>

Users of ARTC's Hunter Valley network raised similar concerns relating to regulatory uncertainty during the ACCC's assessment of ARTC's June 2017 application to vary its 2011 HVAU. In the 29 June 2017 decision to consent to this variation, the ACCC stated that:<sup>24</sup>

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<sup>17</sup> In the draft decision on the 2018 IAU, the ACCC also recommended changes to section 2.2(c) to require ARTC to submit an extension application at the same time that it notifies the ACCC of its intention to submit a replacement IAU under section 2.2(b), see ACCC, *Draft Decision: Australian Rail Track Corporation's 2018 Interstate Access Undertaking*, 20 December 2018, p. 32.

<sup>18</sup> Pacific National, *Attachment to Pacific National Submission on ARTC's 2019 Application to Vary the 2008 Access Undertaking (2019 Variation)*, 14 February 2019, p. 6.

<sup>19</sup> *Ibid.*

<sup>20</sup> NSW Trains, *RE: ARTC 2018 [sic] Interstate Access Undertaking*, 12 February 2019, p. 1.

<sup>21</sup> Pacific National, *Pacific National Submission on ARTC's 2019 Application to Vary the 2008 Access Undertaking (2019 Variation)*, 14 February 2019, p. 3.

<sup>22</sup> See ARTC, *Re: 2018 [sic] Interstate Access Undertaking – Extension Request*, 29 January 2019, p. 2 and ARTC, *2018 Interstate Rail Network Access Undertaking Explanatory Guide*, March 2018, p. 22.

<sup>23</sup> In its 2018 IAU draft decision, the ACCC noted that should ARTC seek to resubmit a revised version of the IAU responding to the ACCC's views and requests for further information set out in the draft decision prior to the expiry of the 2008 IAU, ARTC would need to consider and submit a revised IAU by early to mid-January 2019. See ARTC, *Draft Decision: Australian Rail Track Corporation's 2018 Interstate Access Undertaking*, 20 December 2018, p. vii.

<sup>24</sup> ACCC, *Decision – Australian Rail Track Corporation's application to vary the 2011 Hunter Valley Access undertaking*, 9 June 2017, pp. iii–iv.

*...stakeholders have raised concerns that if the Application to vary the 2011 HVAU is not consented to by the ACCC prior to 1 July 2017, regulation would revert to the Independent Pricing and Regulatory Tribunal (IPART) and the New South Wales Rail Access Undertaking (NSWRAU). While the ACCC does not comment on the appropriateness or otherwise of that regulatory regime, stakeholders consider that this outcome would be inefficient and would result in significant regulatory and commercial uncertainty. In light of this, and the limited time that ARTC has allowed for its Application to be assessed, stakeholders consider they have no alternative but to support ARTC's proposed variation in order to ensure continued operation of an HVAU after 30 June 2017.*

...

*The ACCC acknowledges and shares stakeholders concerns that the outcome of this process illustrates significant issues with the current regulatory framework as it applies to the Hunter Valley rail network.*

The ACCC considers that there are potential parallels between the structural conditions that led to access holders supporting the acceptance of the variation to the 2011 HVAU in June 2017 to ensure regulatory certainty, and the concerns raised by stakeholders in submissions to the Original Application. The 2008 IAU and 2011 HVAU are both entirely voluntary access undertakings submitted by ARTC under Part IIIA of the Act. The ACCC has become increasingly concerned with the appropriateness of this regulatory framework, particularly where ARTC submits applications shortly before the expiry of an existing undertaking.

Given ARTC's previous experience in submitting replacement undertakings in both the Interstate and Hunter Valley networks, the ACCC expects ARTC to include a suitable time buffer in such an extension application to ensure there is more than sufficient time for the development and assessment of an undertaking. Such an approach would avoid concerns, shared by both ARTC and stakeholders, about regulatory gaps in the future. The ACCC notes that if it were to approve a replacement undertaking while there was still a significant amount of time before the existing undertaking's expiry date, the replacement undertaking could supersede the existing undertaking before the end of its term.

### 3. Comparison between Original and Revised Applications

In comparison to the Original Application, ARTC's Revised Application does not include:

- escalation of Indicative Access Charges for the Adelaide to Kalgoorlie Segments by CPI plus 2 per cent
- a reconciliation mechanism that reconciled charges in the Original Application with a future replacement IAU.

The ACCC notes that while these two withdrawn proposals are not subject to the ACCC's assessment of the Revised Application, they relate to issues set out in the draft decision for the 2018 IAU. Accordingly, the ACCC provides its views on both proposals below to provide guidance to ARTC and stakeholders as part of the development of a future replacement undertaking.

#### 3.1. Escalation of Indicative Access Charges

In the Revised Application, ARTC proposes no changes to the provisions relating to Indicative Access Charges compared to the current 2008 IAU. That is, ARTC may increase Indicative Access Charges annually by up to CPI. If CPI were to decrease, Indicative Access Charges will remain the same as the previous year.

In its Original Application, ARTC proposed to vary section 4.6 of the 2008 IAU to replace the table of charges that were effective from 1 February 2008, with a table setting out existing charges (2018–19 charges). Further, at section 4.6(b) of the Original Application, ARTC set out charges to apply from 1 July 2019 (**2019–20 charges**):

- charges for Super Freight or Express Freight services for Segments between Adelaide and Kalgoorlie would be escalated by CPI plus 2 per cent<sup>25</sup>
- all other charges would be escalated by CPI, consistent with the current 2008 IAU.

ARTC stated that these 2019–20 charges reflect the 'standing offer' charges that ARTC published on its website on 25 September 2018 and discussed with all customers.<sup>26, 27</sup>

ARTC stated that it:<sup>28</sup>

*...understands the ability for the ACCC to approve such pricing is dependent upon the approval of the 2019 IAU and not this extension request.*

For this reason, in its Original Application ARTC proposed to include a reconciliation mechanism in a future replacement IAU which reconciled the charges set out in section 4.6(b) of the Original Application, with the charges in a future IAU that has been accepted by the ACCC, as discussed in chapter 3.2 of this Decision.

In response to the Original Application, stakeholders noted the following about ARTC's proposed Indicative Access Charges:

- NSW Trains stated that ARTC's proposal was appropriate 'to the extent that they maintain the existing pricing structure adjusted in accordance with the agreed annual increment of CPI'.<sup>29</sup>

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<sup>25</sup> This includes the Adelaide – Parkeston and Port Augusta – Whyalla Segments.

<sup>26</sup> ARTC, *Re: 2018 [sic] Interstate Access Undertaking – Extension Request*, 29 January 2019, p. 1.

<sup>27</sup> See standing offer proposal at: <<https://www.artc.com.au/uploads/2018-IAU-Standing-Offer.pdf>>.

<sup>28</sup> ARTC, *Re: 2018 [sic] Interstate Access Undertaking – Extension Request*, 29 January 2019, p. 1.

<sup>29</sup> NSW Trains, *Re: ARTC 2018 [sic] Interstate Access Undertaking*, 12 February 2019, p. 1.

- SCT acknowledged that the escalation of charges has been a normal practice in the past and was appropriate, though it noted that it ‘philosophically’ did not like the automatic right to increase rates. In respect of the proposed CPI plus 2 per cent escalation of charges for the Adelaide to Kalgoorlie Segments, SCT stated that while it did not like the quantum of the increase, it understood the rationale.<sup>30</sup>
- SSR stated that CPI escalation was appropriate, given this has been commonplace over the term of the 2008 IAU. SSR noted that it does not operate between Adelaide and Kalgoorlie, so did not provide comment on the proposed CPI plus 2 per cent escalation on these Segments.<sup>31</sup>
- Pacific National stated that ARTC had:<sup>32</sup>

*failed to provide the ACCC, rail operators or customers with a robust and defensible economic justification for either the CPI increase of all ARTC access tariffs, or the additional 2% real price increase on access tariffs between Adelaide and Kalgoorlie*

- Pacific National additionally noted its concerns that the minimum annual CPI adjustment could negatively affect customer perceptions of the competitiveness of rail freight compared with heavy vehicle haulage.<sup>33</sup>

In its Revised Application, ARTC states that it:<sup>34</sup>

*...had initially proposed an extension including a higher real price for East – West traffics with a reconciliation mechanism to be applied upon approval of a new IAU. We have recognised customer concerns around the lack of certainty that this mechanism may provide and accordingly submit this revised extension based on continuance of the CPI indexation from July 1 2019.*

In the 2018 IAU, ARTC proposed a framework whereby charges would be negotiated within a revenue Floor and Ceiling Limit for each Segment—the ‘Indicative Access Charges Range’. ARTC proposed that the Indicative Access Charges Range would be escalated by CPI each year. ARTC additionally proposed standing offer charges for the 2019–20 year that ARTC published on its website, but did not formally include in the 2018 IAU proposal. Like the Original Application, the standing offer charges included CPI plus 2 per cent escalation of charges for the Segments between Adelaide and Kalgoorlie.

In the draft decision on the 2018 IAU, the ACCC noted concerns with escalating charges by CPI. Namely, the ACCC noted that annual CPI escalation is unlikely to:<sup>35</sup>

- reflect the actual year on year variation in costs
- provide any incentives for ARTC to reduce its costs or increase its productivity, particularly as it does not allow for a reduction in charges arising from a reduction in input costs or an increase in efficiency
- represent changes in the cost of maintenance, overheads and capital expenditure for below-rail infrastructure, given that CPI is a measure of household goods and services.

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<sup>30</sup> SCT, *Consultation on proposed variation to the Australian Rail Track Corporation Limited (ARTC) 2008 Interstate Access Undertaking*, 12 February 2019, p. 1

<sup>31</sup> SSR, *January 2019 Variation to the 2008 IAU*, 12 February 2019, p. 1.

<sup>32</sup> Pacific National, *Pacific National Submission on ARTC’s 2019 Application to Vary the 2008 Access Undertaking (2019 Variation)*, 14 February 2019, p. 4.

<sup>33</sup> *Ibid*, p. 1.

<sup>34</sup> ARTC, *Re: 2008 Interstate Access Undertaking Extension Application to the ACCC*, 22 February 2019, p. 1.

<sup>35</sup> ACCC, *Draft Decision: Australian Rail Track Corporation’s 2018 Interstate Access Undertaking*, 20 December 2018, p. 169.

The ACCC also raised concerns in the draft decision on the 2018 IAU that ARTC's proposed approach to escalating the Indicative Access Charges Range did not include a mechanism to allow for nominal or real decreases in access charges.<sup>36</sup> Specifically, the ACCC considers that there could be instances where the cost of inputs making up access charges decrease in real terms. The ACCC notes that the 2008 IAU also does not include a mechanism for nominal decreases in access charges.

However, the ACCC also noted that using CPI as an escalator was likely to provide clarity and certainty to above-rail operators, applicants and ARTC regarding how the Indicative Access Charges Range would change over time. Additionally, it would ensure that any changes would be smoothed from year to year. In its draft decision, the ACCC sought views from stakeholders on whether CPI escalation remained appropriate for the 2018 IAU.<sup>37</sup> The ACCC continues to be interested in views from stakeholders on this issue, as they will likely remain relevant to the assessment of any future IAU.

In its Revised Application, ARTC states that:<sup>38</sup>

*Agreement to the extension will enable ARTC to work with the ACCC and our customers to develop a transparent regulatory framework that will provide for the future recovery of Interstate network efficient operating costs and sustainable commercial returns. As the Interstate Network does not currently earn a commercial rate of return, resetting this framework is essential.*

The ACCC notes that in a future replacement IAU application, the ACCC will assess ARTC's proposed access charges and access charges framework, having regard to the pricing principles under section 44ZZCA of the Act. In particular, the ACCC considers regulated access charges on the Interstate network should be set to:

- generate expected revenue for the below-rail service provided by ARTC that is at least sufficient to meet the efficient costs of providing access to the Interstate network
- include a return on investment that is commensurate with the regulatory and commercial risks involved in providing access on the Interstate network.

Additionally, the ACCC considers that the framework for access charges should provide incentives to ARTC to reduce costs or otherwise improve productivity. The ACCC's decision-making framework for assessing applications to vary or replace an existing undertaking is set out in chapter 5 of this Decision.

In the draft decision on the 2018 IAU, the ACCC set out information that the ACCC required from ARTC in order to assess whether ARTC's proposals were appropriate to accept, particularly in respect of ARTC's proposed pricing framework. This outstanding information is set out in Appendix A of this Decision. The ACCC continues to consider this data necessary for the assessment of a future replacement IAU application. In particular, the ACCC will require ARTC to provide justification and quantitative data in support of how it proposes to change prices over time. This is the case irrespective of the pricing framework that ARTC proposes.

## 3.2. Reconciliation mechanism

In its Original Application, ARTC proposed to include a reconciliation mechanism in a future replacement IAU which reconciled the Indicative Access Charges as set out in section 4.6(b)

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<sup>36</sup> Ibid, p. 192.

<sup>37</sup> Ibid, p. 169.

<sup>38</sup> ARTC, *Re: 2008 Interstate Access Undertaking Extension Application to the ACCC*, 22 February 2019, p. 1.



of the Original Application, with the Indicative Access Charges in a future IAU that are ultimately accepted by the ACCC. The Original Application stated that:<sup>39</sup>

- the reconciliation mechanism would be provided to the ACCC for verification 60 days after a subsequent IAU becomes effective
- ARTC would provide the data used in calculating the reconciliation, including revenue on a user and Segment basis
- the reconciliation would result in either a refund to, or a recovery from, customers.

In its letter withdrawing the Original Application, ARTC acknowledged that the majority of stakeholders expressed concerns with the clarity and certainty of the operation of the reconciliation mechanism.<sup>40</sup> In particular:

- NSW Trains noted that the reconciliation mechanism relies on a new IAU being approved and in effect. NSW Trains submitted that if approved, the reconciliation mechanism should be limited to one year only, rather than accumulating over years if there are further delays in the approval of a replacement IAU. Further, NSW Trains submitted that if approved, the ACCC should ensure compliance with a new pricing methodology in a future IAU.<sup>41</sup>
- SSR considered the reconciliation mechanism was unsuitable. SSR stated that access charges should be established upfront, so that they can be passed onto customers before services are operated. SSR stated that reconciliation would give little opportunity to capture any increased cost from customers, or alternatively, pass on any benefits to customers, without significant administrative costs.<sup>42</sup>
- Pacific National stated that the reconciliation mechanism would result in significant uncertainty and economic inefficiencies for rail operators, which may adversely impact rail operators seeking to provide rail haulage services to end customers. In particular, Pacific National noted that rail operators would not be able to pass through any future 'backdated increases' to customers on existing contracts, leaving operators exposed to unknown and unquantified regulatory risk. Pacific National additionally noted that in the circumstance that the ACCC doesn't approve a replacement IAU that contains the reconciliation mechanism, ARTC would be under no obligation to submit a revised application. Pacific National considers that this is because the ACCC is not empowered to mandate this outcome under the legislative regime in the Act.<sup>43</sup>

SCT did not raise any concerns with the reconciliation mechanism in its submission to the Original Application.

In a future replacement IAU, the ACCC considers that ARTC should incorporate an annual compliance regime into the IAU. This is consistent with views in the ACCC's draft decision on the 2018 IAU. Namely, the ACCC stated that an annual compliance process would provide:<sup>44</sup>

- clarity and certainty as to where charges are positioned with respect to the Ceiling Limit
- greater transparency over ARTC's capital expenditure, operating expenditure, and RAB.

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<sup>39</sup> Section 4.7 of the Original Application.

<sup>40</sup> ARTC, *Re: 2018 [sic] Interstate Access Undertaking – Withdrawal request*, 22 February 2019, p. 1.

<sup>41</sup> NSW Trains, *Re: ARTC 2018 [sic] Interstate Access Undertaking*, 12 February 2019, p. 2.

<sup>42</sup> SSR, *January 2019 Variation to the 2008 IAU*, 12 February 2019, p. 1.

<sup>43</sup> Pacific National, *Pacific National Submission on ARTC's 2019 Application to Vary the 2008 Access Undertaking (2019 Variation)*, 14 February 2019, p. 2.

<sup>44</sup> ACCC, *Draft Decision: Australian Rail Track Corporation's 2018 Interstate Access Undertaking*, 20 December 2018, p. 195.

The ACCC also notes that annual compliance would promote regulatory consistency with the Independent Pricing and Regulator Tribunal's (**IPART**) compliance process.<sup>45</sup>

The ACCC considers that the development of a compliance regime for a replacement IAU may necessitate a reconciliation mechanism to ensure that, for a particular Segment of the Interstate network, ARTC is at least earning the Floor Limit and is not earning more than the full Economic Cost. As a number of stakeholders submitted concerns about the reconciliation mechanism proposed in the Original Application, this highlights the importance of implementing a transparent and robust compliance mechanism in a replacement IAU.

The ACCC therefore expects ARTC to shortly commence constructive engagement with stakeholders and the ACCC regarding the development and implementation of a more robust compliance mechanism in a future replacement IAU. Further, given the concerns raised by stakeholders regarding the reconciliation mechanism proposed in the Original Application, the ACCC expects stakeholders to also constructively engage with ARTC.

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<sup>45</sup> Ibid.

## 4. ACCC's decision to consent to ARTC's variation application

For the reasons set out above, the ACCC consents to ARTC's 22 February 2019 application to vary its 2008 IAU pursuant to section 44ZZA(7) of the Act.

The ACCC has had regard to the matters set out in section 44ZZA(3) of the Act. The matters that are particularly relevant to this decision are:

- the legitimate business interests of ARTC (section 44ZZA(3)(a))
- the interests of persons seeking access to the Interstate network (section 44ZZA(3)(c))
- the objects of Part IIIA as set out in section 44AA (section 44ZZA(3)(aa)).

### 4.1. Next steps

The ACCC recognises that this variation to the 2008 IAU is primarily intended to provide regulatory certainty for ARTC and users of the Interstate network while ARTC consults on and develops an application to replace the 2008 IAU for the ACCC's assessment.

The ACCC set out a number of views and requests for information in the draft decision on the 2018 IAU. The ACCC considers that these should form the basis of ARTC's discussions with industry and the ACCC regarding a replacement IAU. As the terms and conditions set out in the IAU have implications for users of the Interstate network, the ACCC expects that industry will also productively engage in these discussions.

Given the number of issues and requests for information set out in the draft decision on the 2018 IAU, the ACCC expects these discussions to commence shortly after the release of this Decision. In particular, ARTC should engage with the ACCC prior to ARTC lodging a replacement IAU for the ACCC's assessment.

In line with the Revised Application, ARTC must inform the ACCC of its intention to submit a replacement to the 2008 IAU by 29 August 2019, which is 6 months prior to the revised expiry date of the 2008 IAU of 29 February 2020. If ARTC is to submit a replacement undertaking to the ACCC for assessment, the ACCC expects that any extension ARTC applies for under section 2.2(c) and (d) of the 2008 IAU will include a suitable time buffer in its application to ensure there is more than sufficient time for the development and assessment of a replacement undertaking. This would also ensure consistent regulatory coverage of the Interstate network while the assessment of the replacement undertaking is underway. The ACCC considers that this would assist in mitigating the regulatory uncertainty ARTC set out in its Original and Revised Applications, and that users have expressed concerns about in submissions to the Original Application.

## 5. ACCC's decision-making framework

The ACCC has a key role in promoting efficient investment in, operation of and use of infrastructure, as well as identifying market failures. Types of infrastructure regulated and monitored by the ACCC include airport, aviation, energy, fuel, postal services, rail, telecommunications, stevedoring, shipping, bulk water, and wheat export terminals.

Across this infrastructure, the ACCC applies a consistent framework to assess whether there is economically efficient investment in, operation of and use of the infrastructure.

This encompasses:

- transparency
- robustly assessing and testing evidence provided by infrastructure operators and users
- ensuring the relevant statutory criteria are satisfied.

The statutory criteria relevant to the consideration of applications to vary or replace existing undertakings under Part IIIA of the Act are set out below.

### 5.1. Legal framework for accepting an application to vary an access undertaking

Section 44ZZA(7) of the Act provides that the ACCC may consent to a variation of an undertaking if it thinks it is appropriate to do so, having regard to the matters set out in section 44ZZA(3) of the Act.

The matters in section 44ZZA(3) include:

- the objects of Part IIIA of the Act, which are to:
  - promote the economically efficient operation of, use of and investment in the infrastructure by which the services are provided, thereby promoting effective competition in upstream and downstream markets, and
  - provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry
- the pricing principles specified in section 44ZZCA of the Act (see further below)
- the legitimate business interests of the provider of the service
- the public interest, including the public interest in having competition in markets (whether or not in Australia)
- the interests of persons who might want access to the service
- whether the undertaking is in accordance with an access code that applies to the service, and
- any other matters that the ACCC thinks are relevant.

In relation to the pricing principles, section 44ZZCA of the Act provides that:

- regulated access prices should:
  - be set so as to generate expected revenue for a regulated service that is at least sufficient to meet the efficient costs of providing access to the regulated service or services, and
  - include a return on investment commensurate with the regulatory and commercial risks involved

- access price structures should:
  - allow multi-part pricing and price discrimination when it aids efficiency, and
  - not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operations is higher, and
  - access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

## 5.2. Timeframe for ACCC decision

Section 44ZZBC(1) of the Act provides that the ACCC must make a decision on an access undertaking application within the period of 180 days starting at the start of the day the application is received (referred to as 'the expected period'). A request made to the ACCC for the variation of an access undertaking is an access undertaking application.

## Appendix A: Information requests in the draft decision on the 2018 IAU

In the draft decision on the 2018 IAU, the ACCC noted a number of issues that required further information and justification from ARTC. Table 1 provides a summary of the information requested in the draft decision, that the ACCC considers will still be required from ARTC in order to assess a future IAU application.

**Table 1: Information required for a future IAU application**

Chapter	Title	Information required
6	RAB	<p>In the draft decision on the 2018 IAU, the ACCC raised several concerns with the Evans and Peck depreciated optimised replacement cost (<b>DORC</b>) assessment for the Queensland Border to Acacia Ridge Segment, and sought further information from ARTC on these matters. If ARTC seeks to include this Segment into a future IAU application, the ACCC will require this further information from ARTC.</p> <p>Similarly, if ARTC seeks to include the Metropolitan Freight Network or the Southern Sydney Freight Line Segments into a future IAU application, ARTC will be required to undertake a DORC assessment, consistent with section 4.4(d)(i) of the 2008 IAU.</p> <p>In the draft decision on the 2018 IAU, the ACCC sought further information from ARTC on capital expenditure projects in order to assess the prudence of this capital expenditure for inclusion into the RAB.</p>
7	Floor and Ceiling Limits	<p>In the draft decision on the 2018 IAU, the ACCC had significant concerns with ARTC's financial models and the calculated Floor and Ceiling Limits for 2018–19. In assessing a future IAU application, the ACCC will require the actual Floor and Ceiling Limits for each Segment between 2007–08 and 2018–19. The ACCC will also require further information from ARTC on the basis for its proposed incremental cost allocators.<sup>46</sup> This information is needed to assess whether ARTC's revenue is at or above the Ceiling Limit on Segments.</p>
8	Depreciation	<p>In the 2018 IAU application, ARTC did not provide information on the allocation of the depreciation and the return on non-Segment Specific Assets, which is a component of the Economic Cost of a Segment (section 4.4(f) of the 2008 IAU). In the draft decision on the 2018 IAU, the ACCC noted its concerns that the Economic Cost of Segments may not be efficient. The ACCC requires further information from ARTC on how it treats costs of non-Segment Specific Assets.</p>
11	Operating expenditure	<p>In the draft decision on the 2018 IAU, the ACCC noted that it requires further information from ARTC in support of its proposals relating to operating expenditure. The ACCC will require the following in assessing a future IAU application:</p>

<sup>46</sup> The incremental cost allocators are ARTC's proposed proportions of operating expenditure that are included in the Segment Floor Limits. See ARTC, 2018 Interstate Network Access Undertaking Renewal: *Explanatory Guide*, March 2018, p. 33.

Chapter	Title	Information required
		<ul style="list-style-type: none"> <li>If ARTC proposes to use a base year to establish the Segment Floor and Ceiling Limits in a future IAU application, the ACCC will require information and evidence demonstrating why the forecast and maintenance costs in the relevant year should be considered efficient and consequently used as a base year for the term of a replacement IAU.</li> <li>Explanation for why there are inconsistencies in the dates that ARTC states it began operating new Segments between 2007–08 and 2017–18, and when maintenance expenditure was spent on these Segments.</li> <li>Explanation for why ARTC has applied cost adjustments to the Melbourne (Tottenham) – Macarthur, Moss Vale – Unanderra and Metropolitan Freight Network Segments only.<sup>47</sup></li> </ul>
12	Access pricing range and structure	In the draft decision on the 2018 IAU, the ACCC noted concerns that ARTC had not provided information that demonstrates that its proposed structure of charges reflected its costs. Should ARTC make a similar proposal in a future IAU application, the ACCC will require this information in order to determine if the structure of charges is appropriate.
15	Network connections, additions to capacity, and Network Transit Management	In the draft decision on the 2018 IAU, the ACCC was unable to form a view on whether the consultation provision in section 6.5 of the 2008 IAU remains appropriate in its current form. The ACCC therefore seeks information from ARTC and stakeholders on the operation of section 6.5 as to its effectiveness in facilitating consultations in relation to the planning of additional capacity, to determine whether the approach continues to strike the appropriate balance between effective consultation with users and the interests of ARTC as the infrastructure owner.
20	Indicative Track Access Agreement	<p>In the draft decision on the 2018 IAU, the ACCC sought further information from ARTC on particular changes it was seeking in the ITAA. If ARTC seeks similar changes in a future IAU application, the ACCC will require further information on the following matters:</p> <ul style="list-style-type: none"> <li>Loss and Damage provisions</li> <li>insurance costs on the Interstate network</li> <li>Force Majeure provision</li> <li>'non price' terms in the determination of an Indicative Service</li> <li>environmental manual.</li> </ul>

<sup>47</sup> This refers to the 'Interstate Efficiency Dividend' and the 'E&I Corridor Management South' adjustments.