

Roy Hill Infrastructure Pty Ltd proposed Over-payment Rules

Draft Decision

March 2017

Economic Regulation Authority

WESTERN AUSTRALIA

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Invitation to make submissions

Interested parties are invited to make submissions on the Draft Decision by 21 April 2017 via:

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In general, all submissions from interested parties will be treated as being in the public domain and placed on the Authority's website. Where an interested party wishes to make a submission in confidence, it should clearly indicate the parts of the submission for which confidentiality is claimed, and specify in reasonable detail the basis for the claim. Any claim of confidentiality will be considered in accordance with the provisions of Section 55 of the *Economic Regulation Authority Act 2003*.

The publication of a submission on the Authority's website shall not be taken as indicating that the Authority has knowledge either actual or constructive of the contents of a particular submission and, in particular, whether the submission in whole or part contains information of a confidential nature and no duty of confidence will arise for the Authority.

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Introduction

1. The *Railways (Access) Code 2000* (**Code**) establishes the requirement for a railway owner to prepare and submit to the Regulator (the Economic Regulation Authority (**Authority**)) a statement of the rules (**Over-payment Rules**) that are to apply where breaches of clause 8 of Schedule 4 occur on the part of the railway owner that could not reasonably be avoided. Clause 8 of Schedule 4 sets out the maximum amount of the total costs attributable to a route that the railway owner is allowed to recover.
2. The Code requires that the Over-payment Rules must give effect to the following basic requirements:¹
 - the excess referred to in clause 8(4) of Schedule 4 in respect of an operator or group of operators must at all times be within a limit, being a percentage of the relevant costs, from time to time notified in writing to the railway owner by the Regulator;
 - at the expiry of each successive period of 3 years from the commencement of access by an operator or group of operators there must be no such excess in respect of that operator or group of operators.
3. Clause 8 of Schedule 4 to the Code requires, among other things, that the total of all payments to the railway owner and the revenue attributable to its own operations on the route, must not be more than the total costs attributable to the route
4. The Code does not contain any provisions relating to consultation associated with the Regulator's approval of Over-payment Rules. The Code also provides for amendment or replacement of the Over-payment Rules by the railway owner or the Regulator.²
5. On 11 October 2016, Roy Hill Infrastructure (RHI) submitted Over-payment Rules for the Authority's approval. The Authority published RHI's proposed Over-payment Rules and called for submissions on 25 October 2016.
6. The Pilbara Infrastructure Pty Ltd was the sole submission received and is very brief. It expresses support for all of the regulatory instruments proposed by RHI without providing specific comment on any provisions of the proposals.

Draft Decision

7. This document:
 - Summarises each part of RHI's proposed Over-payment Rules, relates these to the relevant provisions of the Code, and compares each part with the provisions of other railway owners' approved Over-payment Rules where relevant;
 - Provides the Authority's assessment of relevant issues; and
 - Provides the Authority's required amendments where appropriate.

¹ Section 47 (2) of the *Railways (Access) Code 2000*.

² Section 47 (4) of the *Railways (Access) Code 2000*.

Part 1 - Introduction

8. Part 1 of the proposed Over-payment Rules acknowledges that RHI is required, in accordance with section 47 of the Code, to submit Over-payment Rules to the Regulator for approval.
9. This part outlines the Ceiling Price Test, as described in clause 8 of Schedule 4 to the Code, and notes that this provision will not be breached where Total Revenue earned on a particular route section exceeds Total Cost if the approved Over-payment Rules are complied with.
10. The objectives detailed in the proposed Over-payment Rules align with the requirements as outlined in the relevant sections of the Code.
11. Part 1 of RHI's proposed Over-payment Rules is substantially identical to, and has the same layout as, the corresponding parts of Brookfield Rail's (**BR**) and The Pilbara Infrastructure's (**TPI**) Over-payment Rules.

Authority Assessment

12. The Authority considers that Part 1 of RHI's proposed Over-payment Rules adequately reflects the obligations of RHI in relation to the establishment of the Over-payment Rules and the basic requirements laid out in section 47 of the Code.

Part 2 – Basis of Over-payment Rules

13. Part 2.1 of RHI's proposed Over-payment Rules provides a definition of route and route section which is consistent with the definitions provided in the Code.
14. Part 2.2 acknowledges that there is a Regulatory 'ceiling' which applies to each route section, commensurate with the Total Cost for the section as determined by the Regulator under section 9 or 10 of the Code.
15. Part 2.3 describes the components of total revenues to RHI in respect of a route or part of a route, as shown at clause 8(3) of Schedule 4 to the Code.
16. Part 2.3 also states that since the Code does not provide Non-Regime Operators a legal entitlement to any refund of any Over-payment, such Over-payments will be retained by RHI unless otherwise specified in an access agreement with the Non Regime Operator.
17. Part 2.4 of RHI's proposed Over-payment Rules details the application of the Over-payment Rules to breaches of the Ceiling price test, as described in clause 8 of Schedule 4 to the Code.
18. Part 2.5 of RHI's proposed Over-payment Rules provides the basic scheme of the overpayment Rules as required by sections 47(2) and 47(2)(a) of the Code.
19. Part 2.6 of RHI's proposed Over-payment Rules provides for the allocation of payments across route sections.
20. Part 2.7 of RHI's proposed Over-payment Rules provides for the allocation of capital contributions as annualised revenue for the purposes of the Over-payment Rules.

Authority Assessment

21. Part 2 of RHI's proposed Over-payment Rules is identical in layout and substantially identical to the Over-payment Rules in place for BR and TPI, except for the conflation of the terms "Regime Revenue"/"Non-Regime Revenue" in RHI's proposed instrument with "Access Revenue"/"Non-Access Revenue" used in BR's and TPI's Over-payment Rules. In particular, the basic scheme of the Over-payment Rules described in Part 2.5, and the numerical example provided, is the same as approved Over-payment Rules for the other railway owners.³
22. The Code does not anticipate the allocation of payments across route sections in the manner prescribed in Part 2.6 of the proposed Over-payment Rules.⁴ BR first proposed this method of allocating revenue and calculating over-payments to address the movement of trains across marginal and non-marginal routes of its network, and TPI proposed an identical scheme. The Authority in both cases approved the allocation method.
23. The use of the terms "regime" and "non-regime" in the BR and TPI Over-payment Rules appears as a way of distinguishing between payments made by operators⁵ and by other entities in respect of the 'Ceiling Price Test' at Clause 8 of Schedule 4 to the Code. At subclause 8(3), it becomes a requirement that the sum of payments to the railway owner by (i) all operators, and (ii) all other entities, including the railway owner in respect of its own operations, must not be more than Total Costs.
24. The use of the terms "regime" and "non-regime" to distinguish between operations "inside and outside the Code" is not required, and does not add clarity to the proposed Over-payment Rules. Further, the Code does not define these terms.
25. The Code defines the term 'Operator' as an "entity to which access is provided under an access agreement". For the purposes of the Over-payment Rules, "other entities" are entities (including the railway owner in respect of its own operations) which undertake operations on the railway owner's network otherwise than under an access agreement. This distinction is not clear in Section 47 of the Code ("Over-payment Rules") but is made clear in subclause 8(3) ("Ceiling Price Test") of Schedule 4 to the Code.
26. In view of the clear distinction provided by the Code, and notwithstanding the approval of BR's and TPI's Over-payment Rules, the Authority considers that the use of the term "regime" and "non-regime" is redundant in RHI's proposed Over-payment Rules, and that an adequate distinction may be made between entities provided with access inside and outside the "regime" by using the Code-defined terms "operator" and "entity".
27. "Access" is a code-defined term and means "the use of railway infrastructure". The use of the term "access" is not confined to access under the Code, and may be applied

³ Except that Part 2.5(c) ascribes the 3 year period for netting out "overs and unders" to an "ERA determination", whereas the 3 year period is prescribed in Section 47(2)(b) of the Code.

⁴ The Code defines a 'route' as including part of a route, and a 'route section' as the sections of a railway network into which the network is divided for management and costing purposes. In practice, it is evident that proposals may be made for access to parts of a route which are not complete route sections.

⁵ Operators defined in the Code as "an entity to which access is provided under an access agreement".

to use of the railway infrastructure by operators, or by entities who have negotiated access outside the Code.⁶

28. The terms “access” and “non-access” appear in other railway owners’ Over-payment rules. BR first proposed the use of these terms to allow for consideration of capital contributions made by operators as part of access agreements, and also by the government, principally by Main Roads WA for level crossings on the SW freight network.
29. That consideration was initially, in BR’s case, a means of incorporating capital contributions in respect of a route section as annualised revenue, rather than requiring the subtraction of the capital amounts from the Gross Replacement Value of the route for the purposes of determining the total cost referred to in the Ceiling price test (clause 8 of Schedule 4 to the Code).
30. The Authority considers that the use of any terms which are not Code-defined should be consistent across railway owners’ instruments. If RHI is to use the terms “access/non-access” to describe payments or revenue, then they should be used in a manner consistent with BR and TPI in their Over-payment Rules.
31. This would require an amendment, for example, to RHI’s proposed Over-payment Rules at Part 2.3(a). This part is identical to the first paragraph of Part 2.3 of both BR’s and TPI’s Over-payment Rules, except for the use of the terms “Regime Revenue/Non-Regime Revenue” in place of “Access Revenue”/“Non-Access Revenue”.
32. RHI’s proposed Over-payment Rules should refer to clause 8(3)(b) of Schedule 4 to the Code (“The Ceiling Price Test”) and the requirement that total payments to the railway owner includes revenue attributable to its own operations on the route.
33. Revenue which the owner’s accounts and records show as being attributable to its own operations on the route may be regime or non-regime revenue, depending on whether those operations are subject to an access agreement, or under an out-of-Code contract.
34. It is appropriate for the Over-payment Rules to state that any entity with access negotiated outside the Code is not entitled to a refund of over-payments. However, the Over-payment Rules must not include statements regarding the treatment of over-payments to entities with contracts negotiated outside the Code. This is because section 4A(1)(c) of the Code makes it clear that nothing in the Code (including the Over-payment Rules) is to be taken into account in determining the rights of entities who have negotiated access otherwise than under the Code.
35. Part 2.5(c) ascribes the 3 year period for netting out of “overs and unders” to a “determination of the ERA”, whereas the 3 year period is prescribed in Section 47(2)(b) of the Code.

⁶ The term “access agreement” however, is a Code-defined term which means “an agreement in writing under this Code between the railway owner and an entity for access by that entity” and cannot be used in conjunction with access negotiated outside the Code by entities other than operators.

Required Amendment 1

Part 2 of RHI's proposed Over-payment Rules should be amended such that:

- The words "Regime Revenue"/"Non-Regime Revenue" are replaced with "Access Revenue"/"Non-Access Revenue" in 2.3(a) and 2.3(b).
- The words "to Operators" and "in accordance with the ERA's approved set of Costing Principles to apply to RHI" are deleted from 2.3(b).
- Part 2.3(c) is replaced with "Revenue from entities who have negotiated access outside the Code, and revenues attributable to RHI's own operations on the route, will be included in evaluating RHI's compliance with the Ceiling Price Test and in assessing the extent of Over-payments under Section 47 of the Code. The Code does not provide these entities with a legal entitlement to a refund of any Over-payment".
- The words "and if RHI has Access Agreements with Operators under the Code" is replaced with "and if Access Agreements are in place" in 2.4(c).
- The words "The ERA has determined that" are deleted from 2.5(c).
- The title of Part 2.7 be changed to "Allocation of Non-Access Revenue" and all references to "non-regime" be changed to "non-access" in that part.

Part 3 – Allocation of an Over-Payment

36. Part 3 of RHI's proposed Over-payment Rules describes the allocation of over-payments. Part 3(a) states that all operators are entitled to a share in over-payments refunds, which is consistent with Section 47(2a) of the Code.
37. Part 3(b) describes the over-payments refund due to each operator as a function of each operator's share in all operators' "regime and non-regime revenue".
38. The wording of Part 3 of RHI's proposed Over-payment Rules is identical to Part 2.8 of TPI's Over-payment Rules and substantially identical to Part 2.8 of BR's Overpayment Rules except for the use of the terms "regime/non-regime" in place of "Access/Non-Access" throughout.

Authority Assessment

39. In relation to Part 3(a), the term "operator" is a Code-defined term meaning an entity to which access is provided under an access agreement. It is not required that the term operator be qualified with the words "who have negotiated their access agreements inside the Code", as that qualification serves to suggest that there are operators who have agreements outside the Code, which is not appropriate.
40. The term "operator" is similarly qualified in the TPI and BR Over-payment Rules, and that term is applied to both operators (as defined in the Code) and to entities who have negotiated access outside the Code in those instruments.

41. Operators, as defined in the Code, are entities with access agreements, and therefore do not make “non-regime” payments to the railway owner. The use of the term “non-regime” in relation to payments made by operators is not correct.
42. The Authority considers that, consistent with RHI’s use of the BR and TPI Over-payment Rules as a template for these sections, that the use of the terms “Access” and “Non-Access” should be consistent with the BR and TPI Over-payment Rules.

Required Amendment 2

Part 3 of RHI’s proposed Over-payment Rules should be amended such that:

- The words “who have negotiated their access agreements inside the Code” in 3(a) are deleted
- The words “Regime Revenue and Non Regime revenue above the floor accumulated on a route section divided by the aggregate of all Operators’ Regime Revenue and Non Regime Revenue” in 3(b) is replaced with the words “all revenues received”.

Part 4 – The Overpayment Rules

43. Part 4 describes the proposed Over-payment Rules. Part 4 is set out and uses substantially the same text as Part 4 of BR’s Over-payment Rules and Part 3 of TPI’s Over-payment Rules, notwithstanding the inconsistent use of Code-defined terms in those instruments.
44. Part 4(a)-(d) provides for the calculation of Over-payments for route sections, the application of the Rules and the applicable time periods for administration of the Rules.
45. Part 4(e) nominates a 10 per cent margin as the applicable margin to apply in respect of section 47(2)(a) of the Code which is the limit, being a percentage of the relevant costs notified to the railway owner by the Regulator, below which an over-payment is considered not to have occurred in terms of the ceiling price test.⁷
46. Part 4(f) describes the formula proposed for allocating net over-payments to operators.
47. In the context of the terminology used by RHI, and based on the similarity of this Part of RHI’s proposed Over-payment Rules with the corresponding parts in the BR and TPI Over-payment Rules, it is apparent that the intent of Part 4(f) is that each operator’s share of the net Over-payment plus interest accrued for the route section is equal to:

⁷ Clause 8(4) Schedule 4 to the Code

The operator's (i) annual access payments above the operator's incremental cost plus (ii) annual non-access payments for the route section

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Total of all entities' (i) annual access payments above the total incremental cost of the combined operations on the route of all entities plus (ii) annual non-access payments for the route section

48. Part 4 includes three notes underneath the formula shown at 4(f).⁸ These notes indicate (i) that total payments include payments from both operators and entities who have negotiated access outside the Code, (ii) operators, but not entities who have negotiated access outside the Code, are eligible for a share of net over-payments, and (iii) entities who have negotiated access outside the Code may be allocated a share of net over-payments, but only if stipulated in their access contract.
49. Parts 4(g)-(i) describe the operation of the Over-payment Rules account. These parts are identical to the corresponding parts of the BR and TPI Over-payment Rules.
50. Parts 4(j)-(k) allow for the Over-payment account to be credited with interest on the amount standing to the credit of the Over-payment account, and for interest to be distributed to operators on the same basis as other amounts distributed to operators. Unlike the BR and TPI Over-payment Rules, which both nominate an interest rate equal to the 10 year long term bond rate, RHI has not nominated an interest rate to apply.
51. Parts 4(l)-(q) excluding 4(m) describe the timeframe for distribution of over-payment shares and provisions for approval of over-payment distributions by the Authority and for auditing of the over-payment accounts.
52. Part 4(m) provides for the retention by RHI of any distribution of funds associated with over-payments to entities who have negotiated access outside the Code. A similar provision appears in BR's Over-payment Rules at Part 3.13, but not in TPI's Over-payment Rules.

Authority Assessment

53. It is not necessary to nominate a commencement date for the Over-payment Rules, as the commencement date will be the date of approval by the Authority.
54. The margin of 10 per cent nominated by RHI in Part 4(e) is appropriate, and is consistent with the margins nominated in other railway owners' Over-payment Rules. The margin is subject to variation by the Regulator from time to time.⁹
55. The qualification applied to the word Operators in 4(f) (viz., "who have negotiated their Access Agreement inside the Code") is redundant, as the Code defines all access agreements as being agreements in writing under the Code, and operators as entities to which access is provided under an access agreement.

⁸ Similar notes also appear under the corresponding formula in BR and TPI Over-payment Rules.

⁹ Section 47(2)(a) "The excess referred to in Clause 8(4) of Schedule 4 in respect of an operator or group of operators must at all times be within a limit, being a percentage of the relevant costs, from time to time notified in writing to the railway owner by the Regulator".

56. The use of terminology such as “annual Regime Revenue above the Floor Price by each Operator” in 4(f) is not consistent with the Code, and is confusing. Terminology consistent with established practice and with the Code would include references to (1) access and non-access¹⁰ payments by each operator and by all entities who have negotiated access, and (2) incremental costs associated with each operator’s operations, and (3) the total of the incremental costs resulting from the combined operations on the route of all operators and other entities and the railway owner.¹¹
57. The notes appearing under the formula shown in 4(f) are redundant, or are stated elsewhere or refer to access negotiated outside the Code, to which none of the provisions of the Code (including these Over-payment Rules) apply.¹²
58. RHI has not nominated an interest rate to apply to the over-payment account in respect of 4(j) and the Authority considers that an interest rate should be nominated. The 10 year long term bond rate, as nominated by both BR and TPI, is an appropriate rate.
59. The provisions of 4(k) reflect the formula shown in 4(f) and the assurance provided by 4(k) is therefore not required, and does not add clarity.
60. Part 4(m) refers to over-payment provisions in respect of access negotiated outside the Code, to which none of the provisions of the Code (including these Over-payment Rules) apply. Therefore the clause is not a required.
61. Parts 4(o) and 4(q) refer to Operators “with Access Agreements under the Regime” or “Access Agreements negotiated inside the Code”. These qualifications are redundant, as the Code defines Operators as entities with access provided under an access agreement, and access agreement is defined in the Code as an agreement under the Code for access by that entity.

¹⁰ As established in BR’s Over-payment Rules but not reflected in the provisions of the Code.

¹¹ This terminology consistent with the form of words used in clause 7(2)(b) of Schedule 4 to the Code “Floor price test”.

¹² In accordance with Section 4A of the Code.

Required Amendment 3

Part 4 of RHI's proposed Over-payment Rules should be amended such that:

- Part 4(a) is deleted
- The words “the 10 per cent amount” in 4(e) should be replaced with “a 10 per cent amount”
- The words “(who have negotiated their Access Agreement inside the Code)” in 4(f) are deleted
- The formula shown at 4(f) is altered to reflect the wording suggested at paragraph 47 of this draft decision, or words to that effect, if these words reflect RHI's intention
- The three notes appearing under the formula shown at 4(f) are deleted
- 4(j) makes provision for an interest rate associated with the long term bond rate be applied to the over-payment account.
- 4(k) and 4(m) be deleted.
- The words “with Access Agreements under the Regime” are deleted from 4(o)
- The words “with Access Agreements negotiated inside the Code” are deleted from 4(q)

Part 5 – Application of the Overpayment Rules

62. Part 5 of RHI's proposed Over-payment Rules provides a numerical example of the application of the Over-payment Rules. The example shows the operation of a three year “overs” and “unders” carry-over scheme, as described in Part 4 of the proposed Over-payment Rules.
63. The numerical example comprising this part is identical in its layout and its empirical elements to the numerical example provided by BR at Part 4 and TPI at Part 5 of their Over-payment Rules.

Authority Assessment

64. The Authority considers the numerical example provided by RHI in this part of its proposed Over-payment Rules is appropriate and adequately reflects the scheme of the Over-payment Rules proposed in the earlier parts of the document.
65. The Authority considers the reference to “Non-Regime Operator” in 5(d) is not required, as the Code defines operators as entities with access negotiated under the Code.

Required Amendment 4

Part 5 of RHI's proposed Over-payment Rules should be amended such that the words "Non-Regime Operator" are replaced with "entity", "Regime" is replaced with "Code" and "that Route Section comprised only Non-Regime Operators" are replaced with "no access to that Route Section was provided under an access agreement" in Part 5(d).

Part 6 – Compliance and Review

66. Part 6 of RHI's proposed Over-payment Rules makes provision for compliance and review. Part 6(a) provides that stakeholders have the ability to express concerns to the ERA for the ERA's consideration. Part 6(b) provides that the ERA may amend the Over-payment Rules at any time, and that stakeholders may request the ERA to consider amendments. Part 6(c) provides for the ERA to commission special audits at any time to monitor RHI's compliance with its Over-payment Rules.
67. The three points contained in Part 6 appear also in BR's and TPI's over-payment Rules in substantially the same form.
68. Part 6 of RHI's proposed Over-payment Rules does not contain provisions for regular audit of the Over-payment account. Part 4(o) of RHI's Over-payment Rules provides for an annual audit of the Over-payment account. The provisions at 4(o) provide for additional assurance in relation to the credit of interest and payment of over-payment amounts at the end of each three year cycle.

Authority Assessment

69. The Authority considers the provisions of Part 6 of RHI's proposed Over-payment Rules are adequate.

Appendix 1 Summary of Required Amendments

Required Amendment 1

Part 2 of RHI's proposed Over-payment Rules should be amended such that:

- The words "Regime Revenue"/"Non-Regime Revenue" are replaced with "Access Revenue"/"Non-Access Revenue" in 2.3(a) and 2.3(b).
- The words "to Operators" and "in accordance with the ERA's approved set of Costing Principles to apply to RHI" are deleted from 2.3(b).
- Part 2.3(c) is replaced with "Revenue from entities who have negotiated access outside the Code, and revenues attributable to RHI's own operations on the route, will be included in evaluating RHI's compliance with the Ceiling Price Test and in assessing the extent of Over-payments under Section 47 of the Code. The Code does not provide these entities with a legal entitlement to a refund of any Over-payment".
- The words "and if RHI has Access Agreements with Operators under the Code" is replaced with "and if Access Agreements are in place" in 2.4(c).
- The words "The ERA has determined that" are deleted from 2.5(c).
- The title of Part 2.7 be changed to "Allocation of Non-Access Revenue" and all references to "non-regime" be changed to "non-access" in that part.

Required Amendment 2

Part 3 of RHI's proposed Over-payment Rules should be amended such that:

- The words "who have negotiated their access agreements inside the Code" in 3(a) are deleted
- The words "Regime Revenue and Non Regime revenue above the floor accumulated on a route section divided by the aggregate of all Operators' Regime Revenue and Non Regime Revenue" in 3(b) is replaced with the words "all revenues received".

Required Amendment 3

Part 4 of RHI's proposed Over-payment Rules should be amended such that:

- Part 4(a) is deleted
- The words "the 10 per cent amount" in 4(e) should be replaced with "a 10 per cent amount"
- The words "(who have negotiated their Access Agreement inside the Code)" in 4(f) are deleted
- The formula shown at 4(f) is altered to reflect the wording suggested at paragraph 48 of this draft decision, or words to that effect, if these words reflect RHI's intention
- The three notes appearing under the formula shown at 4(f) are deleted
- 4(j) makes provision for an interest rate associated with the long term bond rate be applied to the over-payment account.
- 4(k) and 4(m) be deleted.
- The words "with Access Agreements under the Regime" are deleted from 4(o)
- The words "with Access Agreements negotiated inside the Code" are deleted from 4(q)

Required Amendment 4

Part 5 of RHI's proposed Over-payment Rules should be amended such that the words "Non-Regime Operator" are replaced with "entity", "Regime" is replaced with "Code" and "that Route Section comprised only Non-Regime Operators" are replaced with "no access to that Route Section was provided under an access agreement" in Part 5(d).