Marinus Link Pty Ltd
PO Box 606 Moonah
Tasmania
Australia 7009

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Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2001

Project Reference Code: ERC0381

Dear Ms Collyer,

Targeted ex post reviews – Draft determination

Marinus Link Pty Ltd (**MLPL**) welcomes the opportunity to make this submission in response to the Commission's draft determination on 'Managing ISP project uncertainty through targeted ex post reviews', following a Rule change request submitted by the Honourable Chris Bowen, Minister for Climate Change and Energy.

As you know, Marinus Link involves approximately 255 kilometres of undersea HVDC cable and approximately 90 kilometres of underground cable in Victoria. It also includes converter stations in Tasmania and Victoria. The total interconnection capacity will be 1500 MW, provided through two 750 MW cables. Marinus Link will be supported by augmentations of the existing transmission system in Tasmania, known as the North West Transmission Developments (**NWTD**), which are being progressed by TasNetworks. We refer to Marinus Link and the NWTD as 'Project Marinus', which AEMO has confirmed to be an actionable ISP project.

MLPL understands that the purpose of the draft determination is to improve the operation of the ex post review to ISP projects in relation to the 'overspending' trigger. Under the current Rules, the AER conducts an ex post review where the TNSP's total expenditure has exceeded the AER's allowance over the 5 year review period. By introducing a separate ex ante review to each ISP project, the AER would focus on overspending for each ISP project while maintaining the current approach for non-ISP projects.

This proposed approach is intended to avoid the possibility that an overspend in relation to an ISP project could inadvertently trigger a broader review of a TNSP's capital expenditure, creating additional work for the AER and uncertainty for the TNSPs. In the draft determination, the proposed approach is to conduct an ex post review only when the total actual costs of the ISP project are known, i.e., after commissioning and energisation. Furthermore, an ex post review is conducted as part of a revenue determination, and so could occur several years after the commissioning and energisation date.

While MLPL supports the intention of the draft determination, we consider that the proposed process will create uncertainty for TNSPs and consumers that could be avoided. Specifically, the timeframes for conducting an ex post review mean that expenditure may not be assessed for 10 or more years after it has been incurred. In the case of Marinus Link, for example, if commissioning and energisation occurs in 2030 (i.e., at the start of the second regulatory period), an ex post review would not occur until 2034, i.e. as part of the AER's revenue determination for the 2035-2040 regulatory period. Such a review would include a consideration of early works expenditure, which commenced on 1 July 2021, some 13 years prior to the ex post review. Evidently, a delay of this length will create uncertainty for all parties and make the review more challenging, as questions raised by the AER will be more difficult to answer given the passage of time.

MLPL supports a more flexible approach to the timing of ex post reviews, so that the timeframe for completing an ex post review could be brought forward as soon as possible. This increased flexibility is best achieved by allowing an ex post review to commence as soon as the following conditions have been met:

- The TNSP becomes aware that the actual capital expenditure for the ISP project will exceed the AER's capital expenditure allowance;
- The principal causes of the overspend are known and can be explained by the TNSP; and
- If the project has not yet been completed, the remaining costs of the project are reasonably certain.

The relevant TNSP would be in the best position to determine when these conditions have been met. A more flexible approach to conducting ex post reviews could be achieved, therefore, by requiring the TNSP to initiate an ex post review when these conditions have been met. An ex post review would be decoupled from the revenue determination process, similar to the current arrangements for cost pass through applications which are considered by the AER during a regulatory control period. In addition to reducing uncertainty, a benefit of this more flexible approach to the timing of an ex post review will ensure that prices charged to consumers will reflect efficient and prudent costs much sooner, which would promote the achievement of the National Electricity Objective (**NEO**).

In addition to the process issues raised above, MLPL notes that the Commission comments that the AER has the flexibility under the existing Rules to consider how the ex post review and the CESS should work together.[1] While the Commission may be correct that the AER has discretion to apply the ex post review and the Capital Expenditure Sharing Scheme (**CESS**) together, MLPL sees the current Rule change process as an opportunity to substantially improve the incentive arrangements that apply to actionable ISP projects.

At a high level, MLPL questions the appropriateness of applying an ex post review to actionable ISP projects, which are urgently needed projects that have been subject to extensive public scrutiny as part of AEMO's national planning process. The inherent risks associated with such large scale infrastructure projects are not well suited to ex post reviews, which expose investors to the risk of capital loss and tend to exacerbate funding challenges. Given this context, there is an opportunity to develop a more flexible approach to the incentive mechanisms that apply to actionable ISP projects, including the possibility that ex post reviews should not apply.

In terms of a way forward, MLPL would welcome an explicit recognition in the Rules drafting of the linkages between the ex post review and CESS to ensure that the arrangements are fit for purpose. In particular, MLPL notes the following possible approaches that may be appropriate depending on the circumstances of each project:

- The application of the CESS, which provides incentives in each year to minimise capital expenditure, may obviate the need to apply an ex post review. This is because the TNSP will always be seeking to minimise its capital expenditure and, therefore, it is reasonable to assume that the resulting actual expenditure will be prudent and efficient. MLPL notes that this is precisely the approach that applies in relation to the AER's forecasting approach for operating expenditure, which relies on the incentive properties of the Efficiency Benefit Sharing Scheme.

- The application of an ex post review may obviate the need to apply the CESS, as the TNSP faces a powerful incentive not to overspend the capital expenditure allowance for an ISP project, which itself reflects the AER's assessment of prudent and efficient costs. As a practical matter, a TNSP can only respond to an incentive that relates to its total project expenditure by seeking to minimise its capital expenditure for each year and across all aspects of the project.

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[1] AEMC, National Electricity Amendment (Managing ISP project uncertainty through targeted ex post reviews) Rule 2024, Draft Determination, 9 May 2024, page 15.

- It may be appropriate to apply the CESS and ex post review in combination, possibly with a lower incentive rate for the CESS and a materiality threshold applying to the ex post review. In considering a combination of incentives, we note that the uncertainty in forecasting actual expenditure and the inherent challenge in delivering actionable ISP projects on time and budget indicate that lower powered incentives may be more appropriate.

- At present, the unprecedented supply constraints create 'hot market' conditions that are extremely challenging to manage. It is important to factor existing market conditions into the incentive arrangements, rather than adopting a 'one size for all time' approach.

MLPL's view is that further work is required to ensure that the incentives that apply to each actionable ISP project are fit for purpose. In the case of Marinus Link, there are unique challenges in forecasting the costs to deliver the first submarine HVDC interconnector in Australia in more than 20 years. For example, it is not possible to survey the full length of the undersea route, which means that unexpected seabed conditions or contamination may be encountered that require the contractor to undertake additional remediations beyond those included in the contract price. Evidently, the potential cost impact on MLPL arising from this risk is materially different to the risks that may be encountered in constructing an overhead double circuit transmission line of a similar route length.

MLPL is not seeking special dispensation for its particular circumstances. Instead, our position is that the regulatory framework should allow flexibility in the design of the capital expenditure incentive arrangements to address the particular characteristics of each ISP project. Evidently, flexibility in the design of the incentive schemes is likely to yield a better outcome for consumers compared to a 'one size fits all' approach. MLPL notes that a case-by-case design approach is appropriate given that the ex post review and the design of the CESS will both be applied to each individual ISP project.

The best approach to achieving an optimal outcome is to require each TNSP to propose its own combination of incentives, based on each particular actionable ISP project. In making this suggestion, MLPL notes that our collective understanding of what constitutes optimal incentive arrangements is likely to evolve over time in light of experience and circumstances. It is therefore not appropriate to 'lock in' ex post reviews for actionable ISP projects, particularly if providers of finance are deterred from investing in major projects where overruns could be subject to a 100% capital loss. In such situations projects are more likely to be at risk of not passing the project proponent's internal investment governance processes, meaning that they are more likely to not proceed due to the risk of loss of capital.

For the reasons set out above, MLPL strongly recommends introducing additional flexibility in the operation of the capital expenditure incentives that apply to actionable ISP projects. This approach will encourage innovation on the part of TNSPs, following constructive engagement with consumers, to find better ways of encouraging cost efficiencies. The current Rule change provides an opportunity to introduce meaningful change that will promote the long term interests of electricity customers, in accordance with the NEO. In making this observation, it is important to reiterate that actionable ISP projects are urgently needed if consumers are to obtain reliable, clean energy at the lowest total cost. MLPL's view is that building more flexibility in the regulatory framework will help to facilitate the timely delivery of these projects, which are inherently challenging given their size, complexity and risk.

In addition to raising the process and incentive issues relating to ex post reviews, MLPL would like to note its support for the submission lodged by Energy Networks Australia. MLPL looks forward to working with the Commission as it finalises its Rule determination. In the meantime, if you would like to discuss this submission, please contact me at your earliest convenience.

Yours sincerely,

Ben Wagner

Head of Customer Projects