MARINUS LINK

Response to the AER's staff views on Rate of Return

20 October 2023

Responsibilities

This document is the responsibility of the Marinus Link Team, Marinus Link Pty Ltd PO Box 606 Moonah Tasmania 7009, ABN 47 630 194 562 (hereafter referred to as MLPL).

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1 Introduction

Marinus Link Pty Ltd (MLPL) has received an email from the Australian Energy Regulator (AER) in relation to the MLPL Revenue Proposal Stage 1 – Part A (Early works),[1] which sets out the AER's staff view on the rate of return and whether MLPL's Revenue Proposal – Part A (Early works) complies with the National Electricity Rules (the Rules) and the National Electricity Law (NEL).

As explained in this response, MLPL does not agree with the AER's staff views that MLPL's proposal does not comply with the Rules and the NEL. As explained in this response:

- MLPL's first regulatory control period will commence on 1 July 2025, not 1 July 2021 as indicated in the AER's staff view.
- The AER's determination for Part A (Early works) relates to a period that pre-dates the commencement of the first regulatory control period for MLPL. As such, the allowed rate of return provisions in the Rules do not apply to MLPL for the AER's determination for Part A (Early works).
- MLPL will be the network service provider following the completion of the AER's Stage 1 determination, but not for Part A (Early works). This observation confirms MLPL's contention that the rate of return provisions do not apply to MLPL for the AER's determination for Part A (Early works).
- MLPL's rate of return proposal is consistent with the 2022 Rate of Return instrument and the National Electricity Law because MLPL proposes to adopt TasNetworks' allowed rate of return, which complies with the applicable Rate of Return instrument.

Our reasoning on each of these points is provided in section 3 of this response.

There are no confidentiality claims nor supporting documents for this response.

[1] Email from AER to MLPL dated 12 October 2023.

2 AER staff view

The AER's staff view is reproduced in the box below.

1. RAB roll forward half-year WACC allowance

It appears to us that we are bound by the Rate of Return Instrument in making a decision on the Stage 1 Part A revenue proposal. The AER is bound by the Rate of Return Instrument when exercising an AER economic or regulatory function or power: section 18H of the NEL. Under the language of rule 6A.9 of the Rules, it appears to us we are making a transmission determination. If not, it appears to us we are exercising powers in relation to a transmission determination. Therefore, we are exercising "an AER economic or regulatory function or power". We do not consider using TasNetworks' rate of return to be consistent with applying the current Rate of Return Instrument (2022 Instrument).

Our preliminary staff view is that we should apply the 2022 Instrument to estimate the rate of return for Marinus Link's Stage 1 Part A Early Works determination, including:

- Setting a regulatory control period from 1 July 2021 to 30 June 2025 for the purpose of rate of return calculations
- Setting a return on equity based on this regulatory control period
- Setting a return on debt with a trailing average transition period that commences from 1 July 2021

Applying default averaging periods for the risk-free rate and return on debt for historical regulatory years. We note you have the opportunity to nominate a debt averaging period for the 2024-25 regulatory year in accordance with the 2022 Instrument.

We are giving Marinus Link an opportunity to comment on the rate of return before we finalise our approach. Do you agree with our interpretation of the law and proposed application of the 2022 Instrument? If you consider another approach can be justified under the Rules, the NEL and the NEO, please set this approach out and explain why, responding to our discussion of section 18H of the NEL. We'd like to hear your views on this matter and any concerns you might have with our proposed approach.

3 MLPL's response

MLPL does not agree with the preliminary staff view in relation to the Rate of Return Instrument and MLPL's proposed rate of return calculation. Our reasoning is set out below.

3.1 First regulatory control period for MLPL commences on 1 July 2025, not 1 July 2021

Contrary to the AER's staff views, the AER is not setting a regulatory control period from 1 July 2021 to 30 June 2025 for the purpose of the rate of return calculation. The AER's Commencement and Process Paper (page 9) correctly states that the first regulatory control period for MLPL will apply from 1 July 2025 to 30 June 2028.

The AER's Commencement and Process Paper explains that the determination for MLPL will be completed in two stages, as follows (section 3.1, page 6):

> *"Stage 1 is a pre-commissioning stage where prescribed transmission services are not provided, and revenues are not recovered from customers. Costs in Stage 1 are to be rolled into the regulatory asset base, to be determined in Stage 2. Stage 2 sets revenues and tariffs that apply once Marinus Link has been commissioned. The full revenue determination is part of this stage."*

In accordance with the above description, the AER's determination for Part A (Early works) is the first part of a pre-commissioning stage, being Stage 1 of the determination process. The AER's determination for Stage 1 will be completed when it reaches a determination for Part B (Construction costs) in November 2024. As already noted, the determination for Stage 1 will relate to the regulatory control period commencing on 1 July 2025, which is the first regulatory control period for MLPL.

The years prior to 1 July 2025 do not fall within a regulatory control period for MLPL. However, these years do apply to a regulatory control period for TasNetworks. These are important observations when considering the regulatory provisions in the Rules that relate to the rate of return, which we will consider next.

3.2 Allowed rate of return provisions do not apply to MLPL prior to 1 July 2025

The *allowed rate of return* is defined in the Rules as follows[2]:

> "For a *Network Service Provider* for a regulatory year means the *rate of return* calculated in the way stated in the *applicable rate of return instrument* for the *Network Service Provider* for the *regulatory year*." (emphasis added)

For MLPL, the years prior to 1 July 2025 are not *regulatory years as a regulatory year* is defined as[3]:

> "Each consecutive period of 12 calendar months in a *regulatory control period*, the first such 12 month period commencing at the beginning of the *regulatory control period* and the final 12 month period ending at the end of the *regulatory control period*." (emphasis added)

It follows that the Rules provisions relating to the allowed rate of return do not apply to MLPL's Revenue Proposal – Part A (Early works), as the proposed expenditure in that submission relates to a period that pre-dates the first regulatory control period for MLPL and, therefore, are not regulatory years for MLPL.[4]

The same observation cannot be said of Part B of the Stage 1 determination process, which will propose expenditure relating to the construction of Marinus Link. This expenditure will commence on 1 January 2025 and will extend into the first regulatory control period, which will commence on 1 July 2025 (assuming that Marinus Link proceeds as planned). For MLPL's Revenue Proposal for Part B (Construction costs), therefore, MLPL will be required to submit a proposed allowed rate of return that reflects the application of the 2022 Rate of Return Instrument to MLPL.

In summary, the rate of return provisions in the Rules apply to Parts A and B of the Stage 1 determination, as follows:

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2 National Electricity Rules, Chapter 10.

3 National Electricity Rules, Chapter 10.

4 These years are, however, regulatory years for TasNetworks as it is already subject to revenue regulation under Chapter 6A of the Rules. As discussed later, this observation is important because MLPL is currently a wholly owned subsidiary of TasNetworks.

- Part A addresses proposed expenditure that occurs entirely before MLPL's first regulatory control period commences, and therefore the Rules provisions for the rate of return do not apply to MLPL; and
- Part B addresses proposed expenditure that occurs during the first regulatory control period for MLPL and therefore the Rules provisions for the rate of return will apply to MLPL.

The different applications of the rate of return provisions in Parts A and B are reinforced by the fact that MLPL is the network service provider for Stage 1, but cannot be the network service provider in relation to Part A. We explain this point in the next section.

3.3 MLPL will be the network service provider following the completion of the AER's Stage 1 determination, but not for Part A (Early works)

As explained in MLPL's Revenue Proposal – Part A (Early works):

- A final investment decision on whether to proceed with Marinus Link will not be made until December 2024; and
- MLPL is currently a wholly owned subsidiary of TasNetworks.

These matters are important in considering how the rate of return provisions should apply. As explained in the previous section, the *allowed rate of return* is defined in the Rules as follows[5]:

> "For a *Network Service Provider* for a *regulatory year* means the *rate of return* calculated in the way stated in the *applicable rate of return instrument* for the *Network Service Provider* for the *regulatory year*."

This definition applies to a Network Service Provider and, therefore, the question is whether MLPL or TasNetworks is the Network Service Provider in relation to Part A (Early works). MLPL's view is that TasNetworks is the Network Service Provider because:

5 National Electricity Rules, Chapter 10.

- MLPL will only become a Network Service Provider if a positive final investment decision is made in December 2024. Whether a positive final investment decision will be made or not cannot be known when the AER makes its determination for Part A (Early works) in December 2023.
- The financing of MLPL's early works expenditure has been provided by TasNetworks (less grant funding), not MLPL. As the allowed rate of return is intended to remunerate the providers of finance, it is appropriate that it reflects TasNetworks' allowed rate of return, not MLPL's.

MLPL's conclusion that TasNetworks is the Network Service Provider in relation to the AER's determination for Part A (Early works) can be demonstrated by considering the hypothetical case where Marinus Link does not proceed. In this case:

- MLPL would cease to be an Intending Network Service Provider; and
- The AER's Part A (Early works) decision could only be given effect by allowing TasNetworks to recover the early works expenditure as part of its maximum allowed revenue.

Given these circumstances, it would not make any sense for TasNetworks to recover expenditure that reflected MLPL's allowed rate of return. As noted above, while this is a hypothetical case, it illustrates that TasNetworks is the Network Service Provider in relation to early works.

As already explained, if a positive final investment decision is made, then MLPL will be a Network Service Provider in relation to the regulatory control period commencing 1 July 2025. In this case, the AER's determination for Part B (Construction costs) would reflect MLPL's allowed rate of return and would ultimately be given effect through MLPL's provision of prescribed transmission services once Marinus Link is commissioned. For early works expenditure, MLPL's regulatory asset base would adopt TasNetworks' allowed rate of return, which is appropriate as TasNetworks financed this expenditure.

3.4 MLPL's proposal is consistent with the application of the Rate of Return instrument and the National Electricity Law

The AER's staff view is that MLPL's proposal is inconsistent with the section 18H of the NEL, which states that:

> "A rate of return instrument is binding on the AER in relation to the performance or exercise of an AER economic regulatory function or power."

Contrary to the AER's staff view, MLPL's proposal is consistent with this provision because TasNetworks' allowed rates of return are calculated in accordance with the applicable Rate of Return Instrument.[6] [7]

Therefore, if the AER accepted MLPL's proposal in relation to the allowed rate of return, it would reflect the requirements of the applicable Rate of Return Instrument in accordance with the NEL. Furthermore, MLPL's proposal is consistent with the requirements of the Rules because it recognises that it is appropriate to adopt TasNetworks' allowed rate of return in relation to early works expenditure, noting that:

- The early works period from 1 July 2021 to 31 December 2024 are not regulatory years for MLPL, but are regulatory years for TasNetworks; and
- MLPL is not a Network Service Provider during this period, whereas TasNetworks is a Network Service Provider during this period; and
- MLPL will only become a Network Service Provider if the AER completes its determination for Part B (Construction costs) and Marinus Link proceeds following a positive final investment decision in December 2024. At the time of the AER's determination for Part A (Early works) in December 2023, these conditions cannot be satisfied.

6 AER Draft Decision, TasNetworks. Electricity Transmission Determination 2024 to 2029 (1 July 2019 to 30 June 2024), Attachment 3, September 2023, section 3.3.1.

7 AER Draft Decision, TasNetworks. Electricity Transmission Determination 2024 to 2029 (1 July 2024 to 30 June 2029), Attachment 3, September 2023, page 1.