Comments on the AER Issues Paper Marinus Link – Stage 1, Part B (Construction Costs)

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Introduction

First up my apologies for this late submission on the AER Issues Paper. Unfortunately I am currently travelling in outback WA and I have been having problems accessing appropriate internet services. I trust you will accept my apology and consider my comments accordingly.

Secondly, while I acknowledge that the issues paper primarily considers the cost aspects of Marinus, I consider these aspects of the project cannot be considered in isolation from the benefit estimates that Marinus Link is expected to deliver. At Attachment 1 I have attached a short summary of the various gross market benefit studies undertaken by EY in respect of Marinus Link. Within this paper I have also raised a number of observations which I consider need to be addressed as part of the AER's determination.

I will address these concerns further, plus the relationship between the EY and FTI studies within the comments below.

Where ever this project may end up, it is critical that those who will be funding the Marinus Link project at the end of the day, consumers through increased network charges, have a full, comprehensive, easy to understand and highly transparent view of both the costs and benefits of the project.

At a time of ever increasing energy costs this is an essential outcome, and at present I consider too many aspects relating to the costs and benefits of Marinus Link are not transparent and frequently opaque.

Questions on cost uncertainty

1. What level of cost certainty is appropriate before updated RIT-T assessments are finalised?

While this question has its focus on cost certainty, I consider that the AER must consider, when making its determination, that any costs associated with Marinus Link will be directly passed through to electricity consumers (residential, small business, major businesses and large industrial).

In contrast the benefits which are estimated to flow from Marinus Link are nothing more than just that, an estimate.

There is no guarantee that the modelled benefits will actually flow to consumers. Nowhere has this been illustrated so clearly than by the current Prime Minister and the proposed \$275 cost saving for consumers which was based on modelling.

Furthermore, the modelling being undertaken by both EY and FTI does not take the assessment through to an estimated retail price benefit and at best stops at seeking to estimate wholesale price changes. Given the above comments, and in reference to the question raised above, any RIT-T process should be based upon estimates that prescribe the same level of certainty to both costs and benefits, and provide the same level of transparency around the assumptions used, modelling processes adopted and how wholesale price changes, together with the estimated costs of Marinus Link, flow through to regulated consumer prices.

Importantly, such analysis should consider the impact on not only the median consumer, but also reference the impacts across consumer quintile groupings. Within Tasmania it has been estimated that up to 50,000 households are facing financial stress in relation to their power bills and it is critical that the assessment of Marinus Link appropriately considers the impact upon these households.

2. If there are residual cost uncertainties at the time MLPL revisits the RIT-T analysis, how should this analysis account for the uncertainties? For example, should MLPL undertake additional sensitivity analysis.

As stated above, any revisiting of the RIT-T process by MLPL must provide the same level of certainty to both costs and benefits and also address the outcomes of the Marinus Link construction across consumer quintile groups. I also have concerns that the MLPL aspects of the overall Marinus Link project are being largely considered in isolation to the clearly dependent NWTD project being under taken by TasNetworks. Given that there are two separate determinations being run largely side by side there is a real risk that benefit estimates will be double counted.

It would be far preferable that the determination process incorporates both NWTD and MLPL as a single assessment and determination process by the AER with a single capital cost and a single assessment of benefits to avoid the double counting of benefit estimates in any updated RIT-T process for either of the two projects.

I acknowledge that there may be other drivers for NWTD beyond MLPL, however, there is a need for these to be clearly spelt out to ensure that benefits and costs are appropriately allocated across the range of users.

As the assessment process currently stand there is a real risk that Tasmanian retail consumers will end up bearing a disproportionate share of the Marinus Link project costs. At the information session provided by the AER it was indicated that Tasmania would bear 27.6% of MLPL. Based on an estimated cost of around \$3.8 billion this represents a RAB of perhaps \$1 billion which will be funded by Tasmanian consumers. To this must be added the fact that Tasmania will bear 100% of the NWTD RAB bringing the total RAB for the Marinus Link Project which will be recouped from Tasmania to around \$2 billion or around 40% of the total project budget.

This is a very substantial increase in the current RAB of TasNetworks of \$3.88 billion which is presently recovered from Tasmanian electricity consumers. Given the above it is critical that MLPL conduct appropriate sensitivity analysis associated with any updated RIT-T. Such sensitivity analysis should consider appropriate escalation of MLPL and NWTD costs and also sensitivity analysis around the modelled benefits not being achieved. This sensitivity analysis should be conducted within a clearly defined risk framework which identifies the factors which may impact upon the presumed estimates being achieved. In this regard the analysis of the EY reports at attachment 1 indicate how estimates have changed over time. However, EY have been less than clear in outlining how the estimates have changed from one assessment to another as the estimated gross benefits of MLPL have increased in line with the growing cost of the link. Nor have EY sought to back cast the findings of their earlier studies using the updated assumptions of the later studies. Such back casting would clarify why each subsequent analysis has delivered greater gross market benefits when compared to the earlier studies.

Questions on cable 2 contingent project

3. What are your views on the issues raised with respect to the contingent project approach or trigger events?

A critical issue in relation to any contingent project application for the second Marinus Link cable relates specifically to the source of gross market benefits that such a cable may deliver.

EY have conducted similar studies for both Marinus Link and also BassLink. These studies use a similar methodology for each cable. An assessment of these studies indicates that the benefits for the second Marinus Link cable may be associated with a reduction in the underlying benefits received by BassLink. If this is the case then the second Marinus Link cable is in effect simply cannibalising it's benefits from BassLink and not believing any significant returns to the NEM as a whole.

Given this existing analysis undertaken by EY it is critical that any triggering of a second Marinus Link cable be contingent on both its impact on BassLink and also the increase in gross market benefits delivered to the NEM. This may well impact the timing of a second cable and delay its development until BassLink is reaching the end of its economic life.

If analysis indicates such an outcome then consideration may need to be given to whether or not the best approach is to install a second Marinus Link cable or replace the existing BassLink cable.

Whichever route is followed it is critical that any assessment of a second cable is made using cost and benefit estimates that have the same level of certainty

applied to them and that the analysis is carried through to the retail price determination outcome level.

Questions on consumer engagement and how it has impacted the proposal

4. In what ways has MLPL's engagement on key elements of the proposal been genuine?

As a member of the Marinus Link CAP, and also a member of the TasNetworks CAG and the BassLink RRG, I consider that MLPL have been genuine in their consumer engagement process. The CAP has been able to have an independent observer as part of the tender process and our observer has been given appropriate access to the documentation and has been able to brief the CAP on the process and the outcomes. While this process exhibited some initial hiccups, at the end of the day, MLPL was able to largely address the CAP's concerns.

In relation to other aspects of the MLPL process there has been only limited information provided in relation to benefit estimation and the likelihood of the expected outcomes being achieved. As discussed above, the benefit side of a project such as Marinus Link must be adequately assessed and the reasonableness of the modelled outcomes considered, not only by MLPL, but also in a considered way by the CAP.

As an example, during the recent TasNetworks reset process the initial draft assessment delivered a largely cost neutral outcome which if achieved in the final determination would have a very limited impact on retail prices. However, by the time the final determination was made by the AER the cost impact upon consumers was considerable. Throughout this process there was no reconsideration of the proposed works to be undertaken, and it was assumed that ever changing cost estimates would be passed through to and borne by consumers.

The same process appears to underlie the MLPL process as costs have escalated over the period since the project's inception.

5. To what extent do you consider consumers were able to influence the topics MLPL engaged on?

MLPL have been quite transparent with the CAP throughout the process, particularly in relation to costs. There has however, been less opportunity to engage on the benefit side of the assessment.

Most critically, there has been no consumer engagement in relation to cost sharing. Initial estimates of the gross market benefit provided by EY indicated that Tasmania may experience only around 6% of the benefits to flow to the NEM from the project. Yet now we find that Tasmanian consumers will be funding 27.6% of the MLPL cost, plus 100% of NWTD. In all around 40% of the full Marinus Link project will likely be funded by Tasmanian electricity consumers. This is an inappropriate allocation of costs to Tasmania relative to the benefits that Marinus Link will bring to the NEM.

Perhaps more importantly zero percent of the costs of Marinus Link are being incurred by its major shareholder, and, given the accepted importance of Marinus Link to the NEM, consideration should be given to further cost sharing arrangements. The very small size of the Tasmanian energy market vis a vis the NEM means the not only will this disproportionate cost fall upon Tasmanian consumers, it will impact most harshly on those consumers with the least ability to pay.

6. What key themes would you like to see MLPL engage on?

As discussed above there is a real need for considerably more interaction with consumers on the benefit estimation process, how costs will/should be shared amongst jurisdictions, and perhaps importantly how costs and benefits will flow through to retail customers taking full account of the retail price determination process.

Questions on forecast capital expenditure

7. What are your views on the proposed capital expenditure, including the prudency and efficiency, of the undersea cable and installation, converter station, and the proposal to prepare and instal conduits for Cable 2 as part of the construction and installation of Cable 1 for the underground section from the Victorian coastline to Hazelwood?

Obviously it is impossible to address this question in isolation of the benefits which could be expected to flow from Marinus Link and the reliability of those estimated benefits vis a vis the reliability of the cost estimates.

From a technical standpoint, independent of the costs and benefits, the work undertaken by EY demonstrates how gross market benefits may be determined. That analysis shows that the NEM as a whole has the potential to benefit from Tasmania's superior wind resource and the reduction in gas expenses to deliver the required generation load for the NEM. Marinus Link also increases the extent to which Tasmania's hydro system can be used to firm electricity supplies within the NEM.

So in theory the Marinus Link project offers benefits to the NEM.

In relation to whether this technical overview delivers economic benefits, I would have thought that as part of the Marinus Link project a clear and transparent ex post evaluation and assessment of BassLink would have been undertaken to assess its returns to consumers in Tasmania and also across the NEM. As consumers are being required to fund Marinus Link via higher transmission charges I consider that the AER has a critical role to determine both how BassLink has performed and also how that performance relates to the development of Marinus Link.

Of interest in this regard is the fact that the AER considers that the net benefits of BassLink are insufficient to warrant it becoming a regulated link. In this regard the AER, in the interests of transparency for consumers, must demonstrate how a second interconnector across Bass Strait, which has a per megawatt RAB many times that of BassLink will deliver value to consumers.

In relation to the second cable, I consider it makes sense to undertake civil works for this cable at the same time as the initial Marinus Link cable is being placed, given that Marinus Link proceeds. The marginal cost of providing for a second conduit is likely to be small relative to the cost of reworking the alignment at a later stage.

Providing civil works for a second cable during the installation of the first cable will also minimise disruption for landholders along the alignment.

In providing these comments in reference to the second cable it must be noted that the biggest proportion of the currently assessed gross market benefits result from the installation of the first cable. The second cable, based on the current EY assessment, delivers only minor benefits.

Furthermore, when considering the EY assessments for both BassLink and Marinus Link, it appears that much of the benefit of the second Marinus Link cable stems from a reduction in the value of BassLink rather than a general increase in gross market benefits across the NEM. As such it becomes necessary for the AER to clearly highlight how any second cable will deliver appropriate gross market benefits in its own right and not cannibalise the value currently attributed to BassLink.

If such assessment can not be made, with a high degree of certainty, and at a level consistent with the cost estimates for the second cable, then the need for a second cable at this time must be reviewed. This may mean that such a cable may be postponed until BassLink reaches the end of its life and a replacement cable considered as a totally separate stand alone project.

Questions on incentive schemes

8. How should the CESS apply in the 2025–30 regulatory control period given that MLPL will have completed tender processes for most of its construction work by the time the regulatory reset period commences?

Having given further consideration to the operation of the CESs scheme I consider it is not appropriate to change the standard arrangements. As proposed consumers are taking on too much of the cost variation risk. Loading risk onto consumers as proposed will not provide sufficient incentive for MLPL to effectively manage cost changes during construction. The proposed arrangement presents a clear moral hazard problem for consumers.

- 9. What are your views on the 5/95 cost sharing ratio proposed by MLPL? Will it provide sufficient incentives for MLPL to effectively manage cost increases associated with the contract or contract variations? Please note my comments above.
- 10. What specific factors are there in the case of Marinus Link that we should consider in applying any exclusions or variations to the CESS.
 I consider that the AER should be extremely cautious when assessing exclusions of variations. As stated above there are standard measures which have been adopted previously and varying from these risks creating a moral hazard problem and reduces the focus of MLPL in its management of the contract.

Questions on pass throughs

11. What is the case for including or not including the additional pass throughs proposed by MLPL?

Pass throughs should be minimised. As outlined above, during the recent RAC process for TasNetworks cost changes from the draft proposal presented to the RAC resulted in significant consumer impacts in the final determination. Reviewing the most recent draft retail price determination by the Tasmanian energy regulator highlights the fact that the increased network charges are nearly double the saving in wholesale electricity costs. This indicates that the proposed consumer benefits of Marinus Link could be easily over-written by even minor cost pass throughs which are experienced for Marinus Link. This is a project which, should it receive the go ahead, will require extremely strong project management to ensure the project stays within budget and is completed on time. Both of these attributes are critical underlying assumptions within the FTI assessment.

12. How could the proposed additional pass through associated with unavoidable contract variations impact the incentives for MLPL and the contractor to mitigate the risks of potential cost overruns on Marinus Link? The unfortunate reality of a project like Marinus Link is that the way these projects are regulated means most of the risk is carried by consumers who eventually fund the project.

This is the outcome irrespective of how the project is financed via a mix of debt and equity inputs by the project partners. As I have identified above this presents a real moral hazard problem for consumers, and this is exaggerated where the AER permits movement away from the standard CESS considerations.

13. How could the proposed contractor insolvency pass through impact the incentives for MLPL to engage in prudent and efficient management of construction costs of Marinus Link

This pass through simply elevates the moral hazard for consumers of this project. Given this element of the pass through it is surely an imperative that the assessment process clearly consider the impact of contractor insolvency at various points through the project timeline on the expected net benefit for consumers. Such assessment will highlight the risks associated with insolvency and assist in assessing the overall likelihood of Marinus Link delivering a positive net benefit for consumers. This pass through, and all others should form a critical part of the project's sensitivity analysis and be clearly highlighted in an understandable fashion so that consumers can assess the risks they are explicitly taking on board as the funders of this project via the increase in network charges.