# Initial Draft Decision

Marinus Link Stage 1, Part B (Construction costs) Transmission Determination 2025–30

May 2025



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#### Amendment record

Version	Date	Pages
1	16 May 2025	29

## Invitation for submissions

Marinus Link Pty Ltd (MLPL) has the opportunity to submit a revised proposal in response to this initial draft decision by **15 July 2025**.

Interested stakeholders are invited to make a submission on both our initial draft decision and MLPL's revised proposal (once submitted) by Friday, **15 August 2025**.

Submissions should be sent to: <u>marinuslink2025@aer.gov.au</u> and addressed to Dr Kris Funston, Executive General Manager, Network Regulation. Alternatively, you can mail submissions to GPO Box 3131, Canberra ACT 2601.

Submissions should be in Microsoft Word or another text readable document format.

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. We will treat submissions as public documents unless otherwise requested.

Parties wishing to submit confidential information should:

- 1. Clearly identify the information that is the subject of the confidential claim.
- 2. Provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submission will be published on our website.

### **Pre-determination conference**

Consumer engagement is a valuable input to our determination. We encourage all interested stakeholders to join us for the Marinus Link predetermination conference via an online public forum on **27 May 2025**. Details of how to register for this forum are available on our website and through Eventbrite.

## **Executive Summary**

The Australian Energy Regulator (AER) exists to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable, and affordable energy future for Australia as it transitions to net zero emissions (the transition).

Marinus Link is a component of 'Project Marinus,' a single actionable project under the Australian Energy Market Operator's (AEMO) 2024 Integrated System Plan (ISP) optimal development path.<sup>1</sup> Project Marinus also includes the North West Transmission Development which is currently being progressed by TasNetworks. Stage 1 of Project Marinus will deliver a 750 megawatt (MW) interconnector between Victoria and Tasmania (Cable 1) and associated network upgrades under the North West Transmission Development. Stage 2, which as of 16 May 2025 has not yet been committed to, will provide a second 750 MW interconnector (Cable 2) and further associated network upgrades.

The costs of Project Marinus will be recovered through transmission charges levied on Victorian and Tasmanian electricity customers. An important role for the AER is to assess the prudency and efficiency of the costs proposed by Marinus Link Pty Ltd (MLPL).

This document sets out our initial draft decision for MLPL's Stage 1, Part B (Construction costs) revenue proposal (construction costs proposal). A supplementary draft decision is expected to be published in October 2025.

Australia's energy sector is transitioning towards a net zero future, with the Australian Government targeting 82% renewable electricity in our electricity grids by 2030. The transition is further supported by individual state renewable energy targets set in Tasmania and Victoria. Marinus Link will be an important enabler of the transition, provide electricity consumers with greater access to lower cost generation and support energy security and reliability.

We are mindful that our initial draft decision comes at a challenging time for energy consumers, many of whom share concerns about energy affordability and security as well as the impact large scale energy infrastructure projects may have on the environment and communities. It is important that we continue to hear from stakeholders throughout the process so that we can consider their views and ensure our decisions meets the long term interest of consumers.

### Our assessment of MLPL's proposal

We have previously determined to commence a transmission determination process for MLPL under the Intending Transmission Network Service Provider (Intending TNSP)<sup>2</sup> provision of the National Electricity Rules (NER). We published a Commencement and Process Paper (CPP) specifying a modified process for making the transmission determination. The CPP sets out a staged approach comprising:

<sup>&</sup>lt;sup>1</sup> Australian Energy Market Operator (AEMO), 2024 Integrated System Plan, June 2024, p 57.

<sup>&</sup>lt;sup>2</sup> Australian Energy Regulator (AER), *Marinus Link – Notice of decision and Commencement and Process Paper*, June 2023.

- Stage 1, Part A (Early works), referred to in this paper as the 'early works proposal'. This determined the pre-construction costs that can be included in the opening 'regulatory asset base' (RAB). A decision was published for this stage in December 2023.
- Stage 1, Part B (Construction costs), referred to in this paper as the 'construction costs proposal'. This determines the construction costs that can be included in the opening RAB for the first Marinus Link cable.
- Stage 2 revenues (to be finalised in 2030), referred to in this paper as the 'Stage 2 revenue proposal'. This will determine MLPL's revenues using the RAB determined in the Stage 1 processes.

On 29 November 2024, MLPL provided the construction costs proposal which sets out the proposed construction costs for Cable 1. Any construction costs approved by us will form the basis for a subsequent revenue determination which MLPL will lodge in 2029. The process for making our determination on the construction costs proposal is prescribed in our most recent CPP.<sup>3</sup> The CPP includes a two-stage approach where an initial draft decision is limited to the market tested costs, which are classified as AACE Class 2.<sup>4</sup> These costs pertain to the undersea cable and installation of the cable, and converter station equipment which accounts for approximately 46% of the total proposed construction cost expenditure. The remaining cost elements for the first cable, which includes Balance of Works, support activities and risk allowance are either classified as AACE Class 3 or are untendered. These costs will be assessed in our supplementary draft decision in October.

On 29 November 2024, MLPL submitted its construction costs proposal for \$3,534.3 million (\$2023) in capital expenditure (capex). This is the forecasted construction cost for the construction of Cable 1.

Consistent with our CPP, our initial draft decision assesses only the market tested costs, with a total forecasted capex of \$1,632.2 million (\$2023). The total forecast capex comprises \$737.2 million (\$2023) for the converter station design and equipment supply and \$895.0 million (\$2023) for the HVDC cable system consisting of submarine and land cables.

Our initial draft decision is to accept the market tested costs, with a total forecasted capex of \$1,632.2 million (\$2023). Other key initial draft decisions include to:

- apply the capital expenditure sharing scheme (CESS), but reject MLPL's proposed 5:95 sharing ratio. Rather a 30:70 sharing ratio should apply to MLPL, but that this should be limited to the first 10% of any over- or under-spend by MLPL. Any overor under-spend that exceeds the first 10% will apply a sharing ratio that is equivalent to the financing benefit MLPL will receive.
- not accept MLPL's proposed nominated cost pass through events for contractor force majeure event, biodiversity event, unavoidable contract variations event or contractor insolvency event.
- not accept MLPL's proposal to include Cable 2 as a contingent project under clause 6A.8.1(b).

<sup>&</sup>lt;sup>3</sup> AER, *Marinus Link – Updated Commencement and Process Paper*, December 2024.

<sup>&</sup>lt;sup>4</sup> AACE Class 2 refers to a cost estimate classification provided under the Association for the Advancement of Cost Engineering (AACE) International practice guideline 17R-97. These cost estimate classifications ranges from Class 1 to Class 5 in descending expected accuracy levels.

This document sets out the assessment approaches applied, and enquiries made as part of our review, which have enabled us to arrive at our initial draft decision.

## **Next steps**

Following our initial draft decision, MLPL will have an opportunity to submit a revised proposal incorporating any changes, or addressing any matters, raised by the initial draft decision. As outlined in Table 1 submissions in response to our initial draft decision and MLPL's revised revenue proposal will close in August 2025. The AER will publish a supplementary draft decision in October 2025 with submissions closing in November, before the final decision that is expected in December 2025.

## Table 1Indicative timeline – Marinus Link – Stage 1, Part B (Construction costs)<br/>electricity transmission determination

Milestone	Date
Initial draft decision	16 May 2025
Marinus Link to submit revised revenue proposal	15 July 2025
Submissions in response to initial draft decision and MLPL revised revenue proposal close	15 August 2025
AER supplementary draft decision (covering costs that are currently at AACE Class 3 or untendered, and subject to further refinement)	10 October 2025
Submissions in response to supplementary draft decision close	November 2025
AER final decision on Stage 1, Part B (Construction costs) proposal	19 December 2025 or 6 February 2026*

\* Note: The later date of 6 February 2026 would apply under the following conditions:

(a) An uplift of 15% or greater between the initial and revised proposal for the undersea cable and installation and converter station equipment costs, which will be based on AACE Class 2 cost estimates at the initial draft decision, or

(b) A delay for two weeks or more in the submission of the revised proposal from 15 July 2025.

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## 1 Consumer engagement

Consumer engagement is an important element of the regulatory process as it provides us with supporting evidence that proposals are aligned with consumer interests and expectations. Our expectations for consumer engagement in network revenue determinations are set out in the Better Resets Handbook.<sup>5</sup>

We recognise the scope of MLPL's construction cost proposal is narrower than a typical revenue proposal given Marinus Link will not be operational until 2030. Consequently, MLPL's construction cost proposal does not consider issues relating to operating expenditure, replacement or augmentation capex, service performance or transmission pricing. However, we consider effective consultation should inform important aspects of the construction cost proposal, including application of the CESS and cost pass throughs, and is critical to securing and maintaining social licence.

## **1.1 Marinus Link's engagement on its proposal**

MLPL began consumer engagement in July 2018 to provide general information and raise awareness of Project Marinus. This was followed by targeted engagement with landholders, local communities and Traditional Owners in Victoria and Tasmania from early 2020 to date as MLPL progressed Marinus Link.

MLPL established a Consumer Advisory Panel in April 2022, which provides a forum for MLPL to consult, inform and involve consumer representatives on Marinus Link and revenue proposals. MLPL has held 16 sessions with the Consumer Advisory Panel covering a range of topics including social licence, tendering and procurement, incentive schemes and pricing.

MLPL has focused on targeted engagement with key stakeholders such as landholders, local communities and Traditional Owners in Victoria and Tasmania. The targeted engagement includes the establishment of focus groups such as the Aboriginal Advisory Group, First Peoples Advisory Group and the Gippsland Stakeholder Liaison Group. The engagement scope included environmental impacts and landholder concerns which we note are critical in supporting the progression and development of Marinus Link, including obtaining and maintaining social licence.

We note MLPL's submission in response to our issues paper includes a commitment to continue to engage with the Consumer Advisory Panel, stakeholders and the broader community.<sup>6</sup> MLPL also notes it intends to work closely with TasNetworks in this process. The AER considers ongoing engagement, both in terms of the revenue proposal regarding the balancing of risk between consumers and MLPL, and to support social licence is critical. Stakeholder submissions in response to our issues paper have identified some community concerns for Project Marinus, consequently, it will be important for MLPL and TasNetworks to work closely when engaging with stakeholders.

<sup>&</sup>lt;sup>5</sup> AER, <u>Better Resets Handbook – towards consumer-centric network proposals</u>, July 2024.

<sup>&</sup>lt;sup>6</sup> MLPL, AER's Issues Paper on Marinus Link's Revenue Proposal, 17 April 2025, p 4.

## 1.2 What we have heard from stakeholders

We held a public forum on 3 April 2025 and heard from stakeholders on several key issues. Both MLPL and the AER have provided written responses to questions raised by stakeholders during the public forum.<sup>7</sup>

We have received 16 submissions in response to our issues paper with stakeholders providing a range of views on several key issues. These issues include:

**Community engagement**: Clean Energy Tasmania submission highlighted MLPL's extensive consultation at regional events, noted interactions at public consultation sessions were 'open and informative' with 'no topic off the table'. The submission also noted MLPL had presented project overviews and updates to Clean Energy Tasmania on four occasions.<sup>8</sup> The Gippsland Climate Change Network submission noted MLPL demonstrated:

a genuine effort to engage on key elements of the proposal, and that this engagement has shown sincerity, responsiveness, and a willingness to incorporate feedback—while also acknowledging there are opportunities to broaden and deepen this approach as the project progresses.<sup>9</sup>

A number of submissions from private citizens highlighted concerns over MLPL's stakeholder engagement citing limited evidence of consumers influencing outcomes. Community group, Supporting Our Loongana Valley Environment (SOLVE) noted engagement to date had been 'one-way and disingenuous' and highlighted concerns regarding TasNetworks North West Transmission Development, a component of Project Marinus.<sup>10</sup>

**Incentive schemes and pass throughs**: Submissions noted MLPL's proposed 5:95 sharing ratio for the CESS results in consumers bearing the risk and 'does not provide sufficient incentive for MLPL to take a balanced approach to whether the project is worth the risks'.<sup>11</sup> Nexa Advisory noted the importance of supporting timely delivery of Project Marinus and urged the AER to 'pivot toward performance-based regulation' particularly in relation to the application of the CESS.<sup>12</sup>

Regarding MLPL's nominated cost pass throughs, submissions noted concerns over the transfer of risk to consumers including dilution of incentives for MLPL to manage project costs.<sup>13</sup>

**Marinus Link - benefits, costs and alternative approaches**: Submissions highlighted the importance of considering a decentralised alternative rather than an increasing reliance on centralised generation and transmission. In highlighting a decentralised approach,

<sup>&</sup>lt;sup>7</sup> Written responses to stakeholder questions raised during the public forum are <u>available on our website</u>.

<sup>&</sup>lt;sup>8</sup> Clean Energy Tasmania, *Submission – 2025–30 Transmission Determination – Marinus Link*, April 2025.

<sup>&</sup>lt;sup>9</sup> Gippsland Climate Change Network (GCCN), Submission – 2025–30 Transmission Determination – Marinus Link, April 2025.

<sup>&</sup>lt;sup>10</sup> SOLVE, Submission – 2025–30 Transmission Determination – Marinus Link, April 2025, p 1.

<sup>&</sup>lt;sup>11</sup> Jack Gilding, *Submission – 2025–30 Transmission Determination – Marinus Link*, April 2025, p 6.

<sup>&</sup>lt;sup>12</sup> Nexa Advisory, Submission – 2025–30 Transmission Determination – Marinus Link, April 2025

<sup>&</sup>lt;sup>13</sup> Jack Gilding, *Submission – 2025–30 Transmission Determination – Marinus Link*, April 2025, p 3 and Lynette LaBlack, *Submission – 2025–30 Transmission Determination – Marinus Link*, April 2025, p 5.

submissions noted the increasing cost of Project Marinus as well as the environment and social impacts of transmission projects. Submissions noted the importance of the regulatory investment test for transmission (RIT-T), with divergent views regarding cost certainty, ranging from Balance of Works costs being market tested to cost being final and unambiguous.<sup>14</sup>

We have considered stakeholder submissions in response to our issues paper and our role now is to assess the efficient costs proposed by Marinus Link. Interested stakeholders will have additional opportunities to provide submissions, including in response to the initial draft decision and MLPL's revised revenue proposal expected in July 2025 and in response to supplementary draft decision expected in October 2025.

<sup>&</sup>lt;sup>14</sup> Jack Gilding, *Submission – 2025–30 Transmission Determination – Marinus Link*, April 2025, p 1 and Lynette LaBlack, *Submission – 2025–30 Transmission Determination – Marinus Link*, April 2025, p 1.

## 2 Key components of our initial draft decision on the proposal

This section considers key elements of MLPL's construction costs proposal. The AER's CPP specifies modifications to the transmission determination process including the matters for determination at each stage.<sup>15</sup> For the construction costs proposal, the CPP notes these key elements as part of the decision we would make at this current stage. Other determinants of revenues and tariffs, such as operating expenditure, depreciation, and pricing methodologies, will be considered when MLPL submits its Stage 2 revenue proposal in 2029.

## 2.1 Capitalisation of expenditure

This section sets out our calculation of the opening RAB as at 1 July 2030 for Marinus Link. This includes the escalation of capitalised costs that MLPL will recover from customers as an incremental revenue in the regulatory period, commencing after commissioning and once construction has been completed.

We note that the opening RAB may change at the supplementary draft decision in October, based on the updated construction capital expenditure we expect to receive in the revised proposal from MLPL.

In this initial draft decision, we determine an opening RAB value of \$5,070.7 million (\$ nominal) as at 1 July 2030, which is \$19.4 million higher than that proposed by MLPL in its proposal for Stage 1, Part B. This value consists of:

- An updated opening RAB as at 1 July 2025 from that determined in our Stage 1, Part A (Early works) determination reflecting updates for actual and estimated capital expenditure undertaken prior to 1 July 2025 and updated equity raising cost.
- Stage 1, Part B (Construction costs) construction expenditure for the period from 2025– 26 to 2029–30.
- Return on capital for the above expenditures based on the allowed weighted average cost of capital (WACC) (section 2.2).
- Capitalised benchmark debt and equity raising costs.

In determining the opening RAB as at 1 July 2030, we note the following:

 We determine an opening RAB of \$453.8 million (\$nominal) as at 1 July 2025. This is \$307.1 million higher than the opening RAB of \$146.7 million we determined in our determination for Stage 1, Part A (Early works). This increase is due to updates for Stage 1, Part A (Early works) actual capital expenditure for 2022–23 and 2023–24 and updated estimated capital expenditure for 2024–25. It is also due to the addition of Stage 1, Part B (Construction costs) capital expenditure for 2023–24 and 2024–25, which was not included in the Stage1, Part A (Early works) determination. The updated opening

<sup>&</sup>lt;sup>15</sup> NER, cl 6A.9.3(c)(1)

RAB value also includes the capitalised equity raising costs for Stage 1, Part A (Early works) and Stage 1, Part B (Construction costs).<sup>16</sup>

- Stage 1, Part B (Construction costs) may be updated as part of the revised proposal from MLPL which we will assess in the supplementary draft decision in October.
- Our calculation of the opening RAB as at 1 July 2030 does not make any adjustment for depreciation. This is because Marinus Link is not expected to be commissioned until 1 July 2030, and therefore depreciation will not commence until 2030–31.
- The approach to capitalise benchmark debt and equity raising costs into the RAB is consistent with our standard regulatory practice. These costs are to be included in the RAB because no revenue will be recovered from consumers relating to these benchmark allowances until prescribed services are expected to commence in 2030–31.
- MLPL is in discussion with Clean Energy Finance Corporation (CEFC) on the details of concessional financing. We will assess the impact of any concessional financing arrangement on the opening RAB as at 1 July 2030 once the concessional finance agreement is finalised (see section 2.2.6).

Table 2 below sets out the components of our initial draft decision opening RAB of \$5,070.7 million as at 1 July 2030.

	2025–26	2026–27	2027–28	2028–29	2029–30
Opening RAB	453.8ª	973.4	2,260.5	3,423.9	4,432.5
Part B Expenditure (Construction costs) net of grant funding	482.2	1,199.1	1,001.9	776.5	346.6
Allowed return on opening RAB <sup>b</sup>	24.3	54.4	131.5	207.0	278.3
Allowed return on annual expenditure <sup>c</sup>	12.7	33.0	28.7	23.1	10.7
Debt raising costs <sup>d</sup>	0.3	0.6	1.3	2.0	2.6
Closing RAB	973.4	2,260.5	3,423.9	4,432.5	5,070.7

## Table 2AER initial draft decision – Capitalisation of expenditure calculation for<br/>the 2025–30 period – Marinus Link Stage 1, Part B (Construction costs)<br/>(\$ million, nominal)

Source: AER analysis.

- (a) Includes capitalised equity raising costs for Stage 1, Part A (Early works) in 2021–22 and Stage 1, Part B (Construction costs) in 2023–24.
- (b) Calculated by multiplying the opening RAB with the allowed nominal WACC of 5.36% which will be updated annually for return on debt updates as set out in section 2.2 for the 2025–30 period.
- (c) Calculated by multiplying the expenditure (construction costs) net of grant funding with the allowed nominal WACC of 5.36% which will be updated annually for return on debt updates as set out in section 2.2 for the 2025–30 period.
- (d) Updated debt raising cost to reflect the allowed nominal WACC of 5.36% which will be updated annually for return on debt updates as set out in section 2.2 for the 2025–30 period.

<sup>&</sup>lt;sup>16</sup> We have updated Stage 1, Part B (Construction costs) 2023–24 equity raising costs for the 2024–25 CPI as published by the Australian Bureau of Statistics (ABS) and expected inflation with the Reserve Bank of Australia forecast published in its February 2025 Statement on Monetary Policy.

## 2.2 Rate of return and value of imputation credits

The AER's 2022 Rate of Return Instrument (RORI) sets out the approach we will use to estimate the return on debt, the return on equity and the overall rate of return.<sup>17</sup>

The return each business is to receive on its RAB, known as the 'return on capital', is a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the RAB.

We estimate the rate of return by combining the returns of two sources of funds for investment: equity and debt. The allowed rate of return provides the business with a return on capital to service the interest rate on its loans and give a return on equity to investors.

The estimate of the rate of return is important for promoting efficient prices in the long term interests of consumers. If the rate of return is set too low, the network business may not be able to attract sufficient funds to be able to make the required investments in the network and reliability may decline. Conversely, if the rate of return is set too high, the network business may seek to spend too much and consumers will pay inefficiently high tariffs.

We are required by national energy laws and rules to apply the RORI to estimate an allowed rate of return. For this initial draft decision, we have applied the 2022 RORI.<sup>18</sup> In summary, our initial draft decision:

- applies a rate of return of 5.36% for the first year of the 2025–30 period, compared to the placeholder rate of return of 5.24% used in MLPL's proposal, reflecting updates to the return on debt and the risk-free rate
- applies a value of imputation credits (gamma) of 0.57, as adopted by MLPL in its proposal<sup>19</sup>
- applies an estimate of expected inflation is 2.72% per annum.

Detailed aspects of our initial draft decision for the 2025–30 period are set out below.

#### 2.2.1 Initial draft decision

In this initial draft decision, we have applied the 2022 RORI to MLPL's proposal for the 2025–30 period and have estimated a placeholder allowed rate of return of 5.36% (nominal vanilla). This will be updated for our final decision on the averaging periods. MLPL's proposal also applied the 2022 RORI.<sup>20</sup>

Our calculated rate of return in Table 3 would apply to the first year of the 2025–30 period. A different rate of return may apply for the remaining regulatory years of the 2025–30 period. This is because we will update the return on debt component of the rate of return each year, in accordance with the 2022 RORI, to use a 10-year trailing average portfolio

<sup>&</sup>lt;sup>17</sup> AER, *Rate of Return Instrument (Version 1.2)*, March 2024.

<sup>&</sup>lt;sup>18</sup> AER, *Rate of Return Instrument (Version 1.2)*, March 2024.

<sup>&</sup>lt;sup>19</sup> AER, *Rate of return Instrument (version 1.2)*, March 2024, cll 27.

<sup>&</sup>lt;sup>20</sup> MLPL, *Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) - December 2024*, December 2024, p 50.

return on debt that is rolled-forward each year. Hence, only 10% of the return on debt is calculated from the most recent averaging period, with 90% from prior periods. We will update the estimate of the rate of return in our final decision.

	AER's previous decision (2021–25)	MLPL's proposal (2025–30)	AER's initial draft decision (2025–30)	Allowed return over the regulatory control period
Nominal risk-free rate	1.34%	4.19%	4.47% <sup>a</sup>	
Market risk premium	6.20%	6.20%	6.20%	
Equity beta	0.6	0.6	0.6	
Return on equity (nominal post- tax)	5.06%	7.91%	8.19%	Constant (%)
Return on debt (nominal pre-tax)	2.12% <sup>c</sup>	3.46%	3.46% <sup>b</sup>	Updated annually
Gearing	60%	60%	60%	Constant (60%)
Nominal vanilla WACC	3.29%°	5.24%	5.36%	Updated annually for return on debt
Expected inflation	N/A <sup>d</sup>	2.78% <sup>e</sup>	2.72%	Constant (%)

#### Table 3 Initial draft decision on MLPL's rate of return (nominal)

Source: AER analysis; AER, AER - Revenue Determination - Marinus Link - Stage 1, Part A (Early works) -December 2023, December 2023, pp. 13-14; MLPL, Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) - December 2024, December 2024, pp. 51-52.

- (a) Calculated using MLPL's risk-free rate averaging period of 20 business days from 3 January 2025 to 31 January 2025.
- (b) Calculated using MLPL's actual nominated return on debt averaging period.
- (c) Applied to the first year of the 2021–25 regulatory control period.
- (d) Expected inflation was not required input for the estimation.
- (e) MLPL provided separate annual inflation forecasts for each regulatory year. The inflation forecast shown in the table is a geometric average of MLPL's annual forecasts over the 2025-30 regulatory control period. The first year expected inflation for both MLPL and AER is 3.20%.

Our initial draft decision is also to accept MLPL's proposed risk-free rate averaging period<sup>21</sup> and debt averaging periods<sup>22</sup> because they comply with the conditions set out in the 2022 RORI. We specify these periods in Confidential Appendix A and they will be used to update the risk-free rate and return on debt in the final decision.

#### 2.2.2 Expected inflation

Our estimate of expected inflation included in this initial draft decision is 2.72% (detailed in Table 4). It is an estimate based on the approach adopted in our final position paper from our

<sup>&</sup>lt;sup>21</sup> MLPL, *ML-B-014 Attachment 12 - Nominated Averaging Periods CONFIDENTIAL*, December 2024, p 2.

<sup>&</sup>lt;sup>22</sup> MLPL, *ML-B-014 Attachment 12 - Nominated Averaging Periods CONFIDENTIAL*, December 2024, pp 2-3.

2020 Inflation Review<sup>23</sup> and in the Post-Tax Revenue Model (PTRM). Our estimate of expected inflation will be updated for the final decision.

MLPL's proposal adopted our current approach for estimating expected inflation.<sup>24</sup>

#### Table 4Initial draft decision on MLPL's forecast inflation (%)

	Year 1	Year 2	Year 3	Year 4	Year 5	Geometric average
Expected inflation	3.20%	2.70%	2.63%	2.57%	2.50%	2.72%

Source: AER Analysis; RBA, Statement on Monetary Policy, February 2025, Table 3.1: Detailed Forecast Table. See <a href="https://www.rba.gov.au/publications/smp/2025/feb/outlook.html#table31">https://www.rba.gov.au/publications/smp/2025/feb/outlook.html#table31</a>

Our previous approach to estimate expected inflation used a 10-year average of the Reserve Bank of Australia's (RBA) headline rate forecasts for 1 and 2 years ahead, and the mid-point of the RBA's target band (2.5%) for years 3 to 10. The period of 10 years matches the term of the rate of return.

Our Inflation Review considered that this should be augmented by:<sup>25</sup>

- shortening the target inflation horizon from 10 years to a term that matches the regulatory period (typically 5 years)
- applying a linear glide-path from the RBA's forecasts of inflation for year 2 to the mid-point of the inflation target band (2.5%) in year 5.

We noted subsequently that the linear glide-path can apply from the RBA's latest inflation forecasts for year 1 if there is no RBA data for year  $2.^{26}$ 

The key reasons for these changes are:27

- There was a mismatch between our estimate of expected inflation over a 10-year term, and our roll forward of the capital base, which is done over a 5-year term. We consider that shortening the inflation term to match the regulatory period, although creating a mismatch with the term of the rate of return, is the more critical mismatch to resolve. This is because of the sustained decline in the required rate of return and the increased difference between 5- and 10-year inflation expectations due to short-term fluctuations in inflation expectations.
- Applying a glide-path acknowledges that it is likely to take longer than previously for inflation to revert to the mid-point of the RBA's target band following periods of sustained low or high inflation.

<sup>&</sup>lt;sup>23</sup> AER, *Final position – Regulatory treatment of inflation*, December 2020.

<sup>&</sup>lt;sup>24</sup> MLPL, Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) - December 2024, December 2024, p 52.

<sup>&</sup>lt;sup>25</sup> AER, *Final position – Regulatory treatment of inflation*, December 2020, p 6.

<sup>&</sup>lt;sup>26</sup> AER, *Explanatory statement proposed amendments – Electricity transmission and distribution network service providers – Post-tax revenue models (version 5),* December 2020, p 11.

<sup>&</sup>lt;sup>27</sup> AER, *Final position – Regulatory treatment of inflation*, December 2020, p 6.

We considered that these changes will provide service providers with a reasonable opportunity to recover their efficient costs more accurately in an increasingly changing market to better serve consumers with the energy services they want in the long term. Broadly, this was because we take out what we expect to put back into the capital base through our regulatory models.

#### 2.2.3 Imputation credits

Our initial draft decision applies a value of imputation credits (gamma) of 0.57, as set out in the 2022 RORI.<sup>28</sup> MLPL's proposal adopted the same value.<sup>29</sup>

#### 2.2.4 Capital raising costs

In addition to compensating for the required rate of return on debt and equity, we provide an allowance for the transaction costs associated with raising debt and equity.

We include equity raising costs in the capital expenditure (capex) forecast because these costs are only incurred once and would be associated with funding the particular capital investments.

We normally include debt raising costs in the operating expenditure (opex) forecast because these are regular and ongoing costs which are likely to be incurred each time service providers refinance their debt. However, MLPL's debt raising costs are capitalised as it is still in construction phase.

In this section, we set out our assessment approach and the reasons for those forecasts.

#### 2.2.4.1 Equity raising costs

Equity raising costs are transaction costs incurred when a service provider raises new equity. We provide an allowance to recover an efficient amount of equity raising costs.

We apply an established benchmark approach for estimating equity raising costs. This approach estimates the costs of two means by which a service provider could raise equity—dividend reinvestment plans and seasoned equity offerings. It considers where a service provider's capex forecast is large enough to require an external equity injection to maintain the benchmark gearing of 60%.<sup>30</sup>

Our benchmark approach was initially based on 2007 advice from Allen Consulting Group (ACG).<sup>31</sup> We amended this method in our 2009 decisions for the ACT, NSW and Tasmanian

<sup>&</sup>lt;sup>28</sup> AER, *Rate of return Instrument (version 1.2),* March 2024, cll 27.

<sup>&</sup>lt;sup>29</sup> MLPL, Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) - December 2024, December 2024, p 51.

<sup>&</sup>lt;sup>30</sup> AER, *Final decision Amendment Electricity distribution network service providers*, Post-tax revenue model handbook, 30 January 2015, pp. 15, 16 and 33. The approach is discussed in AER, Final decision, Powerlink Transmission determination 2012–13 to 2016–17, April 2012, pp. 151–152.

<sup>&</sup>lt;sup>31</sup> ACG, Estimation of Powerlink's SEO transaction cost allowance – Memorandum, 5 February 2007.

electricity service providers.<sup>32</sup> We further refined this approach in our 2012 Powerlink Queensland decision.<sup>33</sup>

Our benchmark approach is implemented in the PTRM to estimate equity raising costs. Other elements of our decision act as inputs to this assessment, particularly the level of approved capex and the return on equity. It also requires an estimate of the dividend distribution rate (sometimes called the 'payout ratio') as an input into calculating equity raising costs. The dividend distribution rate is also estimated when we estimate the value of imputation credits. We consider that a consistent dividend distribution rate should be used when estimating both the value of imputation credits and equity raising costs.

MLPL has included its equity raising cost forecasts in its regulatory financials.<sup>34</sup> We have updated our estimate for the 2025–30 period based on the benchmark approach using updated inputs.

#### 2.2.5 Debt raising costs

Debt raising costs are the transaction costs incurred each time debt is raised or refinanced, as well as the costs for maintaining the debt facility. These costs may include underwriting fees, legal fees, company credit rating fees and other transaction costs. We provide an allowance in opex to recover an efficient amount of debt raising costs.

#### 2.2.5.1 Current assessment approach

Our current approach to forecasting debt raising costs is based on the approach in a report from ACG, commissioned by the Australian Competition & Consumer Commission (ACCC) in 2004.<sup>35</sup> This approach compensates for the direct cost of raising debt.

It uses a 5-year window of bond data to reflect the market conditions at that time. Our estimates were updated in 2013, based on a report by PricewaterhouseCoopers (PwC) which used data over 2008–2013, and most recently in 2019 by Chairmont.<sup>36</sup>

The ACG method involves calculating the benchmark bond size and the number of bond issues required to rollover the benchmark debt share (60%) of the capital base. This approach looks at how many bonds a regulated service provider may need to issue to refinance its debt over a 10-year period. Our standard approach is to amortise the upfront costs that are incurred in raising the bonds using the service provider's nominal vanilla weighted average cost of capital (WACC) over a 10-year amortisation period. This is then expressed in basis points per annum (bppa) as an input to the PTRM.

This rate is multiplied by the debt component of the service provider's projected capital base to determine the debt raising cost allowance in dollar terms. Our approach recognises

<sup>&</sup>lt;sup>32</sup> For example, see: AER, Final decision, *NSW distribution determination 2009–10 to 2013–14*, April 2009, Appendix N.

<sup>&</sup>lt;sup>33</sup> AER, *Final decision, Powerlink Queensland Transmission determination 2012–13 to 2016–17*, April 2012, pp 151–152.

<sup>&</sup>lt;sup>34</sup> MLPL, *ML-B-017 Regulatory Financials*, December 2024.

<sup>&</sup>lt;sup>35</sup> Allen Consulting Group, *Debt and Equity Raising Transaction Costs: Final Report*, December 2004.

<sup>&</sup>lt;sup>36</sup> PricewaterhouseCoopers, *Energy Networks Association: Debt financing costs*, June 2013; Chairmont, *Debt Raising Costs*, 30 June 2019.

that part of the debt raising transaction costs, such as credit rating costs and bond master program fees, can be spread across multiple bond issues, which lowers the benchmark allowance (as expressed in bppa) as the number of bond issues increases.

Since the debt component of the capital base, and the WACC, will vary from service provider to service provider, so too will our assessment of debt raising costs.

Since late 2019, we have been reviewing our approach to setting benchmark debt raising costs. We have considered using actual debt raising costs data obtained from relevant regulated businesses, but found a number of challenges to this approach. We do not think the benefits of further investigation outweigh the costs at this stage. Therefore, we propose to use our current approach for assessing benchmark debt raising costs—that is, using Bloomberg estimates for the 'arrangement fee' and Chairmont's 2019 estimates for the remaining debt raising costs.

#### 2.2.5.2 Proposal

MLPL has proposed debt raising costs of 8.88 bppa.<sup>37</sup>

#### 2.2.5.3 Conclusion on debt raising costs

Our initial draft decision is to apply debt raising costs of 9.74 bppa. In arriving at this decision, we have applied the approach from our 2020–25 final decision for SA Power Networks.<sup>38</sup> That is, we use updated Bloomberg data to inform the 'arrangement fee' component of debt raising costs and Chairmont's updated estimates for the remaining components.

We use this method because regulated businesses have previously raised concerns with Chairmont's 2019 update, with the key focus being on Chairmont's estimate of 'arrangement fee'.<sup>39</sup> After assessing submissions, we recognised that Bloomberg is likely to be the most suitable source of information for the 'arrangement fee' at this time because it is the only published source of data known to us and was previously used to estimate the 'arrangement fee'.

Therefore, we have updated the 'arrangement fee' using Bloomberg data and the selection criteria consistent with the PwC report. This leads to an annual total debt raising cost of 9.74 bppa.

#### 2.2.6 Concessional finance

MLPL expects to receive concessional finance through the Clean Energy Finance Corporation (CEFC). Should this occur, this would reduce the costs that MLPL would need to recover from its customers.<sup>40</sup>

<sup>&</sup>lt;sup>37</sup> MLPL, *ML-B-017 Regulatory Financials*, December 2024.

<sup>&</sup>lt;sup>38</sup> AER, Final Decision SA Power Networks Distribution Determinations 2020–2025 — Attachment 3 Rate of Return, June 2020.

<sup>&</sup>lt;sup>39</sup> SA Power Networks, *Revised Regulatory Proposal 2020–25: Attachment 3 Rate of Return*, 10 December 2019, pp. 20–21; CEG, *The cost of arranging debt issues*, November 2019, p 3.

<sup>&</sup>lt;sup>40</sup> MLPL, *Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) -* December 2024, December 2024, p 7.

We understand that the details of the concessional benefits are still being finalised with the CEFC, and a concessional finance agreement has not yet been settled.<sup>41</sup> Consequently, MLPL has not included the details of this agreement in its proposal. In its proposal, MLPL highlighted that these arrangements may, depending on the terms of the agreement, impact its:<sup>42</sup>

- opening RAB as at 1 July 2025.
- opening RAB as at 1 July 2030.
- return on capital in the second regulatory period, commencing 1 July 2030.

## 2.3 Capital expenditure

Capital expenditure (capex)—the capital costs and expenditure incurred in the provision of network services—mostly relates to assets with long lives, the costs of which are recovered over the life of those assets. Forecast capex directly affects the size of the capital base and the revenue generated from the return on capital and depreciation building blocks.

MLPL proposed forecast capex of \$3,534.3 million (\$real 2023), including pre-construction expenditure of \$204.9 million undertaken before July 2025, which was not included in the MLPL Stage 1, Part A (Early works) final decision. Table 5 shows the breakdown of MLPL's proposal, noting most segments are commercial in confidence at this point.

<sup>&</sup>lt;sup>41</sup> MLPL, *Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) -* December 2024, December 2024, p 53.

<sup>&</sup>lt;sup>42</sup> MLPL, *Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) -* December 2024, December 2024, p 53.

Category	Pre- period <sup>45</sup>	2025–26	2026–27	2027–28	2028–29	2029–30	Total
Converter Station Design and Equipment Supply	143.1	98.0	372.8	10.1	57.0	56.2	737.2
HVDC Cable System – Submarine and Land Cables	52.4	99.8	106.4	132.7	365.6	138.1	895.0
Balance of Works*	[CIC]	[CIC]	[CIC]	[CIC]	[CIC]	[CIC]	[CIC]
Support activities*	[CIC]	[CIC]	[CIC]	[CIC]	[CIC]	[CIC]	[CIC]
Risk Allowance*	[CIC]	[CIC]	[CIC]	[CIC]	[CIC]	[CIC]	[CIC]
Total expenditure	204.9	444.1	1069.7	870.6	657.7	287.3	3534.3

#### Table 5Proposed construction expenditure (\$m Real 2023)43 44

\*This cost information is commercially sensitive and has been redacted for the purposes of this Revenue Proposal.

Source: MLPL, *ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction)*, December 2024, p. ix.

Our initial draft decision relates to MLPL's capex proposal for:

- The submarine and land cables and undersea cable installation (\$895 million, or 25% of total Part B expenditure).<sup>46</sup>
- The converter station equipment used to convert alternating current (AC) to direct current (DC) and vice versa (\$737.2 million, or 21% of total Part B expenditure).
- These components account for 46% of the total proposed capex. We will assess the remaining components in our supplementary draft decision in October following MLPL providing its revised revenue proposal in July 2025.

<sup>&</sup>lt;sup>43</sup> The expenditure forecasts exclude final milestone payments and commissioning costs, which will occur during the financial year commencing 1 July 2030. The milestone payments and commissioning costs are estimated to be \$105 million.

<sup>&</sup>lt;sup>44</sup> MLPL, *ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) – December 2024*, December 2024.

<sup>&</sup>lt;sup>45</sup> These costs include pre-construction expenditure incurred prior to 1 July 2025, which was explicitly excluded from early works in MLPL's Revenue Proposal Stage 1 – Part A (Early works).

<sup>&</sup>lt;sup>46</sup> We have not assessed MLPL's capex forecast for its Balance of Works costs as part of this initial draft decision. We will consider these when MLPL provides updated costs in the July 2025 revised proposal. This includes MLPL's proposal to prepare a second set of cable ducting for the Victorian land portion of the project at the same time as installing cable 1.

Our assessment of MLPL's capex proposals involves reviewing consistency of the project's technical specifications with the ISP, and then reviewing the efficiency and prudency of the costs proposed to meet those technical specifications.

The ISP identifies the optimal pathway for essential generation, storage and transmission infrastructure to meet consumer needs and achieve emissions targets. In considering which projects to include in the ISP, AEMO considered the project's specification, including the size of the project (in terms of transfer capability), the project's route, and the technology used (in this case undersea DC cables and converter stations). We have relied on AEMO's ISP process to identify the best technical approach to meet the identified need and can confirm that the project specifications included in MLPL's proposal are consistent with the ISP.

The cable and converter station programs were subjected to a competitive tendering process. An AER observer was present throughout the tendering process. We provided detail on the tendering process in our issues paper, which is reproduced in the following section. We consider this competitive process gives a level of confidence that the programs have been procured and can be delivered at an efficient cost, given the specifications and requirements of the Project Marinus actionable ISP project. We also consider the expenditure is prudent and is likely to be necessary to deliver Project Marinus. We have not yet reviewed the cables and converters contracts as we will assess these contracts as part of our supplementary draft decision when MLPL submits its full capex proposal in July 2025. The contracts MLPL enters into will feed into our decision on incentive mechanisms, as contract design and governance mechanisms allow MLPL to exert control over its contractors' spending. Our draft decision, is to approve the costs proposed for the submarine and land cables, undersea cable installation, and the converter station equipment used to convert AC to DC and vice versa.<sup>47</sup>

At this time, we do not have sufficient detail on MLPL's Balance of Works, support activities and risk management components to assess their prudency and efficiency. MLPL has undertaken to provide this information in July 2025. We will examine whether these components have been properly market tested and whether the scopes are appropriate when we make our supplementary draft and final decision.

We will consider MLPL's full capex forecast in our supplementary draft decision when it provides its revised proposal in July 2025.

#### 2.3.1 Procurement process

The MLPL procurement process was conducted in several phases. The initial phase involved research to identify potential service providers for the submarine cables and associated works, and construction and fit out of the converter stations. Registrations of interest were then conducted to identify consortia interested in providing the required services. Evaluations were then conducted to shortlist potential suppliers. The shortlisted firms were then invited to submit tender prices, which were subject to evaluation and executive review.

<sup>&</sup>lt;sup>47</sup> We have not assessed MLPL's capex forecast for its Balance of Works costs as part of this initial draft decision. We will consider these when MLPL provides updated costs in the July 2025 revised proposal. This includes MLPL's proposal to prepare a second set of cable ducting for the Victorian land portion of the project at the same time as installing cable 1.

MLPL established an Evaluation Steering Committee comprising independent industry experts, consultants and MLPL staff to evaluate the tenders. An AER representative and a consumer representative observed the Evaluation Steering Committee meetings. Government representatives also attended when relevant contractual matters were discussed. The evaluation and review processes were conducted by separate panels for the submarine cables and converter stations respectively.

The panels received briefings from expert advisers that evaluated specific elements of each tender, including compliance with the tender requirements for technical, commercial and legal, financial capability, community consultation, indigenous opportunities, and other criteria. All meetings were conducted with a pre-agreed evaluation strategy based on good industry practice for tender evaluations.

Drawing on advice from the expert advisers, panel members scored the tenders. This process was repeated for each subject area. Scoring was revised and debated until a final consensus score was achieved.

The government, AER and consumer representatives each had significant experience in conducting high value public tender processes. To maximise compliance with the expectations of both governments and the AER, the Marinus evaluation and review teams regularly sought feedback from the observers. Each of the observers was satisfied that the process was conducted to a high standard, sustained competitive tension, and was consistent with industry norms and with government procurement requirements.

## **3** Incentive schemes

Incentive schemes form an important part of our regulatory toolkit. They provide financial rewards and penalties to network service providers and complement our approach to assessing costs. They encourage businesses to pursue expenditure efficiencies while still maintaining the reliability and overall performance of their networks.

As MLPL's proposal only covers capital expenditure, only the Capital Expenditure Sharing Scheme (CESS) is relevant. We will consider applying the efficiency benefit sharing scheme (EBSS) and the service target performance incentive scheme (STPIS) as part of our assessment of MLPL's full revenue proposal that will be submitted in 2029.

## 3.1 Capital expenditure sharing Scheme (CESS)

The capital expenditure sharing scheme (CESS) provides financial rewards for network service providers whose capital expenditure (capex) becomes more efficient and financial penalties for those that become less efficient over time. Consumers benefit from improved efficiency through lower regulated prices. The CESS approximates efficiency gains and efficiency losses by calculating the difference between forecast and actual capex. It shares these gains or losses between service providers and consumers.

Our usual approach is to include a CESS that shares underspends or overspends between a service provider and its customers at a ratio of 30:70. That is service providers keep 30% of efficiency gains (or bear 30% of efficiency losses) while customers keep 70% of the gains (or 70% of the losses).

In our most recent CESS Guidelines from April 2023,<sup>48</sup> we noted that we would consider modified CESS arrangements for large transmission projects, though the default position would be to apply the standard approach. When deciding whether to include a modified CESS, the AER would take into account:

- the service provider's CESS and capital expenditure proposals
- benefits to consumers from the exemption
- the size of the project
- the degree of capital expenditure forecasting risk
- stakeholder views.

MLPL has proposed that we do not apply our standard CESS sharing ratio of 30:70, and instead include a ratio of 5:95. Among other things, MLPL considers this is appropriate because of:

 the size and configuration of the Marinus Link project – unlike other TNSPs, the undersea cable is MLPL's only project and it is not possible for it to manage the potential impact of applying the CESS by making cost savings on other projects;

<sup>&</sup>lt;sup>48</sup> AER, *Final decision - Review of incentive schemes for networks*, April 2023.

- the greater level of exposure its equity holders face owing to its concessional financing arrangement;
- the degree of capital expenditure forecasting risk faced by Marinus Link; and
- the benefits to MLPL's customers if the CESS is not applied in its current form.

In deciding whether to apply a modified CESS, we had regard to factors specific to MLPL. In particular, that it is a single asset business, and its single asset is a large transmission project, and is likely to have limited opportunities to diversify its cost across a portfolio of assets.

MLPL submits that there is significant forecast risk associated with its project that are beyond its ability to control, such as striking difficult terrain or delays to approvals as a result of community opposition. MLPL also argued that there are benefits to customers from applying its proposed modified CESS, as consumers would avoid windfall gains and losses associated with over- or under-spends on the project arising from events beyond MLPL's control.

We consider both these factors relate to forecasting risk. The CESS provides a continuous incentive to achieve cost savings for a TNSP, irrespective of whether unforeseen or uncontrollable events occur. That is, under the standard CESS, there is a constant incentive to deliver the capex program at a lower cost. Where unforeseen events occur, there is an incentive to achieve the lowest cost of managing that event, as this will reduce the size of any penalty (or increase the size of the benefit). A lower powered CESS as proposed by MLPL would significantly weaken this incentive. We note that MLPL is best placed to manage its forecasting risk, firstly by effectively managing its exposure through contracting and insurance, and secondly by providing a forecast that reflects its risk profile. MLPL also has access to cost pass through provisions under its determination to further manage unforeseen risks. We consider any substantial forecasting risk would be sufficiently managed by capping the standard sharing ratio at +/- 10% of forecast capex, as was the case with Transgrid's HumeLink second contingent project application (HumeLink CPA2) CESS.

MLPL also argued that the way in which it has structured its funding, which is heavily weighted in favour of debt, means that penalties arising from the CESS will weigh more heavily on equity holders. We note that MLPL's financing structure is an internal matter for MLPL and does not detract from the need to provide an incentive to achieve efficient cost. We do not consider MLPL's choice of financing arrangements is a valid reason for further reducing the incentive power of the CESS.

On the basis of this analysis, the AER does not consider the 5:95 sharing ratio proposed by MLPL is sufficient to incentivise efficient expenditure. For illustrative purposes, an overspend by MLPL of \$200 million would result in a \$10 million penalty for MLPL, while its customers would bear \$190 million of this cost. However, we accept that MLPL, as a large single asset TNSP, faces different risks to other TNSPs, such that a modified CESS may be appropriate. In particular, we accept that MLPL does not have the ability to achieve cost savings on other parts of its portfolio to offset increased costs on Project Marinus.

Our initial draft decision to reject the 5:95 sharing ratio has been informed by stakeholder submissions that highlighted concerns regarding consumers bearing risk and diluted incentives for MLPL to manage project costs.<sup>49</sup>

Our initial draft decision is that a 30:70 sharing ratio should apply to MLPL, but that this should be limited to the first 10% of any over or underspend by MLPL. For illustrative purposes, an overspend by MLPL of \$200 million (an overspend of less than 10%) would result in a \$60 million penalty for MLPL, while its customers would bear \$140 million of this cost. For expenditure over or under the 10% threshold, a sharing ratio equivalent to the financing benefit should apply (the actual value will not be known until the next regulatory decision in 2030). This is consistent with our decision for HumeLink CPA2 from August 2024.<sup>50</sup> At this stage, we consider the approach set out above balances the particular circumstances of MLPL as a large transmission project with the need to provide a scheme sufficient to incentivise efficient capex. We note that this is an initial draft decision, which is being made without the benefit of knowing a number of MLPL's cost forecasts for the regulatory period. The AER will consider whether the modified scheme included here is still relevant when the full costs are lodged, and stakeholder submissions are received.

<sup>&</sup>lt;sup>49</sup> Jack Gilding, *A personal submission in response to the AER's Issues Paper*, 18 April 2025, p 3 and p 6

<sup>&</sup>lt;sup>50</sup> AER, AER - Determination - Transgrid HumeLink Stage 2 Contingent Project - August 2024, August 2024.

## **4** Pass through events

During a regulatory control period, a TNSP can apply to pass through to its customers, in the form of higher or lower network charges, certain material changes in its costs caused by predefined exogenous events. These events are called cost pass through events.

The NER include the following pass through events for all transmission determinations: <sup>51</sup>

- a regulatory change event
- a service standard event
- a tax change event
- an insurance event.

In addition to these prescribed events, other pass through events may be 'nominated' by a service provider to be specified in a transmission determination as a pass through event for a regulatory control period.<sup>52</sup>Our final decision must include a decision on the nominated pass through events that are to apply for the regulatory control period.<sup>53</sup>

MLPL has proposed 8 nominated pass through events. These include the four standard events reflected in all current revenue determinations for other TNSPs in the National Electricity Market (insurance coverage event, terrorism event, natural disaster event, and insurer credit risk event) plus the following four additional events:

• **Contractor force majeure event** – a material change in construction costs incurred by MLPL due to a force majeure event impacting the construction contractor. The contractor force majeure event includes the additional prudent and efficient construction costs incurred because of an unforeseen force majeure event impacting the contractor, where:

(i) the costs are not covered by an existing insurance policy or other pass through event; and

(ii) the force majeure event is declared in accordance with the terms of the relevant contract.

- **Biodiversity event** –occurs if there is a change in biodiversity obligations which results in a cost impact (positive or negative) to achieve compliance, where a change in MLPL's biodiversity obligations means:
  - a) a new legislative or regulatory requirement from those that applied at the date of MLPL's Revenue Proposal.
  - a decision by a planning authority which requires additional measures be taken to avoid and minimise biodiversity impacts (or to refuse an application based on those impacts); or increase or decrease the credit obligations identified by MLPL at the time of its Revenue Proposal.

<sup>&</sup>lt;sup>51</sup> NER r. 6A.7.3(a1)(1)–(4) and (5)–(7)

<sup>&</sup>lt;sup>52</sup> NER, r. 6A.7.3(a1)(5)

<sup>&</sup>lt;sup>53</sup> NER, cl. 6A.14.1(9)

- Unavoidable contract variations event occurs if there is a contract variation that has a material impact (positive or negative) on MLPL's costs of constructing or commissioning as a result of a change in the Marinus Link design or proposed route. The cost of the unavoidable contract variations event may include, but is not limited to, the increase or decrease in the prudent and efficient costs of any civil or building works, environmental and planning approvals; and any plant, equipment, materials and labour costs; and delay costs.
- Contractor insolvency event occurs if a contractor is declared insolvent and as a
  result of that insolvency there is a material increase in MLPL's costs of constructing or
  commissioning Marinus Link. The cost may include, but is not limited to, those arising
  from delays; renegotiation of new contract terms; appointing an alternative contractor;
  and any increase in the costs of completing construction.

Our initial draft decision is to accept the four standard nominated pass through events for MLPL, namely the insurance coverage event, terrorism event, natural disaster event, and insurer credit risk event. However, we do not accept the other 4 new proposed nominated events as we consider these events are either likely to be covered by another existing category of pass through event, or the risks associated with these events should be able to be substantially mitigated or managed by MLPL, and therefore should not be passed through to consumers.<sup>54</sup> We set out our reasoning in more detail below.

#### Contractor force majeure event

We consider the circumstances and risks associated with the proposed contractor force majeure event are likely to be covered by one or more of the existing natural disaster, terrorism, and regulatory change events. It is not clear from MLPL's proposal what other additional risks need to be addressed by this event.

We note that MLPL in part proposed inclusion of this event on the basis that we included a similar pass through event in our determination on the non-contestable elements of Transgrid's Waratah Super Battery project under the *Electricity Infrastructure Investment Act 2020* (EII) framework.<sup>55</sup> However, we note this formed part of an overall package of 'adjustment mechanisms' considered under the EII framework, rather than a nominated cost pass through event to which specific considerations apply under the NER.

#### Biodiversity event

Similarly, we consider inclusion of the biodiversity event is not consistent with the nominated pass through event considerations under the NER because the event is likely covered by an existing category of pass through event. MLPL proposed that a biodiversity event is defined as a new legislative change or regulatory requirement or a decision by a planning authority which results in a biodiversity cost impact. We consider these circumstances are likely to be already covered by either the regulatory change pass through event or the service standard pass through event under the NER.

<sup>&</sup>lt;sup>54</sup> NER, Chapter 10, Definition of *nominated pass through event considerations*.

<sup>&</sup>lt;sup>55</sup> MLPL, *Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) -* December 2024, December 2024, pp 66 and 73.

#### Unavoidable contract variations event

Our initial draft decision to not accept the unavoidable contract variations event is based on a number of considerations:

- It is difficult to clearly define the event as it is unclear what would constitute 'avoidable' and 'unavoidable' events or costs in this context.
- Including this pass through event would materially weaken MLPL's incentives to minimise the costs of construction.
- Some contractor cost variation risks, such as unforeseen outcomes of planning and environmental approvals, have been mitigated by early works.
- MLPL can mitigate some of the risks in other ways, for example by hedging commodity prices, and including escalation allowances for labour and material costs.

We also note that MLPL's proposed event definition sought to define a materiality threshold for this event of <u>not less than</u> \$30 million.<sup>56</sup> This is not consistent with the 'adjustment mechanism' included in our determination on Transgrid's Waratah Super Battery project under the EII framework, which provided for a <u>maximum</u> amount of \$30 million. The NER framework does not provide for the materiality threshold for a specific event to be defined in this way. The materiality threshold for all nominated cost pass through events under the NER is defined in Chapter 10 of the NER.

#### Contractor insolvency event

In regard to the contractor insolvency nominated pass through event, we consider there are ways in which the risk of such an event occurring and causing material additional costs can be substantially mitigated or managed by a prudent service provider. We are therefore not satisfied that this event is consistent with the nominated pass through event considerations in the NER. We consider:

- There is scope for MLPL to mitigate the risk of contractor insolvency during the tendering and contracting process. The contractor's size and track record are relevant factors in choosing a contractor. Also, prudent service provider could reasonably require contracts to include clauses to prevent or mitigate the cost impact of a contractor insolvency event, for example, the novation of contracts, provision of appropriate security, registration of interests, and provision of guarantees. It is therefore not clear why MLPL considers the pass through event is required given the level of control it has in establishing appropriate contracting terms, and the scope to choose a low risk contractor.
- The risk to MLPL of an insolvency event is mitigated by the application of the CESS included in this initial draft decision. This limits the impact of an insolvency event to the first 10% of any overspend MLPL incurs. We consider this helps to balance the particular circumstances of MLPL as a large transmission project, with the need to continue to incentivise efficient expenditure and risk management.

<sup>&</sup>lt;sup>56</sup> MLPL, *Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction)* - December 2024, December 2024, pp 72 and 75.

• Inclusion of this nominated pass through event would likely reduce MLPL's incentive to minimise constructions costs under any renegotiated contract following an insolvency event.

Our initial draft decision to not accept the nominated pass through events for unavoidable contract variations and contractor insolvency has also been informed by stakeholder submissions in response to our issues paper. Stakeholders noted the nominated pass throughs transferred risk to consumers and diluted incentives for MLPL to manage project costs.<sup>57</sup>

<sup>&</sup>lt;sup>57</sup> Lynette Black, *Marinus Link – Stage 1, Part B (Construction costs)*, 18 April 2025 and Jack Gilding, *A personal submission in response to the AER's Issues Paper*, 18 April 2025

## **5** Contingent Project Application

Contingent projects are major capital expenditure projects which are characterised by uncertain costs, timing or need due to external factors. Due to the associated uncertainty, these projects are not included as part of the total forecast capital expenditure and are tied to specified predefined conditions or 'trigger events.' When the trigger event is met, this allows the proponent to submit a contingent project application (CPA) to seek an adjustment to the revenue determination to include expenditure allowances for the project.

The NER provides for contingent projects under two possible pathways.58

#### The revenue determination pathway:

• A contingent project proposed by the TNSP (MLPL in this case) and determined by the AER, in accordance with clause 6A.8.1, to be a contingent project for the purposes of that revenue determination; or

#### The ISP pathway:

- An actionable TNSP project for which the trigger event specified under clause 5.16A.5 has occurred. For an early works contingent project, a contingent project application is the only trigger. For other actionable ISP projects, the trigger events are:
  - The completion of a compliant RIT-T and issue of a RIT-T project assessment conclusions report that identifies the contingent project as the preferred option;
  - The expiry of the RIT-T dispute period and the resolution of any disputes;
  - Completion of the AEMO feedback loop process and confirmation of the status of the contingent project as an actionable ISP project and part of the optimal development plan; and
  - A contingent project application in which the cost of the project is no greater than the cost considered by AEMO in its feedback loop assessment.

The 2024 ISP identified Project Marinus, both Stage 1 which will deliver a 750 MW cable and associated works (Cable 1) and Stage 2 which will provide second 750 MW cable and associated works (Cable 2), as an actionable ISP project.

#### MLPL's proposal

MLPL proposed that our determination set out the following contingent projects in accordance with clause 6A.8.1(b) of the NER;

- The early works required to support the construction of the second 750 MW Marinus Link cable.
- A second contingent project pertaining to the construction of the second cable and associated works.

<sup>&</sup>lt;sup>58</sup> cl. 6A.8.A1

The proposed triggers for the contingent projects are:

- AEMO's 2026 or 2028 ISP confirms that early works in relation to the second cable should proceed as soon as practicable;
- MLPL updates the RIT-T analysis to confirm that the second cable should proceed; and
- MLPL completes the feedback loop for the second cable in accordance with 5.16A(b) of the Rules.

MLPL contends there may be benefits in including Cable 2 as a contingent project under the 2025–30 revenue determination as relying on Marinus Link's actionable ISP status would not provide clarity regarding the likely timing of MLPL's contingent project application to the AER. MLPL submitted that AEMO has an important role to play in providing guidance to stakeholders on the optimal timing of Stage 2 through its ISP process.

At the time of the revenue proposal, MLPL estimated the cost of constructing the second cable and associated works to be approximately \$2.2 billion (\$2023).<sup>59</sup>

#### AER's initial draft decision

Our initial draft decision is to reject MLPL's proposal to include Cable 2 as a contingent project in our revenue determination under clause 6A.8.1(b) of the NER. However, Cable 2 will remain as a possible contingent project via the actionable ISP project pathway under clause 5.16A.5.

Clause 5.16A.5 of the NER provides contingent project triggers for actionable ISP projects, of which Project Marinus is one. However, MLPL proposes we also include in our revenue determination a separately stated contingent project and trigger events for the second cable. This provides two pathways for MLPL to seek a contingent project determination for Cable 2. The difference in the two pathways lies in the criteria for triggering a contingent project assessment.

Clause 6A.8.1(b)(4) of the NER provides that we must accept a proposed contingent project in our revenue determination if, among other things, we are satisfied that the trigger events in relation to the proposed contingent project are appropriate. Our initial draft decision is to reject MLPL's proposal given we are not satisfied that the proposed contingent project trigger events are appropriate. We do not consider it appropriate to include in our revenue determination trigger events for an actionable ISP project that are different from the trigger events set out in clause 5.16A.5 of the NER.

Trigger events for actionable ISP projects that provide less stringent requirements than those in clause 5.16A.5 would be contrary to the intent of the NER. Trigger events for actionable ISP projects with more stringent or alternative requirements would not have any binding effect as the pathway under clause 5.16A.5 would remain available to MLPL. As a consequence, additional trigger events provided through the revenue determination may lead

<sup>&</sup>lt;sup>59</sup> MLPL, *Marinus Link - ML-B-002 MLPL Revenue Proposal Stage 1 - Part B (Construction) -* December 2024, December 2024, p 83.

to misunderstanding among stakeholders about the conditions under which MLPL may submit a contingent project application for Project Marinus as an actionable ISP project.

In determining whether a trigger event in relation to a proposed contingent project is appropriate we must have regard to the factors set out in clause 6A.8.1(c) of the NER, though we may also consider any additional relevant matters. While our initial draft decision to reject is based on clause 6A.8.1(b) of the NER, for completeness our consideration of the factors in clause 6A.8.1(c) is set out in Table 6 below.

Trigger event factors <sup>60</sup>	AER consideration
The trigger event is reasonably specific and capable of objective verification.	The trigger events proposed by MLPL are reasonably specific and capable of objective verification.
The trigger event is a condition or event, which, if it occurs, makes the undertaking of the proposed contingent project reasonably necessary in order to achieve any of the capex objectives.	MLPL's proposed trigger event relating to updated RIT analysis would establish whether Cable 2 is the preferred option to address the identified need. MLPL's proposed trigger event relating to the AEMO feedback loop process would establish if Cable 2 is included in the ISP optimal development plan. The occurrence of these events are reasonably necessary to confirm that Cable 2 would promote the achievement of the capital expenditure objectives particularly with regard to meeting or managing the demand for prescribed transmission services.
	However, MLPL's proposed trigger event relating to AEMO confirmation of the timing of early works for Cable 2 is not reasonably necessary for Cable 2 to promote the achievement of the capital expenditure objectives. The other two trigger events associated with the RIT and the feedback loop are sufficient to establish that the contingent project would promote the capital expenditure objectives.
The trigger event is a condition or event that generates increased costs or categories of costs that relate to a specific location rather than a condition or event that affects the transmission network as a whole.	The trigger events proposed by MLPL relate to the construction (and early works) of Cable 2, and do not affect the costs of Cable 1.
The trigger event is described in such terms that the occurrence of that event or condition is all	The trigger events proposed by MLPL are appropriately described to allow the revenue

#### Table 6 Contingent project trigger event factors

that is required for the revenue determination to be amended.	determination to be amended should the events occur.
<ul> <li>The trigger event is an event or condition, the occurrence of which is probable during the regulatory control period, but the inclusion in the initial revenue determination of capital expenditure in relation to the event is not appropriate because:</li> <li>it is not sufficiently certain that the event of condition will occur during the regulatory control period, or</li> <li>the costs associated with the event or condition are not sufficiently certain.</li> </ul>	Both the timing of Cable 2 and its costs are not sufficiently certain to be included in the initial 2025-30 revenue determination for MLPL.

## 6 Constituent decisions

As approximately 54% of MLPL's costings are not yet fully market tested and may be subject to significant change, the AER will consider these elements in the supplementary draft decision following MLPL providing a revised revenue proposal in July 2025. Before issuing its final decision on MLPL's revenue proposal, in our CPP, the AER decided to issue:

- an initial draft decision which is informed by stakeholder submissions in response to our issues paper published in March 2025, and
- a supplementary draft decision in October 2025 to allow consumers and other stakeholders to review and comment on the full scope of works and more accurate costings.

These additional steps will allow reasonable consultation with consumers and other stakeholders, and appropriate regulatory consideration.

The constituent decisions to be made for an intending TNSP are prescribed in our CPP.

Our initial draft decision on MLPL's transmission determination for the 2025–30 regulatory control period includes the below constituent components.<sup>61</sup>

#### **Constituent component**

In accordance with clause 6A.14.1(1)(v) of the NER, the AER's initial draft decision is to approve the commencement and length of the regulatory control period as MLPL proposed in its revenue proposal. The regulatory control period will commence on 1 July 2025 and the length of this period is five years, expiring on 30 June 2030.

In accordance with clause 6A.14.1(2)(i) of the NER and acting in accordance with clause 6A.6.7(c), the AER's initial draft decision is to accept MLPL's proposed total net forecast capital expenditure for market tested costs of \$1,632.2 million (\$2023) for the 2025–30 regulatory control period. The reasons for our initial draft decision are set out in section 2.3 of this initial draft decision.

In accordance with clause 6A.14.1(4)(i) of the NER, the AER's initial draft decision is to not accept that the following project is a contingent project for the purpose of this revenue determination for MLPL.

- The construction of the second 750 MW cable and associated works
- The early works associated with the construction of the second 750 MW cable and associated works

In accordance with clause 6A.14.1(5A) of the NER, the AER's initial draft decision is that a varied capital expenditure sharing scheme (CESS) as set out in section 3 will apply to

<sup>&</sup>lt;sup>61</sup> National Electricity Law, s. 16(1)(c).

#### **Constituent component**

MLPL in the 2025–30 regulatory control period. The reasons for our initial draft decision are set out in section 3 of this initial draft decision.

In accordance with clause 6A.14.1(5A) of the NER, the AER's initial draft decision is that the demand management innovation allowance mechanism (DMIAM) for electricity transmission networks will not apply to MLPL in the 2025–30 regulatory control period.

In accordance with clause 6A.14.1(5B) of the NER, the AER's initial draft decision is that the allowed rate of return for the 2025–26 regulatory year is 5.36% (nominal vanilla), as set out in section 2.2 of this draft decision. The rate of return for the remaining regulatory years of the 2025–30 period will be updated annually because our draft decision is to apply a trailing average portfolio approach to estimating debt which incorporates annual updating of the allowed return on debt.

In accordance with clause 6A.14.1(5C) of the NER, the AER's initial draft decision is that the value of allowed imputation credits is 0.57. The reasons for our initial draft decision are set out in section 2.2 of this initial draft decision.

In accordance with clause 6A.14.1(5D) of the NER, the AER's initial draft decision, and in accordance with clause 6A.6.1 and schedule 6A.2, the opening regulatory asset base (RAB) as at the commencement of the 2025–30 regulatory control period, being 1 July 2025, is \$453.8 (\$ nominal). The reasons for our initial draft decision are set out in section 2.1 of this initial draft decision.

In accordance with clause 6A.14.1(9) of the NER, the AER's initial draft decision is to apply the following nominated pass through events to MLPL for the 2025–30 regulatory control period in accordance with clause 6A.7.3(a1)(5):

- Insurance coverage event
- Insurer's credit risk event
- Terrorism event
- Natural disaster event

The definitions of these events and the reasons for our initial draft decision are set out in section 4 of this initial draft decision.

## Glossary

Term	Definition
AACE	Association for the Advancement of Cost Engineering
AC	Alternating current
ACCC	Australian Competition and Consumer Commission
ACG	Allen Consulting Group
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Врра	Basis points per annum
Capex	Capital expenditure
CEFC	Clean Energy Finance Corporation
CESS	Capital expenditure sharing scheme
СРА	Contingent project application
CPP	Commencement and Process Paper
DC	Direct current
EBSS	Efficiency benefit sharing scheme
HVDC	High voltage direct current
ISP	Integrated System Plan
MLPL	Marinus Link Pty Ltd
MW	Megawatt
NER	National Electricity Rules
NEO	National Electricity Objectives
PTRM	Post-Tax Revenue Model
PWC	PricewaterhouseCoopers
RAB	Regulatory asset base
RBA	Reserve Bank of Australia
RORI	Rate of Return Instrument
STPIS	Service target performance incentive scheme
TNSP	Transmission network service provider
WACC	Weighted average cost of capital