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Gavin Fox
General Manager Network Pricing
Australian Energy Regulator (AER)
Level 17 Casselden, 2 Lonsdale Street
Melbourne VIC 3000
Email: RateOfReturn@aer.gov.au

Dear Gavin,

Subject: Rate of Return Instrument - Review discussion paper

Marinus Link Pty Ltd (MLPL) welcomes the opportunity to make this submission in response to the AER's Discussion Paper on the Rate of Return Instrument (Discussion Paper).

Project Marinus will play a crucial role in Australia's transition to net zero, having formed part of the Australian Energy Market Operator's Optimal Development Path since 2020. It will provide 1500 MW of interconnector capacity between Tasmania and Victoria, to be delivered in two stages. Stage 1 of Project Marinus is an anticipated project, which is expected to be operational by 2030. Stage 2 is likely to remain an actionable ISP project.

Marinus Link is the component of Project Marinus that is being delivered by MLPL, involving approximately 255 kilometres of undersea HVDC cable and approximately 90 kilometres of underground HVDC cable in Victoria. The remaining component of Project Marinus is known as the North West Transmission Developments, and will be completed by TasNetworks.

MLPL will benefit from concessional finance that MLPL has been able to secure from the Clean Energy Finance Corporation (CEFC) in relation to the cost of debt, and MLPL's shareholders in relation to the cost of equity. Consumers will benefit from concessional finance in the form of substantially reduced network charges compared to those that would apply on a non-concessional basis. Accordingly, there is an effective 'buffer' between the AER's allowed rate of return determined in accordance with the applicable Rate of Return Instrument (RORI) and the concessional cost of capital.

For Stage 1 of Marinus Link, therefore, there are no direct consequences if the AER's allowed rate of return is lower than the efficient benchmark cost of capital, providing that it is not lower than the concessional cost of capital. In these circumstances, the 'buffer' will be eroded by the lower allowed rate of return, but it will be sufficient to enable MLPL to finance the project. However, there are implications for other transmission projects, including Stage 2 of Project Marinus, if concessional finance is not available to compensate for the lower allowed rate of return.

MLPL notes that the AER’s simple trailing average approach to estimating the cost of debt may result in periods where the allowed cost of debt is consistently lower (or higher) than current market rates. As TNSPs are only able to raise debt at the prevailing market rate, not historical rates, the simple trailing average approach may be unable to support major transmission projects where prevailing rates are above the historical average. Accordingly, the simple trailing average approach may set an allowed rate of return that is lower than the TNSP’s actual cost of capital, i.e., lower than the efficient benchmark cost of capital.

A more effective approach to determining the trailing average cost of debt would be to consider the TNSP’s expenditure profile, factoring in the amount of debt that must be raised at current market rates. Furthermore, by taking a weighted average approach, the systematic differences that arise from a simple averaging approach will not undermine the incentives for efficient and timely transmission investment in actionable ISP projects, which is much needed to ensure that the energy transition is achieved at the lowest cost to consumers.

Given the above comments, MLPL welcomes the AER’s reconsideration of this issue in its Discussion Paper, which was previously raised at the time of the 2022 RORI. In terms of the detailed application of the trailing weighted average approach, MLPL notes that there are complexities in the AER’s suggested approach that need to be worked through. While MLPL favours a simple formulation of the weighted trailing average approach, the primary objective should be to ensure that the allowed rate of return is sufficient to promote efficient transmission investment, particularly given the need to attract funding where there is significant competition for funding from major infrastructure projects nationally and internationally.

In addition to the cost of debt, MLPL notes the AER’s commentary on the equity beta in its consideration of the benchmark cost of equity. In particular, the AER explains that there is a loss of domestic comparators, with only one energy company remaining from the nine original comparators. On that basis, the AER is contemplating international data, but suggests that it should apply filters to establish “a potentially suitable sample of international energy firms for consideration and to adjust for differences between them and Australian energy networks.”

MLPL would be concerned if the AER’s assessment of the evidence regarding equity beta is anchored to the existing value of 0.6. Instead, MLPL considers that the AER should conduct an objective appraisal of the data, recognising that it may indicate that the current estimate for the equity beta may be too low. In making this observation, MLPL notes that the equity beta is at the low end of the values adopted by regulators internationally, with Ofgem having previously recognised the significantly higher levels of investment required for electricity networks in setting an equity beta of 0.95.

While MLPL’s focus is on delivering Marinus Link at the lowest cost to consumers, we are conscious of the need for the AER to establish cost of capital parameters so as to support the significant capital investment that the sector requires over the next 10 years. While MLPL has obtained concessional finance for Stage 1 of Marinus Link, there are no guarantees that similar arrangements will be available for Stage 2, or for other major transmission projects on which the energy transition depends. For those reasons, MLPL encourages the AER to make the necessary changes to the existing RORI to promote efficient investment for the long term benefit of consumers.

Should you wish to discuss these matters further, please feel free to contact Eamon Sullivan at [redacted].

Yours sincerely,

Prajit Parameswar
Chief Financial & Commercial Officer