

11 March 2022

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General Manager  
Australian Energy Regulator  
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*via email:* [RateOfReturn@aer.gov.au](mailto:RateOfReturn@aer.gov.au)

Dear Mr Anderson

### **Rate of Return – Information Paper**

Marinus Link Pty Ltd (**MLPL**) appreciates the opportunity to comment on the Rate of Return Information Paper (**RoR Paper**). As you are aware, Project Marinus is included as an actionable project in AEMO's Draft 2022 Integrated System Plan (**ISP**), being a proposed 1500 MW project comprising two 750 MW stages to further link Tasmania and Victoria in the National Electricity Market. The project is currently progressing through the design and approvals stage. Project Marinus consists of two components - MLPL will be responsible for the HVDC interconnector and converter stations, and TasNetworks will be responsible for the North West Transmission Developments.

MLPL will be established as a 'single project' transmission network service provider (**TNSP**) and it is envisaged that its electricity transmission services will be regulated under Chapter 6A of the National Electricity Rules. MLPL's costs for the project are estimated to be in the order of \$3 billion (\$2021). The profile of this capital expenditure will be 'lumpy' as it will be driven by the project approval and construction timelines, including any project staging decisions. Consequently the establishment of an appropriate regulatory cost of debt approach that recognises the particular circumstances of a new TNSP, such as MLPL, is essential to promoting the achievement of the National Electricity Objective.

The RoR Paper recognises the issue of 'lumpy' capital expenditure for existing TNSPs that are delivering actionable ISP projects, especially where these projects may have a material impact on the value of a TNSP's regulatory asset base. The paper explains that the lumpy nature of the capital expenditure may create a mismatch between the regulatory allowance for the cost of debt (which assumes a 10%

refinancing of the TNSP's debt each year) and the company's actual capital requirements and resultant cost of debt.

The RoR paper canvasses options to address this issue that would employ a cost of debt weighting which reflects the profile of capital expenditure, rather than assuming a constant 10% weighting for each year. By weighting the cost of debt by the profile of capital expenditure, the cost of debt allowance should more accurately reflect the TNSPs cost of debt, consistent with the NPV=0 principle. The different options discussed in the RoR paper would each employ the same cost of debt weighting based on the forecast capital expenditure in the PTRM, but vary in terms of which businesses it would apply to and when.<sup>1</sup>

For existing network businesses, the introduction of a new approach to weighting the cost of debt adds a degree of complexity, particularly as these businesses are already at different stages of transitioning to the 10% weighting from the previous 'on the day' approach to the cost of debt. Furthermore, for existing network businesses the lumpy profile of capital expenditure may not have a significant impact on the company's debt financing activities. As such, a judgment needs to be made whether the benefits of introducing change outweighs the costs.

For MLPL, however, the situation is different because the debt financing activities for a new business may be materially different to that implied by the current 10% per annum weighting. Furthermore, as a new business, a new approach to weighting the cost of debt can be adopted without needing to consider how best to transition from the existing approach. In terms of the cost-benefit assessment, therefore, the case for adopting a weighted average based on the capital expenditure profile is likely to be more compelling for a new business.

To illustrate this point, MLPL's capital expenditure profile in the first 5 years of regulation may constitute almost the entirety of capital expenditure and resultant borrowings for the business. Evidently, a weighted average approach that implicitly assumes a flat capital expenditure profile over ten years may produce a cost of debt allowance that is materially different to the company's actual cost of debt, and indeed, the profile of any benchmark efficient business in the same circumstances. MLPL therefore favours an approach that better reflects a new TNSP's capital requirements and resultant cost of debt so that customers or shareholders do not face a windfall loss produced by a poorly designed trailing average methodology.

The particular circumstances of MLPL, as a new TNSP, therefore suggests that a weighted average approach based on the capital expenditure profile should be adopted. Once the 'lumpy' capital expenditure period

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<sup>1</sup> The options contemplate transmission and distribution businesses, or transmission only. The paper also discusses whether the capital expenditure weighting should apply in all cases or only apply when a defined threshold has been met.

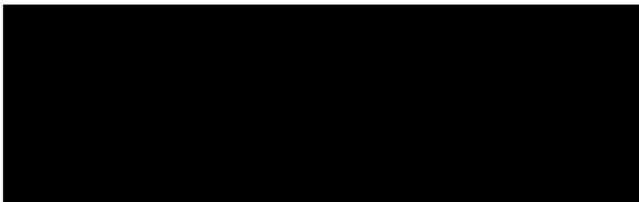
has been completed, the weighted averaging approach should transition to the standard 10% per annum refinancing assumption. While the details of this transition would need to be developed, it may be as simple as applying the same 10 year transition as was applied when transitioning from the previous 'on the day' approach to the current trailing average approach to estimating the cost of debt. In the case of a new TNSP, such as MLPL, however, the transition would be from a weighted average of the cost of debt based on the historical capital expenditure profile.

In summary, MLPL's position is that the weighted average cost of debt is likely to be a more significant issue for new TNSPs compared to existing TNSPs. Given this observation, MLPL considers it important that the AER considers how best to address the cost of debt for new TNSPs, particularly during the construction phase. MLPL considers that the benefit of this nuanced approach to the cost of debt will likely outweigh the costs associated with developing and implementing this approach.

Considering and allowing for this issue in the 2022 Rate of Return Instrument is particularly imperative given the binding nature of the instrument and the fact that it will apply to MLPL, as a new TNSP, in the revenue determination for its first regulatory control period.

We look forward to working with the AER as it considers these issues further and develops its thinking on cost of debt approaches and the 2022 Rate of Return Instrument. If you would like to discuss this submission further, please contact me at [REDACTED]

Yours sincerely



**Heath Dillon**  
**Executive Manager Customer and Revenue**