Marinus Link Pty Ltd
PO Box 606 Moonah
Tasmania
Australia 7009

3 March 2023

Mr Sebastian Roberts
Network Expenditure
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Mr Roberts

Review of incentive schemes

Marinus Link Pty Ltd (MLPL) welcomes the opportunity to lodge this submission in response to the AER's draft decision on its review of the incentive schemes.

As you are aware, Project Marinus is included as an actionable project in AEMO's Draft 2022 Integrated System Plan, being a proposed 1500 MW project comprising early works and 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 DC interconnector and converter stations, and TasNetworks will be responsible for the North West Transmission Developments.

MLPL is in a unique position from a regulatory perspective. At this time, MLPL is embarking on a major project that will deliver very substantial net benefits to the National Electricity Market. In contrast to other transmission businesses, MLPL does not currently provide prescribed transmission services, nor does it have an established business structure with recurrent operating expenditure. In some respects, our unique circumstances enable us to provide different insights regarding the application of the incentive schemes. Before turning to the application of the incentive schemes, we comment first on the purpose and benefits for incentive schemes more generally.

Purpose and benefits of incentive schemes

MLPL's view is that the purpose of an incentive scheme is to deliver better consumer outcomes. The success or otherwise of an incentive scheme must be assessed against this objective.

The AER's Draft Decision presents compelling data to show that its incentive schemes have been successful, delivering substantial benefits to consumers in terms of lower costs and improved service performance. As noted by the AER, Houston Kemp estimates that the Efficiency Benefit Sharing Scheme (EBSS) alone has provided operating expenditure savings of $7 billion to consumers while the network companies have earned an additional $3 billion from the operation of that scheme.[1]

For any incentive scheme, once efficiency improvements have been achieved, it is tempting to question whether the incentive bonuses, in this case $3 billion, were necessary. Specifically, consumers may ask whether tougher operating expenditure allowances could have been set in the first place, without the need for any incentive payments.

MLPL does not support this view. Incentives are important in driving better performance, as they encourage companies to commit resources to find better ways to deliver services, including by working smarter to extend asset lives and manage risk more effectively. Naturally, business innovations and process changes take time to develop, implement and refine – and some will fail to achieve their objectives. Importantly, however, incentive schemes create the commercial environment for businesses to improve their performance, to the benefit of consumers.

If incentive schemes are removed or weakened, then it is likely that fewer total efficiencies will be obtained. This means that consumers will obtain a larger share of a smaller pie, leaving consumers worse off. MLPL considers that the current incentive schemes should be retained, as they have been working well as demonstrated by the AER's analysis.

Application of the incentive schemes

While incentive schemes are essential in driving better consumer outcomes, their effectiveness depends on the company's ability to respond to the incentives they provide. For the Capital Expenditure Sharing Scheme (CESS), its effectiveness therefore depends on whether the network company can take action to achieve capital expenditure savings compared to the expenditure allowance provided by the AER.

For existing TNSPs, there is a strong likelihood that incentives to drive capital expenditure efficiencies will be effective in delivering better outcomes for consumers. This is because there are opportunities to improve investment decision-making, asset management techniques and business processes to drive cost savings. For these companies, therefore, the CESS plays an analogous role to the EBSS. While there may be

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1 AER, Draft decision: Review of incentive schemes for networks, December 2022, page 10

scope for forecasting error in estimating the capital expenditure allowance, this does not weaken the case for exposing existing TNSPs to an incentive regime that rewards efficiencies and penalises inefficiencies.

The AER's draft decision suggests that the CESS may encourage TNSPs to overstate their capital expenditure requirements, so that they can obtain a bonus. For that reason, the AER has concluded that a lower incentive rate should apply if the difference between forecast and actual capital expenditure exceeds 10%. MLPL questions whether this proposed change will improve outcomes for consumers. Specifically, it seems unlikely that reducing the incentive rate will have any impact on the accuracy of the TNSP's capital expenditure forecasts. On the other hand, it may discourage capital expenditure efficiencies, which would be to the detriment of consumers. MLPL considers that a cautious approach should be adopted in relation to any proposed changes, particularly as the current scheme is working well.

While MLPL supports the CESS, a question arises as to whether it should be applied in circumstances where the magnitude of forecasting error may dominate the potential for efficiency improvements. In MLPL's case specifically, we will be working hard through procurement and joint planning processes to ensure that Project Marinus Link is delivered as efficiently as possible. The nature of such a major infrastructure project, however, is that it will be exposed to the risk of forecasting error.

In MLPL's circumstances, the application of the CESS may be counter-productive in terms of delivering the lowest cost outcome for consumers. This is because it may encourage MLPL to secure fixed priced contracts to avoid the negative exposure of cost overruns, rather than taking on more risk on behalf of consumers. Ultimately, this may result in higher costs for consumers, rather than lower costs. For the AER's review of the incentive schemes, MLPL's circumstances highlight the importance of considering whether the network company will be able respond to the incentive scheme as intended.

We note that section 2.6 of the AER's Draft Capital Expenditure Incentive Guideline states that the AER intends to assess whether to apply the CESS to large transmission projects, having regard to the capital expenditure proposal and the degree of forecasting risk. MLPL will be raising these issues in its revenue proposal to the AER.

We look forward to working with the AER as it considers these issues further. If you would like to discuss this submission further, please contact [redacted] Executive Manager Revenue and Customer, [redacted]

Yours sincerely

[redacted]

Stephen Clark

Project Director