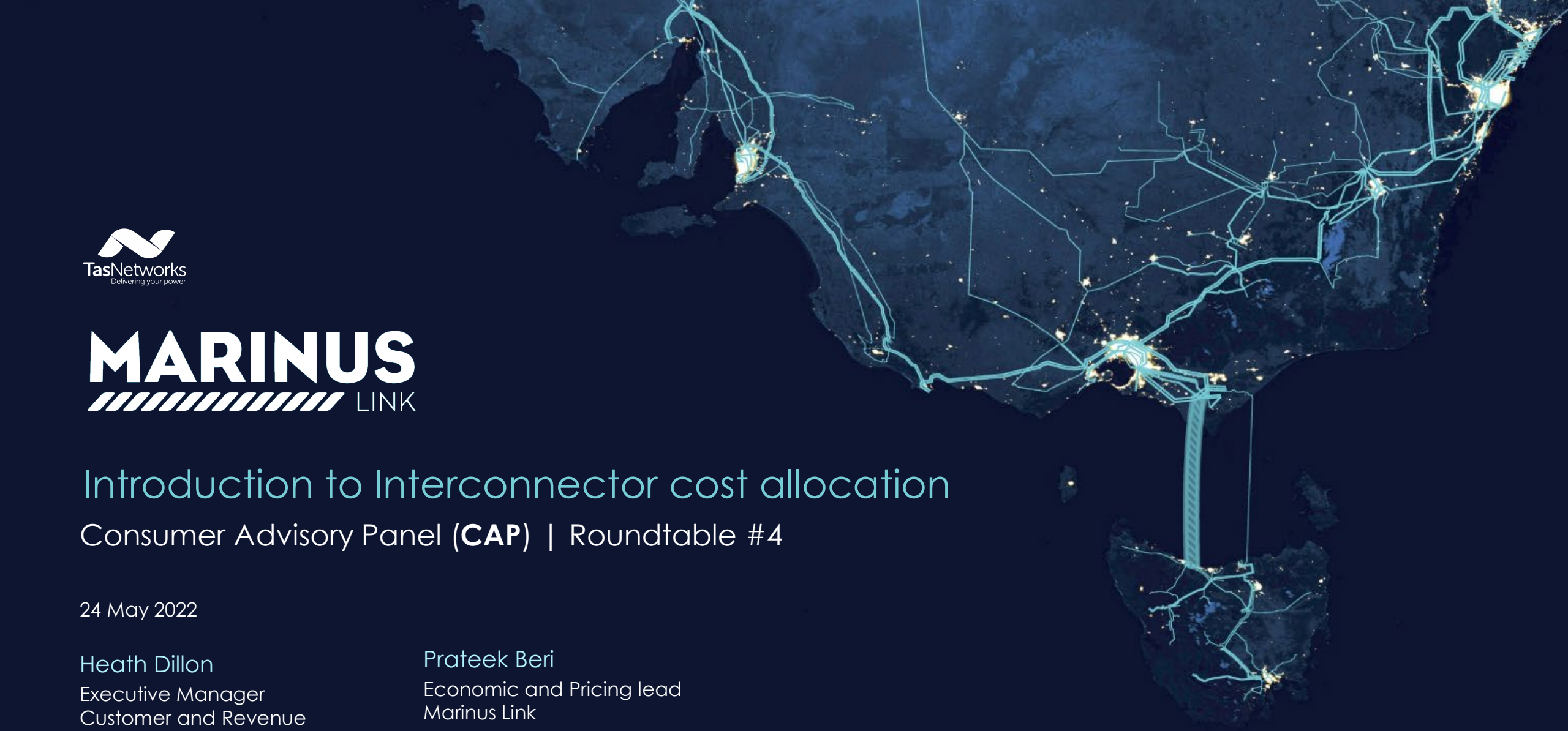

TasNetworks
Delivering your power

MARINUS LINK

Introduction to Interconnector cost allocation

Consumer Advisory Panel (**CAP**) | Roundtable #4

24 May 2022

Heath Dillon
Executive Manager
Customer and Revenue
Marinus Link

Prateek Beri
Economic and Pricing lead
Marinus Link

Acknowledgement of Country

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AGENDA

2:00pm	**Meeting Start** - Acknowledgement of Country - Introduction - Housekeeping
2:05pm	**Overview on Interconnector cost allocation**
2:50pm	**Q&A**
3:00pm	**Meeting close**

Next session
In person
30 and 31 May

Overview on ‘Who pays’ question

Heath Dillon, Executive Manager, Customer and Revenue
Prateek Beri, Economic and Pricing Lead

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4

Purpose

- The fair cost allocation of interconnector revenues (**Interconnector pricing**) is on the critical path for Marinus Link. This presentation provides an overview of the cost allocation issue and the work undertaken by Marinus Link Pty Ltd (**MLPL**).
- This presentation covers the following items:
  - Critical nature of Interconnector pricing to the project
  - Overview of the design flaws
  - Initiatives underway or completed to address this design flaws
  - Possible pathway forward
  - Potential timelines
  - Summary and next steps

While the project economics is settled, Interconnector pricing is on the critical path for Marinus Link

- The CAP has heard from industry experts on the economics of Marinus Link. This includes:
  - The Project Assessment Conclusions Report (**PACR**) in June 2021 that confirmed the economic case for the project with net market benefits in excess of $2.2 billion; and,
  - Owing to the ongoing pace of transition, the Draft ISP further strengthened the case for Marinus Link by classifying the project as an actionable project without decision rules. The Draft ISP also stated that the project is required **'in service as early as possible' and estimated $4.6 billion in net benefits**.
- The **resolution of Interconnector pricing** is now on the **critical path for Marinus Link**.
- The Wholesale Pricing Report, released with the PACR, also confirmed that the benefits of Marinus Link extend to the whole of the NEM.
- To commence the revenue setting process, **sufficient confidence is needed that pricing will be resolved (or on a clear pathway to resolution) this year**.
- The resolution of the transmission cost allocation issue is a **pre-condition for obtaining a revenue determination** from the AER, which must be in place prior to final investment decision (**FID**).
- To ensure that a 2028-29 in-service date is achievable, a FID must be capable of being made before December 2024.
- In the absence of a pathway for resolving the transmission cost allocation issue, optimal project delivery may not be achievable.

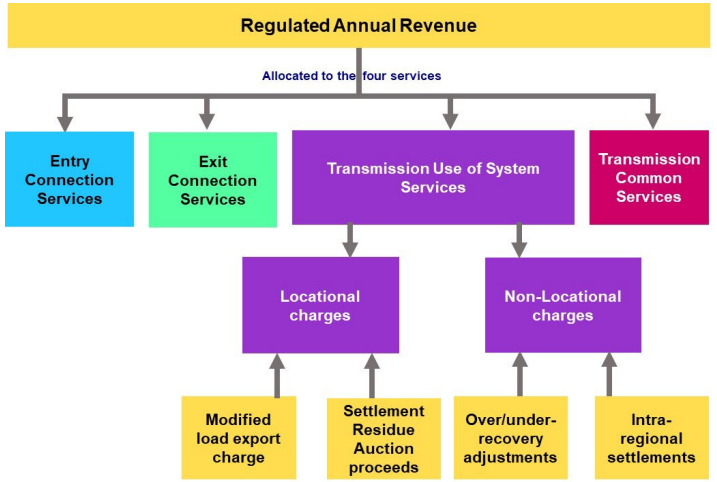
The Rules separate the investment decision from the ‘who pays’ question

Investment Decision
- Clause 5.15

Total Costs

Total Benefits

Transmission pricing
- Part J, Chapter 6A



The question of ‘who pays’ should be a transparent component of the investment decision, consistent with real world commercial decisions

Separation of ‘who pays’ from the investment decision doesn’t matter if….

1. The investment is relatively small compared to the existing regulatory asset base, so the price impact is modest; and/or
2. There isn’t a significant mismatch between those parties that benefit from the investment and those that pay for it - i.e. ‘the beneficiary pays’ principle is met

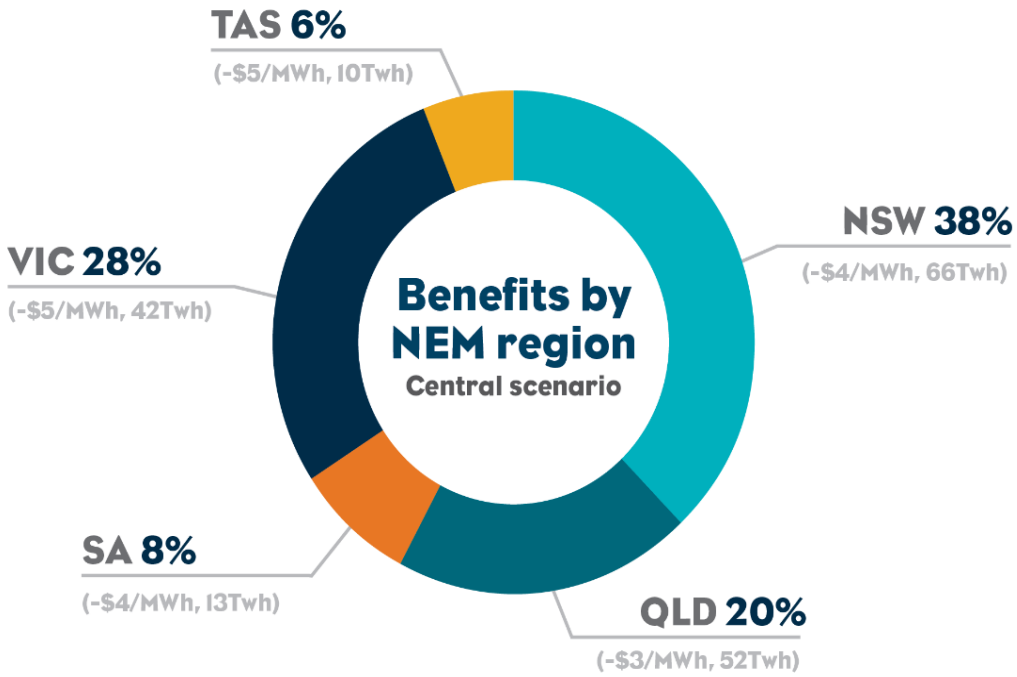
Historically, arrangements have worked well…..

… but Marinus Link has revealed a design flaws in the Rules

- **Marinus Link is projected to lower costs for all consumers** by unlocking cost-effective Tasmanian dispatchable generation as NEM continues to transition away from ageing thermal generation fleet.
- **Marinus Link is able to exert downward pressure on wholesale electricity price by introducing additional dispatchable capacity** that replaces other more expensive marginal generators.
- **Under current pricing framework**, while **Victoria and Tasmania** would pay for the cost of the interconnector, significant benefits are received by states not physically connected by Marinus Link.

Benefits by NEM region for Central Scenario

projected reduction in wholesale electricity price and annual energy consumption

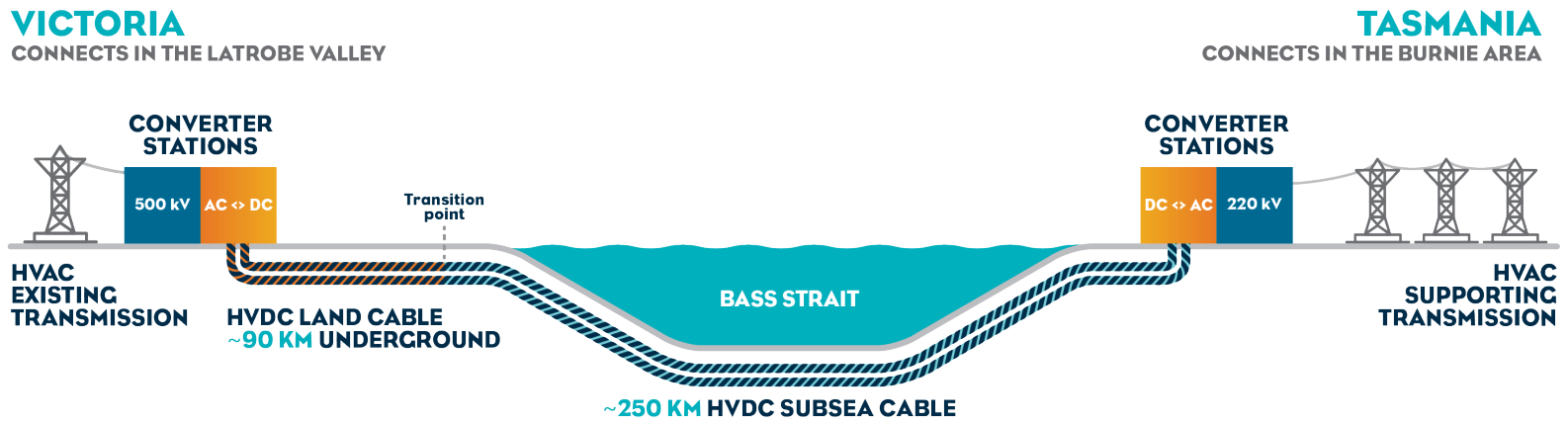


Precedence and pricing impact for Marinus Link

- Historically, initial cost allocation of interconnectors has occurred according to the geographical location of assets.
- For Marinus Link, a reasonable interpretation of the existing Rules is that they would result in an approximate 50/50 sharing of costs between Victoria and Tasmania (see next slide).
- The transmission cost for Tasmania is **expected to more than double under the current cost allocation approach**.
- The Marinus Link team has undertaken, and participated in various stakeholder initiatives, to highlight the current design flaws in the Rules and advocate for a fair and equitable outcome.
- Additionally, the geographical location of Marinus Link between the Victorian and Tasmanian NEM regions has not yet been determined, noting that the undersea cables will be located in Commonwealth waters.

Justification for 50/50 regional cost allocation of Marinus Link (Status Quo)

- The Status Quo would allocate Marinus Link and transmission assets based on state boundaries.[1] The annual revenues would be recovered by the jurisdictional pricing bodies (AEMO in Vic and TasNetworks in Tasmania) as part of annual regional transmission charges.
- A pragmatic approach to the cost allocation of the Bass Strait component of the HVDC cable is that it is equally split between the Tasmanian and Victorian regions.
- The resulting allocation based on geography is 50% to Victoria and 50% to Tasmania.



Marinus Link cost allocation ($2020, million)

	Tasmania	Victoria
Network upgrades	$550	$50
Converter stations	$600	$600
Bass Strait cable	$600	$600
Land cable	$0	$500
Total	$1,750	$1,750
Allocation	**50%**	**50%**

[1] It is assumed that the regional boundary between Victoria and Tasmania is set in the middle of Bass Strait, so the subsea cable cost is shared equally between states.

Overview of Interconnector pricing initiatives

- In December 2018, AEMC's Coordination of generation and transmission investment (**COGATI**) review considered the transmission pricing issue in a transitioning NEM, but ultimately its scope was reduced to not include interconnectors.
- In November 2019, Council of Australian Governments (**COAG**) Energy Council asked Energy Security Board (**ESB**) to provide advice on approaches to cost allocation for transmission.
- In the following month, TasNetworks published a Cost Allocation Discussion Paper. The paper was published alongside the Project Assessment Draft Report for Marinus Link. This paper advocated for a forward-looking beneficiaries modelling approach to identify the jurisdictions that would benefit from Marinus Link.
- In June 2021, we lodged a submission to the ESB's Post 2025 Market Design Options Paper, highlighting the potential value in reforming the current transmission pricing Rules. We therefore recommended that this issue should be included in the ESB's 'immediate reform' work program.
- The ESB's work informed a review now being undertaken by the Energy National Cabinet Reform Committee (**ENCRC**), which replaced the COAG Energy Council.
- Owing to the classification of discussions between States and Commonwealth as Cabinet in Confidence, limited information is shared but Interconnector cost allocation is currently classified as a priority by the ENCRC with an aim to deliver next steps by end of 2022.

Priority 2.b.iii[1]
reviewing the current cost allocation approach and suitability of those arrangements for inter-regional transmission

[1] Priorities, ENCRC (link)

Despite the various initiatives, limited progress has been made…

- MLPL continues to engage with the State and Commonwealth and other market bodies to support pricing reform through national review processes.
- However, owing to the limited progress on the resolution of interconnector pricing for Marinus Link, we believe that the **lodging of a Rule change proposal for revised cost allocation for Marinus Link** (rather than all interconnectors) may be the most viable and proactive means of bringing this issue to resolution.
- A whole of NEM reform for interconnector cost allocation is unlikely to be resolved in time for the Project's FID, therefore our preliminary view is seeking cost allocation solution for Marinus Link only.
- The overarching principles of a potential Rule change proposal and options being considered are outlined in the following slides.

‘Beneficiaries pay’ should be a guiding principle

- MLPL advocates for a beneficiaries pay principle as a means to resolve the ‘who pays’ question. In general, this principle achieves an outcome that is consistent with the National Energy Objective and recognised by the AEMC as an important principle:
  - Equitable and efficient
  - Adopted in other jurisdictions
  - Supported by consumer groups
- There are other important assessment criteria such as practicality, simplicity etc, but beneficiaries pay should remain the key guiding principle or assessment criterion.
- Consistent with the current market mechanism, our initial proposal would be for the cost recovery of Interconnector pricing to occur from the end-customer of the delivered energy. MLPL is not opposed to generators paying for transmission, but we believe this needs to be part of a major reform of the existing transmission access arrangements rather than just for Marinus Link.

Cost allocation approach – modelling and observable metrics

- The interconnector cost allocation approach could be based on beneficiaries modelling at the time of the investment decision and/or observable beneficiaries/data over the asset's life.
- Summarised below are the merits and shortcomings of each approach.
- Based on feedback from stakeholders, MLPL supports 'observed metrics' methods for beneficiaries pays, because relying exclusively on modelling beneficiaries can be complex, costly and open to interpretation.
- Overall, simplified methods are valid, providing that they reasonably reflect the distribution of benefits.

Modelled outcome approach

Benefits	Disadvantages
• Aligns the identification and revenue recovery from the modelled beneficiaries at the time of decision making • Large infrastructure decisions are commonly made on forecasts • Meaningful counterfactual case can be undertaken	• Modelling can be complex • Open to manipulation based on policy setting • Actual outcomes may be materially different to forecasts • Challenging to recalibrate the beneficiaries

Observable metrics approach

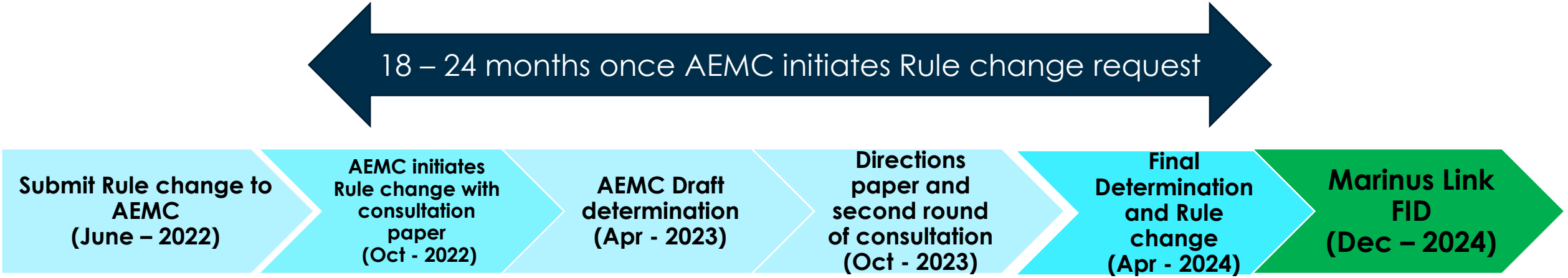
Benefits	Disadvantages
• Easy to compute • Better captures the possible evolution of the NEM and beneficiaries over time	• Beneficiaries allocation can be approximate

We will ensure our Rule change options promote the NEO…

- A Rule change can only be approved by the AEMC where it promotes the National Energy Objective (**NEO**); essentially, the new Rule will promote efficient investment in and use of network for the long term benefit of customers.
- Our Rule change option will be **drafted for Marinus Link** and supporting transmission **only**, however the AEMC/stakeholders could choose to apply it more broadly to future ISP interconnector projects.
- By allocating costs more fairly, customers in each region will obtain a net benefit from Marinus Link through lower delivered electricity costs (based on an assessment of transmission and wholesale energy cost impacts). This will allow the project to proceed and further promote the NEO.
- We are developing further advocacy positions and strategies for impacted NEM regions to support any rule change process.

Estimated timeline for a Rule change

- A conservative timeline for a rule change proposal process is outlined below and is based upon complex rule change processes such as the 5 minute settlement process and transmission review in 2013.
- The timeline outlined below could be shorter given the scope is limited to Marinus Link only.
- Once the final Rule is established, the AEMC may include a transitionary period so the Rule change does not disrupt any projects going through their regulatory process.[1]



[1] This would only eventuate in case the AEMC/stakeholders decided to broaden the Rule change proposal to include all actionable ISP interconnector projects.

Summary and next steps

- By MLPL submitting a Rule change proposal that is focused on Marinus Link, we hope to take a proactive role in supporting and seeking a resolution to the interconnector pricing matter.
- To date, there is no clear way forward to resolve the cost allocation model for Marinus Link, although governments might be working with the Energy Ministers through the ENCRC process. Any recommendations from the ENCRC process is likely to be incorporated into the Draft determination that AEMC might make in the Rule change process. It is also unclear how a change in Government will impact this process.
- We will hold a **detailed workshop with the CAP on the key issues of Rule change proposal** and options under consideration during our workshop on **May 30 and 31**.
- Pre-reading material will be provided prior to the workshop, so the panellist have additional information regarding the Rule change proposal.
- Engagement with the CAP and other stakeholders is on a pathway to seeking to lodge the Rule change proposal in **late June 2022**.

Q&A

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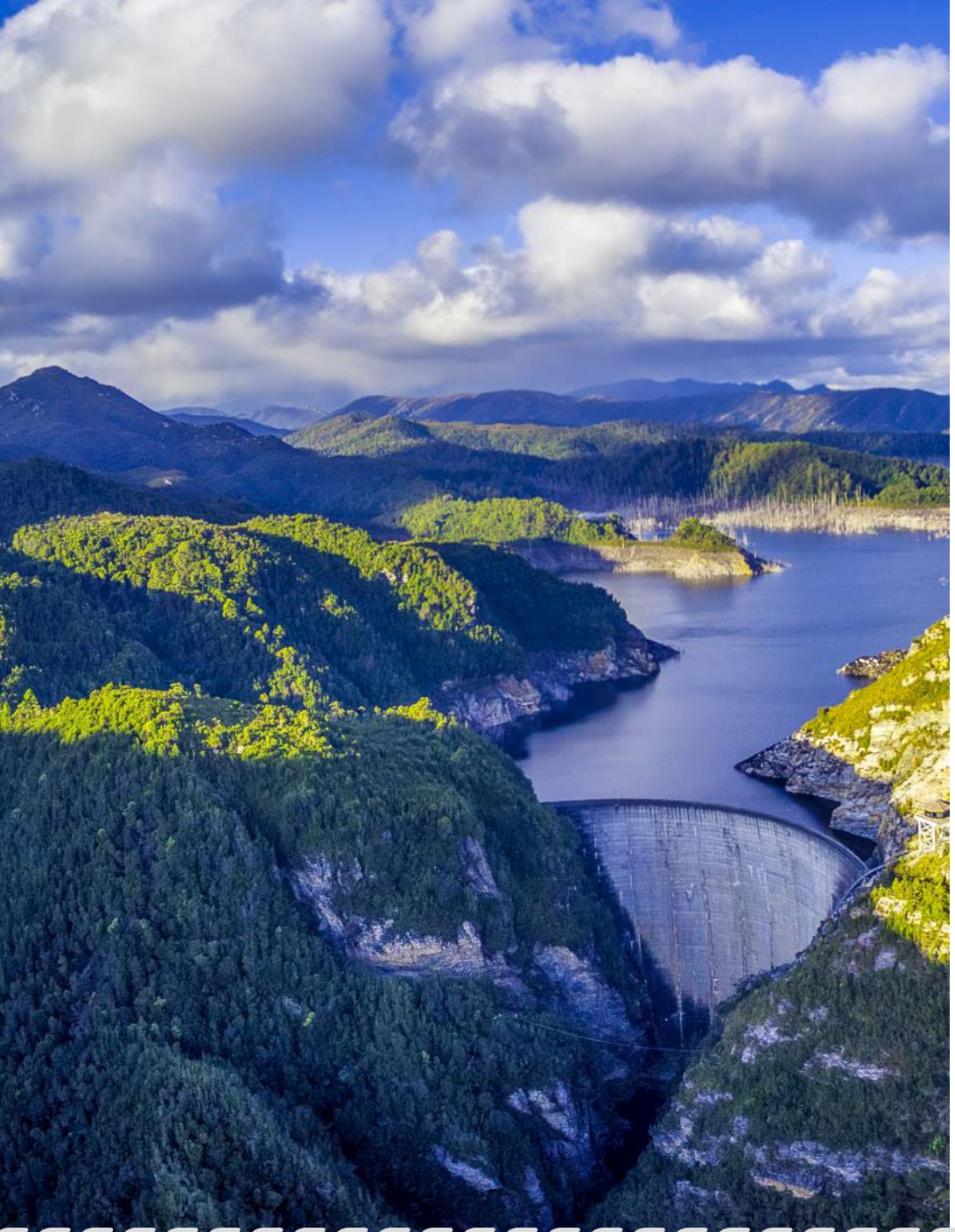

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