

20 September 2024

Australian Energy Regulator
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To whom it may concern,

RE Basslink Conversion Application Consultation Paper

TasNetworks welcomes the opportunity to respond to the Australian Energy Regulator's (AER's) Consultation Paper regarding Basslink owners', APA Group, application to convert Basslink from a market network service to a prescribed transmission service. TasNetworks is the primary Transmission Network Service Provider (TNSP) in Tasmania and expects to be the Coordinating Network Service Provider (CNSP) should Basslink become regulated.

Basslink has contributed significantly to the Tasmanian power system since its connection in 2006. Interconnection allows efficient transfer between Tasmania and the mainland, improving energy security and providing Tasmanian customers access to lower cost electricity.

As stated as part of our submission to the Basslink Issues Paper in February 2024, TasNetworks is particularly concerned about the impact that conversion would have on Tasmanian electricity customers. We agree with the AER's approach that the conversion test should be based on the costs and benefits of conversion.

However, TasNetworks does not consider the modelling is presented in a manner that articulates if the benefits of conversion outweigh the costs. It is not clear if the parties receiving and bearing the benefits and costs have been clearly identified.

TasNetworks appreciates the complexity and competing interests that the AER must manage in assessing the merits of conversion and we would like to provide the following comments for consideration.

- The counterfactual to conversion should be Basslink operating as a merchant link rather than a market interconnector traded by Hydro Tasmania;
- Given the uncertainty in the modelling, it is unclear if there are net benefits to conversion;
- The AER should consider the possibility of Basslink ceasing operation should it not be converted;

- The costs of conversion should be further scrutinised, including the transfer of costs to customers and impact of proceeds from settlement residue auctions.
- The AER should consider the timing of any proposed conversion and its relation to the annual pricing process; and
- TasNetworks supports a cost allocation between Tasmania and Victoria based on 'use'.

These points are expanded on below.

Counterfactual

The AER has considered two counterfactuals modelled under two different levels of Hydro Tasmania contract cover. Although the continuation of Basslink's agreement with Hydro Tasmania (**HT**) is a possible state-of-the-world, we do not consider it should be used as the base case against which to test the benefits of conversion.

Specifically, a continuation of the HT agreement is based on commercial decisions by HT and APA Group and is not guaranteed. Relying on this counterfactual could provide an unrealistic assessment of the benefits of conversion should it not eventuate.

TasNetworks notes that this approach is consistent with public statements from HT and APA Group, the parties best placed to comment on the probability of a continuation of the HT agreement.

TasNetworks also notes that the counterfactuals to regulation appear to assume Basslink continues to operate in perpetuity. As explained later in this submission, TasNetworks queries if this a realistic assumption noting Basslink's asset life and projected revenues.

Benefits modelling

In the market modelling report, ACIL Allen concluded that there were benefits to conversion compared to a counterfactual of Basslink operating as a merchant link. ACIL Allen has estimated the consumer benefits (based on the product of changes in projected electricity prices and consumer demand) and market benefits.

Although the modelling demonstrates gross consumer benefits to conversion compared to a merchant link, TasNetworks does not consider the method of determining consumer benefit is sufficiently robust to rely on for the conversion test. Although the modelling suggests downwards pressure on prices in most of the scenarios modelled, the actual quantum of this price decrease is uncertain. As stated by ACIL Allen in the report, given consumer benefits are calculated with reference to consumer demand, very small changes in power prices can result in significant changes to consumer benefits. This is clearly demonstrated in the modelling, where consumer benefits from conversion range from almost \$5 billion to negative \$19 million. As such, although the modelling is strong evidence that there are likely gross consumer benefits from conversion, it is not clear if these are net benefits given the uncertainty in the modelling.

ACIL Allen also concluded that there are market benefits associated with conversion compared to Basslink operating as a merchant link. Unlike the consumer benefits, the market benefits appear relatively stable across the different Marinus Link and HT contract cover scenarios. Given these benefits are presented as reductions in economic cost, it is not clear if these benefits are including (i.e. are net benefits) or excluding (i.e. gross benefits) the cost of conversion. It is therefore difficult to conclude if the market benefits exceed the costs to the market from conversion. Furthermore, the market benefits are expectedly low because of the

modelling assuming Basslink continues to operate regardless of its regulatory status. This is discussed further in the following section.

Revenue modelling

TasNetworks notes the benefit modelling assumes that Basslink will continue operating in the long term should it not be regulated. Based on the revenue forecasts modelled by ACIL Allen, it is not clear if Basslink will remain commercially viable following the establishment of Marinus Link. In this circumstance, TasNetworks considers it possible that Basslink will cease operating. This would likely result in a worse outcome for Tasmanian customers than if it were to be converted (and therefore continue operating).

Although TasNetworks agrees with the AER that the conversion test should consider the benefits of converting Basslink rather than the benefits of the asset, we are conscious that the outcome of the conversion decision may result in the asset no longer being available in the market. We expect this would materially impact the outcome of the conversion test. TasNetworks suggests that the AER consider the scenario of Basslink ceasing operation after the introduction of the first Marinus Link cable. This could be done as an alternative counterfactual in the model.

Cost of conversion

The AER has relied on the opening asset value (\$813 million) and ongoing operating costs (\$589 million) provided by APA to determine the cost of conversion (\$1.402 billion). TasNetworks agrees that this reflects the new prescribed transmission costs that customers would face in response to Basslink becoming a regulated asset. TasNetworks agrees with the AER and ACIL Allen that, in practice, this would be reduced by any proceeds AEMO receives from settlement residue auctions. However, similar to the consumer benefits, settlement residues are dependent on the electricity price and therefore difficult to predict. TasNetworks suggests the AER conduct further analysis on the expected reduction in costs to customers stemming from settlements residues. This should also be considered in assessing an equitable cost allocation between Tasmania and Victoria. We also note that although proceeds from settlement residue auctions reduce the cost to customers, they are not a market benefit and should not be considered when comparing market benefits to market costs.

Similarly, it is not clear from the AER's report if they consider the new prescribed transmission costs as an additional cost to the market or simply a transfer of costs to customers. TasNetworks does not consider that this has been clearly articulated in the report, which makes it difficult to determine if there are net benefits to conversion.

TasNetworks also notes that, under current arrangements, the costs of the Basslink System Protection Scheme (SPS) are not recovered from electricity customers through transmission charges. TasNetworks considers the AER should be aware that there could be different cost recovery arrangements for the costs of the SPS if Basslink is converted.

Conversion timing

The AER and impacted participants should consider the proposed conversion timing. If Basslink is converted, TasNetworks, as the CNSP, will be required to calculate transmission prices by 15 March each year reflecting the aggregate annual revenue requirement of all TNSPs in Tasmania. This will be based on, among other things, the maximum allowable revenue approved by the AER in their Final Determination on Basslink's' Revenue Proposal.

If the AER makes a Final Determination at the end of February 2025 as planned, it will be difficult for TasNetworks to incorporate the final regulated revenue allowance into transmission pricing on 15 March 2025 and engage with customers on 2025-26 pricing. If the conversion proceeds on the proposed timeline, TasNetworks will seek to rely on the AER's Draft Basslink Decision for 2025-26 annual pricing and then account for any differences in the Final Determination as part of 2026-27 pricing (i.e. as part of a true-up).

Cost allocation

TasNetworks understands that the Consultation Paper only concerns the cost and benefits of conversion, however notes that the cost allocation between Tasmania and Victoria is also a relevant consideration in understanding if there are net benefits to Tasmanians. TasNetworks suggests the AER also consider the locational aspects of the benefit modelling to ensure benefits are accruing to the parties that are ultimately paying for the conversion.

As stated in our response to the Issues Paper, TasNetworks supports an approximate allocation of 10% of the prescribed transmission costs to Tasmanian electricity customers consistent with APA's proposed cost allocation methodology based on total customer connections.

If you would like to discuss any aspect of this submission, please contact [REDACTED]
Regulation Specialist at [REDACTED]

Yours sincerely

[REDACTED]

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