

30 September 2024

Clare Savage
Chair, Australian Energy Regulator (AER)
Submitted via email: resetcoord@aer.gov.au

Dear Ms Savage

Basslink Conversion Application: Consultation Paper

Hydro Tasmania welcomes the opportunity to respond to the Australian Energy Regulator (AER) on the Basslink Conversion Consultation Paper.

The Consultation Paper outlines the AER's consideration of the costs and benefits of converting Basslink to a regulated interconnector. In particular, the Consultation Paper presents modelling of the National Electricity Market (NEM) undertaken by ACIL Allen for scenarios where Basslink is converted to a regulated asset or where Basslink remains a Market Network Services Provider (MNSP).

The AER is considering the regulation of Basslink during a period of significant change across the NEM. The market is shifting from electricity being predominantly provided by thermal baseload assets to an increased reliance on variable renewable energy (VRE) and storage, both of which Tasmania is ideally placed to provide from existing and planned generation assets. As demonstrated in AEMO's Integrated System Plan (ISP), investment in transmission and interconnectors is critical for providing lowest-cost, reliable and secure supply to electricity consumers.

Hydro Tasmania considers that converting Basslink from an MNSP to a regulated Transmission Network Service Provider (TNSP) would maximise its availability and accessibility to the market, thus promoting efficient dispatch of and investment in VRE, and ensuring equitable allocation of Basslink's costs to consumers. For these reasons, regulation would best achieve the National Electricity Objective (NEO).

Additionally, the conversion of Basslink to a regulated TNSP would align Basslink's arrangements with those of all other interconnectors in the NEM.

Likely Counterfactual

ACIL Allen modelled two counterfactuals to conversion to show the range of possible benefits:

- Basslink operates as an unhedged merchant interconnector; and
- Basslink's owner contracts its capacity to Hydro Tasmania under a contract which is authorised by the ACCC.

Hydro Tasmania considers that a future services agreement between Basslink and Hydro Tasmania for the full interconnector capacity for the next 25 years is unrealistic, thus an unreasonable counterfactual to regulation, because:

- The current services agreement between Basslink and Hydro Tasmania expires at the earlier of the date that Basslink is converted and 30 June 2025.
- Although Hydro Tasmania has previously acknowledged that if conversion does not occur it is possible the agreement may be extended, there is no certainty that the parties would seek an extension or reach agreement on its terms. The growth of VRE in Tasmania and Victoria will diversify participation in the generation market thus diluting participants' incentive to become a counter-party to an agreement with Basslink for the remainder of the asset's life.
- The modelled agreement between APA and Hydro Tasmania assumes ACCC authorisation is applied for and obtained for 25 years. The expected growth of VRE and additional interconnection makes this an implausible assumption.

Therefore, the unhedged merchant Basslink scenario is the most appropriate counterfactual for the AER to use in assessing the benefits of conversion. Clearly, market participants including Hydro Tasmania and Basslink would have some incentives to contract with each other under continued merchant operation, to increase mutual certainty of market revenues and reduce commercial risks. However, those incentives would likely result in much shorter, diverse and partial contract cover than a 25-year agreement with Hydro Tasmania, particularly as the growth of VRE increases transaction costs and free rider incentives.

Benefits of conversion

Hydro Tasmania encourages the AER to make qualitative assessments of the benefits of conversion. This would recognise the limitations and uncertainties of modelling and would be consistent with the approach taken by the ACCC in considering the Murraylink conversion. The ACCC accepted the qualitative public benefit argument put by Murraylink as to why discretion should be exercised to allow conversion.

In the case of Basslink, the benefits of conversion include:

- **Efficient generation dispatch and interconnector utilisation:** Regulation of Basslink will maximise its accessibility to the market, resulting in the most efficient dispatch of generation and higher interconnector flows than under merchant operation.
- **Continued operation under Marinus Link:** ACIL Allen notes that if Basslink is operating as an MNSP then it "may struggle to meet its operating and maintenance costs if both stages of Marinus are developed. In those circumstances, Basslink may face financial pressure to exit the market". Were Basslink to withdraw from the market, this would be a perverse and inefficient outcome.
- **Equity in cost recovery:** Regulation ensures that costs are distributed across the beneficiaries of the interconnector's services, aligning with the NEO.
- **VRE investor confidence:** Given that regulation would provide the greatest certainty of Basslink's accessibility and operating life, it would maximise investors' confidence to develop renewable energy projects in Tasmania and Victoria. It is important to provide that confidence soon and for as long as possible, given the long development and investment horizons of VRE proponents.

- **Asset performance:** Under regulation, the certainty and stability of Basslink’s revenues relative to merchant operation would provide a superior funding base for good asset management, and its operational performance would be subject to regulatory oversight and targeted financial incentives. These factors would ensure that it remains a more secure and reliable asset over its operating life.

Conversion would also ensure consistency in rule application, settlement processes, and dispatch and bidding mechanisms across all NEM interconnectors. This would increase efficiency for entities that operate in multiple regions and regulatory bodies such as AEMO.

Reliability considerations

The merchant model does not provide the certainty needed to ensure the efficient, reliable and durable operation of a vital transmission asset.

A merchant Basslink owner is incentivised to maximise profit using the bidding tools available to it which provides no certainty of when its capacity would be available. This can materially reduce system reliability, as evidenced during the market events that took place in June 2022. At that time Basslink was operating as a merchant interconnector, as it did not have an agreement with Hydro Tasmania, and reduced its export capacity to zero¹. The consequence for the market was reduced reserves from Tasmania flowing into Victoria at a time of critical supply shortages. Although past behaviour is not indicative of future behaviour, the example demonstrates that the risk of market disruption under a merchant scenario is real and so should be given due consideration.

Basslink’s capacity above Tasmania’s generator and load contingency bands (144MW and 200 MW respectively) is only available with continued operation of the central Frequency Control System Protection Scheme (FCSPS) and the procurement of large quantities of Tasmanian load and generation for tripping. Conversion provides an opportunity to the AER to assume oversight over the arrangements for this scheme and provide the market with greater certainty of its continuation. Under merchant operation, incentives may change. For example, if tripping is not procured this would effectively result in a reduction in either or both of Basslink’s import and export capacity. Accordingly, Hydro Tasmania does not consider the assumption utilised in ACIL Allen’s analysis of Basslink’s full capacity being maintained consistently in all scenarios is reasonable.

If you would like to discuss any aspect of this submission, please contact John Cooper

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Yours sincerely

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Richard Bolt
Chairman

¹ AEMO. [NEM Market Suspension and Operational Challenges in June 2022](#). August 2022