

Australian Energy Regulator Basslink Conversion Application Consultation Paper

Comments from

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Background

Before considering the consultation questions raised by the Australian Energy Regulator (AER) in its consultation paper, I wish to make the following observations. I note that the AER has stated in its consultation paper that:

“a number of stakeholders sought assurance that any benefits of conversion demonstrably exceed any costs.”

While not denying the validity of requiring assurance that the benefits of conversion exceed the costs, it must be recognised that Marinus Link, based on its initial RIT-T submitted in June 2021, has been declared a regulated transmission link. Marinus Link has also been identified by AEMO, in its latest Integrated Systems Plan (ISP), as a required piece of infrastructure to meet the growing demand for electricity as coal generation retires and renewable energy zones (REZ) increasingly meet that growing demand.

As such the conversion of Basslink cannot be considered in isolation of these findings by the AER in relation to Marinus Link and its decision that Marinus Link be a regulated link.

The AER further state that:

“If BassLink is converted consumers will face new regulated transmission charges relating to Basslink’s services.”

Such charges will be analogous to consumer charges that will be applied to Marinus Link. The AER also states that:

“These regulated transmission charges may be offset by any inter-regional settlement residues that can be auctioned if Basslink is regulated (if Basslink is not regulated then these residues are the merchant trading revenue). The size of any inter-regional settlement residues is highly uncertain, but they could be significant.”

As a network services provider, Basslink has been operating for a considerable period of time. Over that period Hydro Tasmania have been paying a usage charge and, as identified above, benefiting from the merchant trading revenues. It can only be presumed that the use of Basslink has delivered a net positive return to Hydro Tasmania. If this presumption is incorrect then the operation of Basslink cannot be presumed to have offered any benefits to consumers in the National Electricity Market (NEM) and the benefits of any future interconnection must be seriously questioned.

Had Hydro Tasmania incurred an on-going loss in relation to its Basslink activities then either its wholesale electricity prices to consumers would have been higher, or its returns to its owner lower, or a mixture of both. This would not have been a net benefit for consumers in the NEM.

Underlying this presumption that Basslink has delivered a positive return to consumers are the various studies undertaken as part of the APA assessment in relation to the conversion of Basslink and also the assessments undertaken by Marinus Link PL. These studies show that the savings in electricity costs outweigh the costs associated with these two links for consumers.

Clearly, the assessment that a positive return can be delivered to Marinus Link, while at the same time consumers receive a price benefit that offsets the regulated costs of Marinus Link, must have been fundamental to the decision by the AER to accept the proposal from Marinus Link to be a regulated link.

In this regard it is noted that the AER has also stated that:

“ACIL Allen has estimated net market benefits in each scenario. This assessment of market benefits is akin to the approach taken to assessing benefits in the RIT-T.”

The analysis by ACIL Allen has identified that its *“modelling suggests changes in market costs may be small”* relative to the total market costs. The counterfactual to this finding is that it is highly unlikely that the costs of conversion will have a significant impact on total market costs. This finding is supported by the proposed consumer charges identified by APA in their submission, which when offset against the potentially significant inter-regional market settlement returns, could result in net consumer costs significantly lower than the regulated level identified by APA in their submission.

The ACIL Allen modelling also indicates that the size of the market benefits will be determined by the possibility of an agreement between Basslink and Hydro Tasmania. In the consultation paper the AER state:

“If the counterfactual to conversion is an unhedged merchant Basslink the estimated market benefits range from \$146 million to \$210 million (\$2024). If the counterfactual is an agreement with Hydro Tasmania the estimated market benefits range from -\$8 million to \$3 million (\$2024).”

These are substantial market benefits resulting from conversion and APA have clearly indicated during its consultation with members of the RRG that it should not be presumed that, should the conversion application for Basslink not be supported, it would re-enter into an on-going agreement with Hydro Tasmania.

As a result, the ACIL Allen scenario offering the very low, and perhaps negative, market benefits from conversion can perhaps be considered as a highly unlikely outcome. It is more likely conversion will deliver market benefits at the higher end of the range estimated by ACIL Allen.

It is also noted that this variable, whether or not there is an agreement between Basslink and Hydro Tasmania, appears relatively less significant and more varied than other modelled variables.

The modelling undertaken by ACIL Allen has led them to conclude *“the extent to which consumers might be expected to face lower wholesale prices as a result of conversion is highly uncertain.”* This conclusion must be weighed against the assessment already made by the AER in relation to Marinus Link where it has been already accepted that interconnection of Tasmania with the eastern states’ grid will deliver significant wholesale price benefits.

The AER in its consultation paper states that the *“estimated price effects range from \$3,500 million to -\$164 million (\$2024).”* It would seem that the use of the words “highly uncertain” by ACIL Allen relate to the wide range in consumer benefits across the scenarios modelled. While there is a significant range, and as stated much larger than the range associated with whether or not an agreement is reached with Hydro Tasmania (the market benefits which range from a high of \$210 million to a low of \$-8 million), it indicates that the outcome will likely be significantly positive, unless of course the distribution of results are substantially skewed towards the lower number.

Considering the data provided in Figure 6 on page 22, it would appear that most scenarios assessed by ACIL Allen will provide market benefits which offset the cost estimates provided in Table 2 on page 17. This outcome aligns with that concluded by the AER in response to the Marinus Link RIT-T.

Concluding Comments

However, when it comes to its conclusion, the AER appears to have focussed on the following statement from ACIL Allen:

“ACIL Allen’s report states that the level of wholesale price benefits is highly uncertain, and should be considered in the context of the highly certain prescribed services costs consumers will be required to pay should Basslink be converted. It also states that “Basslink’s conversion may also have long term market benefits, and model outcomes suggest a more certain level of these benefits, but these are unlikely to exceed the costs of the prescribed services, should Basslink be converted.”

This conclusion by ACIL Allen seems to be at odds with the conclusions reached by the AER when considering the Marinus Link project. ACIL Allen appear to have placed considerable weight upon some of the scenarios which result in negative outcomes for consumers and negative market benefits relative to other scenarios which appear, based upon their modelling, to deliver substantial consumer and market benefits.

The AER then finalise their conclusion with:

“Given that the net benefits of conversion are highly sensitive to assumptions, particularly regarding future states of the world we are seeking stakeholder views and evidence to support our consideration of the costs and benefits relating to the conversion of Basslink to a prescribed transmission service.”

As a stakeholder representative, via my membership of the APA Basslink RRG, I am only in a position to reflect upon the information which is being provided by the various analyses presented by a range of consultants in relation to both Basslink and Marinus Link, and the decisions already taken by the AER, and also AEMO, as a consequence of those analyses.

What seems clear is that it is extremely difficult to model future wholesale price outcomes in the NEM.

However, despite this uncertainty around future wholesale prices, which ACIL Allen have stated has the highest impact on consumer benefits derived from the conversion of Basslink, a decision has already been made by the AER in respect of Marinus Link, based on its initial cost estimates.

I recognise that this decision will be updated as the cost estimates for Marinus Link are refined, but in the context of this decision on the conversion of Basslink, the cost estimates provided in the Marinus Link RIT-T are in a similar range for those put by APA in its submission. The Marinus Link RIT-T proposed a cost for the 1500 MW dual interconnector of around \$3 to \$3.5 billion. On a per MW basis this compares favourably with the \$800 million to the \$1 billion Regulated Asset Base (RAB) being sought for Basslink.

As a volunteer, I do not have access to the sophisticated modelling tools used by ACIL Allen, Ernst Young, FTI Consulting, the AER and AEMO nor the inside knowledge available to APA. I can only consider the results presented to consumers in public documents and then provide an assessment in relation to the conversion of Basslink.

The following can be concluded from work undertaken in relation to these two interconnectors, one already existing and one proposed:

- 1) The Marinus Link RIT-T indicates a cost structure, on a per MW basis, very similar to that proposed by APA for Basslink;
- 2) Modelling carried out for both Basslink and Marinus Link by EY indicates significant market benefits from interconnection;
- 3) Modelling undertaken by FTI Consulting, and provided to the AER as part of the documentation in relation to Marinus Link, indicates a significant wholesale price benefit for consumers from the first Marinus Link cable. This result seems to align with the upper end of the ACIL Allen modelling results;

- 4) The second Marinus Link cable delivers lesser, though still positive and considerable, wholesale price benefits for consumers;
- 5) This outcome from the Marinus Link modelling implies that even when the interconnection capacity is doubled there are still considerable consumer benefits available;
- 6) The AER has concluded, based on the Marinus Link RIT-T submitted in June 2021, that Marinus Link should be a regulated link;
- 7) AEMO have concluded that Marinus Link is important as part of the development of REZs within the NEM in order to meet emerging electricity demands;
- 8) The ACIL Allen modelling indicates that the changes in total market costs from a decision to convert Basslink to a regulated link are likely to be small;
- 9) It is most likely that the market benefits of conversion for Basslink will be aligned to those scenarios associated with the highest levels modelled by ACIL Allen;
- 10) The low and negative market benefits from conversion which are associated with scenarios where there is an agreement between Basslink and Hydro Tasmania can be discounted based on statements made by APA during its consultation that this is not their preferred way forward;
- 11) ACIL Allen modelling highlights that the consumer benefits associated with wholesale price outcomes, while varying across a wider range, are significant;
- 12) The data that is provided by ACIL Allen on the distribution of modelling results appear to align with the modelling carried out for Marinus Link, and show a higher likelihood of a positive consumer benefit than a net consumer cost from regulation;
- 13) Underlying this consideration are the significant modelled consumer benefits associated with the construction of the second Marinus Link cable;
- 14) While such consumer benefits are lower than for the first Marinus Link cable, they are still positive, leading to the conclusion that Basslink provides even higher, and perhaps more likely, wholesale cost savings than Marinus Link provides;
- 15) The current merchant trading revenues received by Hydro Tasmania are perhaps more likely to deliver a positive return to Hydro Tasmania from its Basslink trading activities than a net loss; and
- 16) That while there will be an explicit consumer cost associated the regulation of Basslink, this cost will be offset by highly uncertain, but potentially significant, inter-regional settlement revenue.

Like any assessment based upon the sophisticated modelling, one must weigh the uncertainties. However, given all the data I have been able to assess in relation to interconnection of Tasmania with the NEM, the most likely outcome, based upon the various consultant reports into interconnection, appears to be a positive benefit for the NEM as a whole and for Tasmanian consumers in particular.

In reaching this assessment I recognise there are scenarios which deliver lower, and perhaps negative outcomes. However, the evidence presented indicates these scenarios are less likely to result than those that have been estimated to deliver positive benefits.

Attachment 1

Questions for stakeholders

1. What are your views on the types of potential costs and benefits that conversion may provide?

Conversion will primarily impose a direct cost upon consumers by way of the regulated revenue which will be applied to their bills as part of the overall transmission and distribution component of those bills.

Conversion also has the potential to have the above costs offset by the level of inter-regional settlement revenues which flow to the transmission network service providers (TNSPs) in each jurisdiction.

Interconnection is also likely to confer market benefits where access to better renewable resources is provided, such as Tasmania's hydro electric system and its superior wind resource. Market benefits can also flow from reduced use of gas generation in the NEM. The EY reports into both Marinus Link and Basslink provide additional insight into more minor market benefits associated with interconnection.

Consumer benefits will primarily flow by way of access to lower wholesale prices.

2. If the range of outcomes across scenarios remains wide or subject to significant uncertainty, would you support a decision to convert or a decision not to convert? What is the rationale for this position?

As has been identified by ACIL Allen in its modelling there are indeed wide ranges and uncertainty across the various scenarios modelled. However, as I have discussed above, this information provided by the ACIL Allen modelling must be weighed against other information available. For example, based on statements provided by APA the modelling results which indicate low or negative market benefits can be discounted. As a result greater consideration should be given to those modelled market benefits at the higher end of the range.

Similarly, in relation to the very wide range of modelled consumer benefits associated with wholesale price outcomes, consideration must be given to the likelihood of the various scenarios. Each scenario is not equally likely. In addition, it is noted that both the AER and AEMO have noted the significance of Marinus Link to the NEM. The AER have agreed to it being a regulated link based upon its initial RIT-T which is based upon a cost basis similar to the requested RAB for Basslink.

Modelling carried out by FTI Consulting for Marinus Link PL shows that there are considerable consumer benefits available from the construction of not just the first cable, but also the second cable. These modelling results from FTI Consulting would suggest that the consumer benefit outcomes modelled by ACIL Allen which show low, or even negative, consumer benefits should be significantly discounted.

The modelling results from ACIL Allen showing higher levels of consumer benefit appear to be more aligned with the consumer benefit outcomes accepted by the AER in their decision to support that Marinus Link be a regulated link.

On the basis of:

- all the modelling which is publicly available for both Basslink and Marinus Link;
- the decisions already made by the AER and AEMO in relation to Marinus Link; and

- statements made by APA during its consultation process

it would appear that those modelling results provided by ACIL Allen showing low or negative consumer and market benefits are less likely outcomes and the outcomes associated with the higher market and consumer benefit estimates are more likely.

This rationale would support a decision to convert Basslink to a regulated interconnector. A decision to not support regulation of Basslink would raise questions around the validity of the current decision relating to Marinus Link. It would also highlight the need for the AER to provide a clear demonstration that a regulated Marinus Link operating alongside a market based Basslink delivers the best outcome for consumers within the NEM.

Basslink cannot be considered in isolation of decisions made in respect to Marinus Link.

3. What degree of significance should we place on outcomes from market modelling when considering possible benefits of conversion? What other inputs should feature in our decision making?

Obviously, the market modelling undertaken by EY, FTI Consulting and now ACIL Allen will play a very significant role in making a decision on the conversion of Basslink. In considering the modelling by the various parties, the underlying scenarios used and assumptions adopted must also be considered and weighting placed upon the likelihood of alternative parameters.

The AER should be guided by its decision processes in relation to other mainland interconnectors which have sought conversion and its approach to new interconnectors which are either under construction or considered to be priorities within the AEMO ISP.

The modelling undertaken by ACIL Allen indicates that the results for both market and consumer benefits vary across a wide range. In such cases the AER should give consideration to the distribution of such results. While the results show significant benefits at one end of the range, at the other end the benefits assessed, while negative are quite small. Given the distribution of results shown in the Consultation Paper, the expected outcome is most likely to be significantly positive. This is especially the case in regard to the modelled market benefits, given statements provided by APA in relation to certain scenarios which deliver poor outcomes.

The AER should also give consideration to how a market based link can exist alongside a regulated link and the impact of this on the optimal return to infrastructure under-pinning the NEM. In this regard the AER should give careful consideration to the relative benefits flowing from the second Marinus Link cable and its impact on the underlying value of Basslink.

4. In modelling possible outcomes, we have modelled a range of different scenarios encompassing the future role of Marinus Link. What are your views on the likelihood of Marinus Link being constructed, the number of Marinus Link cables that will ultimately be constructed, and the timing of any construction? What weights would you place on these different possible outcomes for Marinus Link?

Given the Commonwealth government's major holding in Marinus Link, and the role this interconnector plays in opening up access to renewable energy and storage resources in Tasmania I consider that it is highly likely that the first Marinus Link cable will be constructed.

The business case for the second cable will most likely rest upon the success of the first cable. As such the first cable is likely to be constructed within a timeframe leading up to

2031 or 2032. The second cable, if a decision is made to proceed, may be delayed until 2035 at the earliest.

A high weight should be placed upon the construction of the first Marinus Link cable. However, a significantly lower weight should be placed upon the second cable being constructed due to a wide range of factors including:

- what the NEM looks like post 2030;
- the impact of the second Marinus Link cable upon Basslink;
- the cost escalation likely in relation to the second cable; and
- technological advancements in storage and its cost over the next 6 to 8 years.

5. In modelling possible outcomes, we have modelled a range of scenarios for the likelihood of Basslink entering into agreements with Hydro Tasmania and the level of contract cover. What are the most likely future states of the world with respect to these issues and what is the reasoning for your position?

The AER should be guided by statements made by APA in respect to this aspect of its consultation paper.

I have also noted the statements made by the Victorian Government in this regard which are outlined on page 8.

6. To what degree do you consider that reliability and/or security of supply risks may be different if Basslink is converted, relative to Basslink operating as a MNSP?

As a regulated link, with a regulated income stream, it is likely that Basslink will have improved reliability and security of supply. The costs of these elements are being built into the regulated cost base. As a market link the possibility of changing market conditions could potentially result in cost pressures on Basslink which impact on its reliability and ability to deliver a secure supply of electricity.

In this regard, regulation could be seen as part of an insurance policy to ensure Basslink maximises its contribution to the NEM.

7. Are there any additional, material factors that we should consider in the analysis?

My answers to the questions above, together with my statement leading into these answers completes the comments I wish to make in regard to the consultation paper.