Department of State Growth
RENEWABLES CLIMATE AND FUTURE INDUSTRIES TASMANIA

Office Address
GPO Box 536, Hobart TAS 7001 Australia
Ph 1800 030 688
Email info@stategrowth.tas.gov.au Web www.stategrowth.tas.gov.au
Your Ref ERC0383/Our Ref D24/237050

Tasmanian Government

Dr Kris Funston
Executive General Manager
Australian Energy Regulator
GPO Box 3131
CANBERRA ACT 2601

Dear Dr Funston

RE Basslink conversion consultation paper

I am writing on behalf of the Tasmanian Government in response to the AER's call for submissions on the August 2024 Consultation Paper on the Basslink Conversion Application.

Tasmania welcomes the publication of the ACIL Allen modelling because it provides an analytical lens that was previously missing on the potential benefits of regulation relative to other counterfactuals. The modelling provided by APA in its conversion application gave an insight into market outcomes with and without Basslink but did not examine the counterfactuals to regulation. The ACIL Allen modelling addresses that gap.

Tasmania considers it appropriate that, through the Consultation Paper, the AER seeks input from stakeholders on the modelling outputs and on the weight that it might be given by the AER in informing the conversion question prior to the AER making its draft determination.

As noted in the Tasmanian Government's submission on the Issues Paper, Tasmania's overall position is that Basslink's regulation is in the best interest of Tasmania, and the NEM more widely. Conversion would bring surety to the sustainable and open flow of electricity between Tasmania and Victoria, which is an essential element of the national energy transition, and particularly important for energy security in Tasmania ahead of Marinus Link. Regulation provides an open, transparent process for driving those outcomes, and enables all interested parties to provide input on important regulatory considerations.

If, alternatively, Basslink was to continue as a MNSP, flows of electricity between the two states would be at the control of Basslink, and would be driven by profit maximisation incentives, rather than by the interactions of the two spot markets with Basslink playing an equalisation function.

Tasmania has always wanted Basslink's owner to operate the interconnector efficiently and effectively and to continue to invest in the asset to ensure its ongoing sustainable operations – in the first instance to its original design life of 40 years (until 2046), and potentially beyond.

Economic regulation by the AER, through transparent and open processes, provides the path to ensure Basslink's electricity transfer capability remains fully and readily available to the market and that its ongoing efficient operations (including necessary capital investments) are delivered in the long-term interests of Tasmanian energy consumers, as well as customers in the NEM more widely.

The broad conclusion that can be taken from the ACIL Allen modelling is that there is a robust case for Basslink's regulation from the perspective of modelled customer benefits and assumed customer costs. ACIL Allen finds that:

- under the no-Marinus counterfactual, the modelled consumer benefits of regulation are broadly double the modelled gross customer costs (i.e. excluding the potential value of SRA proceeds[1]), and around ten times the net customer costs (when the potential value of SRA proceeds are taken into account, offsetting the gross regulated costs).

- Under the Marinus 1 only scenario, the modelled consumer benefits of regulation are around 1.5 to 2.4 times the gross costs to customers, with one of the scenarios showing no consumer benefits from regulation relative to that counterfactual (that being the combination of a highly contracted Hydro Tasmania and there being an enduring and long-term arrangement providing Basslink bidding rights to Hydro Tasmania). When modelled SRA proceeds are considered, the net benefits to customers rise to 3.8 to 5.8 times net customer costs under the three (of four) modelled scenarios.

- Under the Marinus 1 and 2 scenarios, only one of four scenarios (Merchant Basslink and a higher level of Hydro Tasmania contract cover) has modelled customer benefits of regulation higher than gross customer costs, but when net customer costs are considered, three of the four scenarios deliver net customer benefits.

The Consultation Paper highlights ACIL Allen's caution that the modelled price effects of conversion are highly sensitive to wholesale price levels, and this is recognised by Tasmania. However, given the scale differences between the modelled net costs of Basslink to customers under regulation and the modelled benefits (as highlighted above), even with a conservative factor applied to the modelled customer benefits to account for uncertainty, the modelling presents a solid case to support Basslink's regulation (noting that final costs will be determined by the AER through the revenue determination process, and that process is yet to be finalised).

The primary scope of this submission on the Consultation Paper is on the counterfactuals modelled by ACIL Allen and the weight that the AER should give to those modelling outcomes.

The issue of cost allocation is highly important to Tasmania, and the appropriate place to take that matter up is in response to the AER draft determination, scheduled for November 2024. However, Tasmania notes and welcomes the conclusion reached by the AER in the Consultation Paper that the market-size methodology proposed by APA in its application (which was founded upon its consultation process with customers in both Victoria and Tasmania), is permissible under the NER. As noted in the Tasmanian Government submission on the Issues Paper, this is the approach Tasmania considers should be adopted, because of the importance on equitable outcomes for customers in Tasmania and Victoria.

Counterfactual issue one – Marinus Link

Unsurprisingly, the modelling demonstrates that the greater the option for transmission between Tasmania and Victoria from sources other than Basslink, the less the scope for opportunity for transport bidding by Basslink, and consequently, the lower the modelled benefits of regulation relative to counterfactuals that involve transport bidding.

Tasmania, Victoria, and the Australian governments are unquestionably working towards an outcome that would see the first 750MW phase of Marinus commissioned in 2030. That said, there will need to be a final investment decision (FID) made by the three jurisdictions on the future of the project, and

[1] Using the assumption that 75 per cent of the modelled IRRs under a scenario are delivered as SRA proceeds and assuming that all SRA units are sold (as flagged in the Consultation Paper). Whether that level of SRA clearance occurs in the specific context of Basslink cannot be known.

this is currently scheduled for May 2025. From Tasmania's perspective, the work currently being undertaken on the Tasmanian Whole-of State Business Case will be a critical element informing the Tasmanian Government's Marinus FID decision.

This means that at the time of the AER's draft and final determinations (on the current schedule), there will not be a confirmed FID for Marinus 1. In that context, the possibility of a no-Marinus outcome must be given some weight in the AER's conversion assessment. This counterfactual was modelled by ACIL Allen, but not given as much prominence in the Consultation Paper as the single and dual Marinus link counterfactuals.

The second phase of Marinus remains on the ISP path (2032[2]), and similarly, there will be no clarity on its status for the AER's draft and final determinations on Basslink's conversion. It is accurate to say that arrangements for Marinus 2 are not as fully progressed as that for Marinus 1, and that if the AER was seeking a 'central case' for utilising the ACIL Allen modelling, it would be more appropriate to focus on Marinus 1, with some weight given to the Marinus 1 and 2 scenario (in addition to weight being given to a no-Marinus possibility).

Counterfactual issue two – an enduring agreement between Basslink and Hydro Tasmania

It is appropriate that the ACIL Allen modelling exercise seek to gain insights into the potential implications of an enduring agreement between Hydro Tasmania and Basslink as a potential counterfactual to Basslink's regulation.

As noted in the Consultation Paper, for the purposes of modelling, the AER has simply assumed that "under the 'Basslink agreement with Hydro Tas counterfactual, Hydro Tasmania has the right to dynamically trade Basslink's capacity (in a manner authorised by the ACCC)" (p.9).

While that may be a reasonable assumption to take in terms of developing a modelling approach to gain analytical insights into the potential market outcomes of such a situation, it is very much a simplifying assumption that needs to be questioned for the purposes of determining the weight to be given to the modelling outcomes of such a scenario in the conversion decision.

The apparent weight being given to the possibility of there being an enduring agreement appears at least partly to be predicated on the fact that the Basslink Services Agreement (BSA) was in existence from the period Basslink commenced operations in 2006 until it went into receivership in 2022. For example, as noted in p.8 of the Consultation Paper, the Victorian Government submission on the Issues Paper said:

> *Past behaviour confirms that both parties are likely to maintain an agreement akin to the current one. Since April 2006 Basslink Pty Ltd has been subject to a service agreement with Hydro Tasmania for all but ten months in 2022. This ten-month period was the result of a disruption to Basslink's service and a subsequent legal dispute between the parties. Both events are anomalies and should not be the basis of a business-as usual case."*

What is missing from this discussion is the historical context that gave rise to the BSA in the first place, and an assessment of the degree to which those conditions continue to exist.

The BSA was effectively a financing transaction that enabled National Grid to make a positive investment decision to build Basslink. The BSA was the vehicle through which National Grid (as the project proponent) could demonstrate a sustainable revenue path to convince debt providers and itself to make the investment in progressing the link. National Grid was not alone in that view – none of the short-listed proponents to progress the link had sufficient confidence in the-then regulatory process to progress the link as a regulated interconnector.

---

[2] Neither the ACIL Allen modelling report nor the Consultation Paper provides a rationale for the modelling of Marinus 2 to commence in Jul 2036, noting that this is inconsistent with the Step Change scenario.

Turning to the contemporary situation, there is no equivalent FID to be taken. APA acquired the asset from the previous owner when Basslink Pty Ltd (BPL) was in administration and receivership. There was a short-term contract agreed to by Hydro Tasmania and BPL, which effectively provides a bridge to the regulatory process. That transaction is not and was not intended to be enduring.

Should the AER determine not to accept APA's application to have Basslink regulated, the asset will enter into an entirely 'new' operating context under APA's ownership, with the linkage to the original financing arrangements entirely severed, and the context for the bridging agreement providing a path out of administration also no longer applying. Tasmania argues that 'past behaviour' is context-specific and not relevant to future potential scenarios.

Moreover, the legal feasibility of a long-term enduring arrangement between Hydro Tasmania and BPL from a competition law perspective is a further consideration that should be given to considering the weight given to this counterfactual in making the conversion decision – is it a plausible counterfactual.

While the BSA was never authorised by the ACCC, the NEM entry negotiations led to careful and detailed consideration of that arrangement by the ACCC. A foundation element of the ACCC's consideration was the inextricable link between the BSA and Basslink's progress, and what that development would deliver – it was the enabler for Tasmania to become a NEM jurisdiction and implement the market reforms that were to be delivered with NEM participation. Without the BSA, none of those outcomes would have been possible[3].

Those outcomes are now delivered, and the AER must have regard to the fact if a proposed new enduring arrangement was to be considered and submitted to the ACCC for authorisation that would necessarily involve the exercise of discretion by the ACCC following consideration of any prospective forward-looking expected benefits and detriments of the proposed agreement. In the context of a MNSP Basslink and Hydro Tasmania vying for the value of arbitrage between Tasmania and Victoria, it is difficult to accept the premise that a long-term enduring arrangement between BPL and Hydro Tasmania should be considered a base-case scenario[4].

Tasmania argues that a heavy discount should be applied to it being a counterfactual to regulation.

Counterfactual issue three – Basslink as an unhedged MNSP

In Tasmania's view, insufficient consideration has been given in the Consultation Paper to the possibility of a merchant Basslink ceasing to operate post the commissioning of Marinus Link 1, or even more likely, with the commissioning of Marinus Link 2.

The potential impact on a merchant Basslink from further interconnection between Victoria and Tasmania is one of Tasmania's greatest concerns, and a key reason for the State's support of conversion.

It is one thing for Tasmanian customers to face the State's share of regulated Marinus Link costs and the bill impacts from the associated North West Transmission Developments (and for Victorian

---

3 It is noted that the terms of the BSA saw Basslink operating like a regulated interconnector, and the enhancements to the Tasmanian NEM entry arrangements agreed by the Tasmanian Government through the NEM entry negotiations with the ACCC (which included the sell down by Hydro Tasmania of the import IRRs and limitations on Hydro Tasmania's bidding rights that were otherwise available under the BSA) further reinforced Basslink's physical operation effectively as a regulated interconnector (rather than strategic bidding as assumed in the ACIL Allen modelling).

4 There will clearly be tensions between Hydro Tasmania and a MNSP Basslink for capturing arbitrage value. While it might be argued that this provides "natural incentives" for the two parties to enter into an agreement that allocates that value between the parties on a predictable basis (rather than it being 'fought over'), the same arguments apply to many market situations (the major retailers, retail banking etc). Few would accept that a long-term agreement between competitors in these sectors should be considered a base-case/central/most likelyscenario and Tasmania argues that this is also the case for Basslink.

customers their share of Marinus Link costs) for the benefits of increasing interconnection by 750MW (in the case of Marinus 1), but an entirely different proposition for that same quantum of costs to effectively deliver only a net increase of around 250MW in interconnection should Marinus Link undermine the sustainable business case for an MNSP Basslink.

The only revenue available to a merchant Basslink is the IRRs (either directly, or through the development of contractual arrangements based on those revenue streams). The ACIL Allen modelling shows the very material impact that further interconnection might have on that revenue outlook (under the assumptions underpinning that modelling), as demonstrated in Figures 1 and 2 on page 10 of the Consultation Paper, which also contains the following observation:

> *The results also indicated that there may be a risk of insufficient revenue to cover stay-in-business costs if both Marinus Link cables are constructed.*

It is noted that the stay-in-business costs considered in those Figures do not include the costs of SPS services, which will need to be funded by a merchant Basslink, and therefore understate stay-in-business costs.

The ACIL Allen modelling does not include a counterfactual of Basslink ceasing operations post the commissioning of Marinus Link (either cable 1 or 2). It would be concerning if that reflects an implicit view that this is not a potential counterfactual. Both the modelled market benefits[5] and modelled customer benefits of conversion will be different if the assumption that Basslink remains fully available at its current full capability until 2050 does not hold – and Tasmania argues that this a distinct possibility if conversion is not approved.

Tasmania argues that if the modelling of counterfactuals is going to have any weight in the AER's conversion decision, the market and consumer benefits of regulation relative to Basslink operating as a merchant MNSP only pre-Marinus 1 and pre-Marinus 2 should be undertaken, and the outcomes considered.

Reliability considerations under a merchant model

As flagged in the State's submission on the Issues Paper, Tasmania is concerned about the potential markedly different incentives facing a merchant Basslink relative to regulation in relation to stay-in-business capital expenditure. It is highly important that Basslink continues to be reliable, available at its full capability for both export and import, and that there are sufficient incentives for APA (or any future owner) to invest in the asset so that it achieves, at least, its design life of 40 years (2046). Moreover, the regulation provides a robust framework for considering future investments that could extend Basslink's operation post 2046.

A merchant operating environment, particularly in light of Marinus Link, does not provide such a framework. The net revenue profile shown in Figure 1 and 2 in the Consultation Paper gives rise to serious questions about the incentives for APA to undertake key capital expenditure that will ensure Basslink continues to operate reliably and with high levels of availability over the long term.

A good example is the control and protection system, which APA argues needs to be replaced at an estimated cost of $44.2m. While a matter for APA, who would have its own revenue modelling scenarios to consider under a merchant model, it is reasonable to question whether such an investment could be warranted if conversion is rejected in light of Marinus 1 (and potentially Marinus

[5] One of the reasons that the market benefits modelling present more consistent outcomes across the scenarios (and is therefore argued to be preferred over the consumer benefits modelling) is partly because Basslink is assumed to operate across all counterfactuals. *A priori*, if the modelling alternatively assumed Basslink ceased operating post Marinus 1, there would be differences in the modelled roll-out of generation in Tasmania and Victoria, and the consistency in modelled market benefits would be reduced. On this basis, Tasmania does not support the contention that market modelling should have greater weight than consumer benefit modelling.

2). In this context, the assumption underpinning the ACIL Allen modelling that Basslink's technical performance would be consistent across all counterfactuals needs to be reconsidered.

Modelling versus reality

Tasmania accepts the reality that any decision by the AER to approve Basslink's conversion to a regulated interconnector is a once-off decision that needs to be made in the coming months. That decision will necessarily be made under considerable uncertainty about the future of the NEM - the AER cannot divine the future. Modelling provides important insights into possible futures and is a useful analytical tool.

Assumptions must be made about how the national energy transition will evolve. Whether or not interconnector flows between Tasmania and Victoria will be of the nature assumed in the modelling (and therefore modelled benefits delivered) will only be borne out through experience.

Almost certainly, time will prove any modelling assumptions made today to be incorrect.

Whatever decision is made in relation to Basslink's conversion, the counterfactuals to that decision will never actually be experienced. In this context, modelling provides useful insights into potential futures, but can only be used as one source of input into what ultimately is a judgement exercise confronting the AER. That said, that source of input appears to land in favour of Basslink's conversion.

In coming to any judgement on the conversion question, weight also needs to be given by the AER to what is known, relative to what might be assumed. What is known at this time is that:

- Basslink is the only existing interconnector between Tasmania and Victoria.
- Victoria structurally relies on Tasmanian generation (transported by Basslink) to meet capacity at certain times of the year, and regularly at other times on a less predictable basis.
- Tasmania relies on Basslink for energy security to deal with hydrological risk.
- For almost all of Basslink's operating life, electricity customers in both regions have experienced the consequences of Basslink being bid as a MNSP in a way that is equivalent to it operating as a regulated interconnector. There is very little demonstrated experience of the consequences of the link being strategically bid to restrict flows and drive price differences between the two regions. In that sense, while Basslink is funded entirely differently to a regulated interconnector, it has physically operated much like a regulated interconnector[6]. In this sense, conversion reflects the status quo, whereas a merchant MNSP has little observable precedent[7].
- Looking to the future, generation from firm thermal sources in Victoria (and elsewhere in the NEM) will be withdrawing over the coming years, being replaced by non-firm variable renewable generation. Ongoing (indeed increasing) access to Tasmania's firming resources,

[6] Hydro Tasmania's historic bidding has reflected that it captures the value of the northward and southward IRRs under the BSA and NSA. Accordingly, it will not be indicative of future bidding patterns under a regulated Basslink if it does not acquire the IRRs through the SRA (noting that the ACIL Allen modelling assumes that it does not acquire the IRRs), and certainly is not indicative of how it might bid with a merchant Basslink.

[7] The small period in which Basslink operated as an unhedged MNSP during 2022 happened in parallel with unusual NEM circumstances, and when control of the asset was in the hands of the receivers (as opposed to a fully functional trading team operating the asset as an enduring MNSP). Accordingly, it could not be considered to be representative of an enduring situation.

through our hydro generation sources, will become increasingly critical to the functioning of the Victorian wholesale market and prices seen by Victorian customers. Critically, while the development of firming options in Victoria can be modelled by ACIL Allen, that remains potential/assumed capacity, whereas Tasmania's firming capability that will increasingly be needed is in existence today.

- Basslink regulation provides confidence that its available capacity at all points in time will be fully available to transmit excess renewable generation from Victoria when it is available to displace dispatchable hydroelectricity in Tasmania, and that same capacity (with dynamic rating) to transmit from Tasmania the increasingly needed firm electricity Victorian customers need when that new renewable generation is not available.

- It is difficult to see how it is in the interests of customers in either jurisdiction to have a situation where those flows can be curtailed to drive up price differences between the jurisdictions – this will be the outcome of Basslink continuing to operate as a MNSP if its application to become a regulated interconnector is rejected by the AER.

As Australia moves through the energy transition, particularly the shift from firm thermal energy on the mainland to variable renewable production, the importance of interregional trading between Tasmania and Victoria, with our existing reliable deep storage and world-class untapped renewable reserves (both energy and capacity) becomes increasingly important. While Basslink will always be important to Tasmania, it is becoming increasingly important to the NEM, and particularly the Victorian region. This reality (as opposed to modelling) is a key consideration in thinking about Basslink's future, either as a regulated interconnector or as an MNSP. In Tasmania's view, it reinforces the case for regulation over and above the ACIL Allen modelling, which in the broad, supports the same proposition.

Yours sincerely

Mark Bowles
Acting CEO - ReCFIT

23 September 2024