

# Basslink

## Decision: Commencement and Process Paper

July 2023

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# Summary

Basslink is a 500 MW undersea transmission cable which links Loy Yang in Victoria to George Town in Tasmania. In 2022, APA Group acquired Basslink Pty Ltd, the owner and operator of Basslink.

In December 2022, the Australian Energy Market Commission (AEMC) implemented a rule change which provides for us to make a transmission determination for an intending transmission network service provider that has applied to us seeking to convert its network services to prescribed transmission services.

On 19 May 2023, APA Group lodged an application:

- to convert Basslink’s network services from market network services to prescribed transmission services
- requesting us to commence, and determine, the process of making a transmission determination for Basslink.

As a Market Network Service Provider who intends to provide prescribed transmission services by means of its converting transmission system, Basslink is an ‘Intending TNSP’ under rule 6A.9 of the National Electricity Rules (NER). An Intending TNSP may ask us to commence the process of making a transmission determination.

This decision constitutes:

- notice of our decision to commence a transmission determination process for Basslink pursuant to clause 6A.9.2(f) of the NER, and
- our Commencement and Process Paper for Basslink, in which we specify the modifications to the normal transmission determination process set out in Chapter 6A of the NER that we will apply.

We will assess APA Group’s request to convert Basslink concurrently with undertaking the transmission determination process for Basslink.

# 1. Background

## 1.1 About Basslink

Basslink is a 500 MW undersea transmission cable which links Loy Yang in Victoria to George Town in Tasmania. It was built in 2006 by a subsidiary of the UK's National Grid and is owned and operated by the company Basslink Pty Ltd (BPL). It was then sold to CitySpring Infrastructure Trust, a subsidiary of Singapore's Temasek.

CitySpring (and subsequent owners) derived most of their revenue from Basslink through a 25-year long Basslink Services Agreement with Hydro Tasmania. Hydro Tasmania paid BPL an annual interconnector facility fee to transport electrical energy. The contract allowed Hydro Tasmania to participate directly in the Victorian market and sell electricity in Victoria when prices were high. Hydro Tasmania also purchased electricity from Victoria to support supply during drought conditions, and to optimise dam availability for exports. Since 2006, electricity imports into Tasmania have been about the same as exports.

In December 2015, a fault on the cable caused a six-month outage. The outage contributed to BPL incurring financial losses and in 2021 the company went into receivership. In February 2022 the Basslink Services Agreement was terminated. Later in 2022 APA Group acquired BPL from Basslink's administrator for \$773 million, and a network services agreement between Hydro Tasmania and BPL commenced on 21 October 2022. The agreement expires on the earlier of 30 June 2025 or the day Basslink is regulated (unless extended by mutual agreement between Hydro Tasmania and BPL).

## 1.2 Regulation of Basslink

Basslink is one of three transmission links built to operate as a Market Network Service Provider (MNSP) along with Murraylink and Directlink. The National Electricity Code (which preceded the National Electricity Rules (NER)) encouraged market-based transmission infrastructure investment. It allowed investors to build unregulated inter-connectors and earn revenue from price differentials between the states. It also included a 'safe harbour' provision which allowed MNSPs to convert to regulated status provided the regulated transmission assets provided net benefits to consumers.

Murraylink and Directlink decided to utilise the safe harbour provisions in the National Electricity Code because price differentials between the states were lower than expected. However, conversion to regulation came at a cost to the owners as the Regulatory Asset Base (RAB) adopted in both cases was considerably lower than the original construction cost.

APA Group now seeks to convert BPL from a MNSP to a Transmission Network Service Provider (TNSP), and to classify the network services Basslink provides as prescribed transmission services so that it derives its revenues from tariffs set by us. As noted by APA Group, the alternative is for Basslink to derive its revenues from price differentials between Victoria and Tasmania, through financial derivatives underpinned by Basslink's capacity or by selling dispatch rights to Basslink to an energy market participant.

In respect of Basslink's application for conversion, we can classify Basslink's network services as prescribed transmission services if among other things this would, or is likely to, contribute to the achievement of the National Electricity Objective (NEO). We may also take into account the Revenue and Pricing Principles (RPP) in making this determination if we consider that to be appropriate. We will assess APA Group's request to convert Basslink concurrently with undertaking the transmission determination process for Basslink.

If we convert Basslink, we will regulate it like any other TNSP under the regulatory framework set out in Chapter 6A of the NER. The NER require us to publish a transmission determination for each TNSP. A transmission determination comprises a revenue determination and a pricing methodology. In a revenue determination, we must set the maximum allowable revenue a TNSP can recover from consumers during a regulatory control period (typically five years) to cover its efficient costs, and a rate of return to the owner.

To determine the maximum allowable revenue a TNSP may recover, we apply a building block model. The building blocks are:

- the TNSP's regulatory asset base
- a return on capital
- depreciation costs
- the estimated cost of taxation liabilities
- forecast operating expenditure
- revenue increments or decrements arising from the application from of incentive schemes
- any revenue decrements that may arise from providing services other than prescribed transmission services
- compensation for other risks.

Consumers pay for regulated transmission services through their electricity bills. TNSPs recover most of their costs from distribution network service providers (DNSPs). DNSPs in turn recover their costs from retailers and retail customers. Some large businesses are directly connected to the transmission network, rather than a distribution network. They also contribute to recovery of transmission costs.

### **1.3 Commencement and Process Paper**

In December 2022, the Australian Energy Market Commission (AEMC) implemented a rule change which allows us to make a transmission determination for a network service provider that has applied to us seeking to convert its network services to prescribed transmission services.<sup>1</sup>

On 19 May 2023, APA Group lodged an application:

- to convert Basslink's network services from market network services to prescribed transmission services under clause 11.6.20(c) of the NER, and
- requesting us to commence, and determine, the process of making a transmission determination for Basslink under clause 6A.9.2 of the NER.

As a Market Network Service Provider who intends to provide prescribed transmission services by means of its converting transmission system, Basslink is an 'Intending TNSP' for the purposes of rule 6A.9 of the NER. An Intending TNSP may request us to commence, and determine, the process of making a transmission determination.

APA Group proposed a 15-month transmission determination process. This time frame is consistent with our normal revenue determination processes and includes a two-stage consultation process with an issues paper and draft decision. APA Group also proposed that we assess its request to convert Basslink concurrently with undertaking the transmission determination process.

This decision sets out the matters we are required to address in a Commencement and Process Paper. We have also decided to assess Basslink's request to convert concurrently with undertaking the transmission determination process.

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<sup>1</sup> AEMC, Establishing Revenue Determinations for Intending TNSPs, 22 December 2022.

As a next step, APA Group has proposed to submit its revenue proposal and proposed pricing methodology, and further information in support of converting Basslink, by 19 July 2023.

Section 2 sets out our reasons for deciding to commence the transmission determination process for Basslink. Section 3 sets out the modified transmission determination process that we have determined to apply for Basslink. Section 4 outlines our decision and the specific matters we are required to address under the NER.

## 2. Decision to commence transmission determination

### 2.1 APA Group proposal

APA Group has requested us to commence, and determine, the process of making a transmission determination for Basslink under clause 6A.9.2 of the NER. It has also applied to us to convert Basslink's network services from market network services to prescribed transmission services under clause 11.6.20(c) of the NER.

APA Group acquired BPL from Basslink's administrator for \$773 million in 2022. The network services agreement between Hydro Tasmania and BPL will expire on the earlier of 30 June 2025, or the day Basslink is regulated (unless extended by mutual agreement between Hydro Tasmania and BPL). APA Group's intention is for Basslink to be regulated as a TNSP under Chapter 6A of the NER from 1 July 2025. If this does not occur, the alternative options for Basslink to earn revenues are to:

- operate as a stand-alone MNSP, pursuing a bidding strategy designed to optimise inter-regional price arbitrage
- sell dispatch rights to an energy market participant, who would hold those rights either on a standalone basis or as part of a larger energy portfolio
- sell one or more financial derivatives underpinned by the capacity of Basslink, with Basslink then being operated in line with the incentives determined by the operation of the derivative.

APA Group submits that if Basslink remains an MNSP beyond 2025, its dispatch will be driven by opportunities for revenue optimisation arising from price arbitrage, or the interests of the participant that holds dispatch rights. This means it will be dispatched in a manner designed to accrue benefits to a particular participant, rather than benefits accruing to the whole market through the efficient use of the asset in transmitting the lowest cost electricity at each point in time. Overall, APA Group submits that of these options, regulating Basslink under Chapter 6A is preferred, and would result in Basslink being operated efficiently and reliably in the long-term interests of consumers.

APA Group will submit further information in support of converting Basslink when it submits its transmission revenue proposal.

### 2.2 Rule requirements

Rule 6A.9 of the NER provides for an 'Intending TNSP' to request us to commence the process for making a transmission determination for a proposed prescribed transmission service, and to determine the process to apply for making that transmission determination.<sup>2</sup>

An 'Intending TNSP' is defined as:<sup>3</sup>

...

- (a) an *Intending Participant* who intends to provide *prescribed transmission services* by means of its *proposed transmission system*; or
- (b) a *Market Network Service Provider* who intends to provide *prescribed transmission services* by means of its converting transmission system,

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<sup>2</sup> NER, cl 6A.9.2.

<sup>3</sup> NER, cl 6A.9.1(b).



and ... includes that person once registered as a *Network Service Provider* for the provision of *prescribed transmission services* by means of its *transmission system*.

A 'proposed prescribed transmission service' is defined as:<sup>4</sup>

...

*prescribed transmission services* to be provided by means of:

- (a) a proposed *transmission system*; or
- (b) a converting transmission system.

A 'Market Network Service Provider' is defined as:<sup>5</sup>

A *Network Service Provider* who has classified any of its *network services* as a *market network service* in accordance with Chapter 2 [of the NER] and who is also registered by AEMO as a *Market Network Service Provider* under Chapter 2 [of the NER].

A 'converting transmission system' is defined as:<sup>6</sup>

... a *transmission system* that provides *market network services* and in respect of which the *Market Network Service Provider* has applied to the AER to determine the service to be a *prescribed transmission service*.

An MSNP can apply to us to determine a service is a prescribed transmission service under clause 11.6.20 of the NER. The clause includes transitional provisions that apply to Basslink. In particular, clause 11.6.20(c) provides:

If, after the commencement date, a *network service* provided by means of, or in connection with, the Basslink *transmission system* ceases to be classified as a *market network service*, it may at the discretion of the AER be determined to be a *prescribed transmission service*, in which case the relevant *total revenue cap* may be adjusted in accordance with Chapter 6A and this clause 11.6.20 to include to an appropriate extent the relevant *network* elements which provide those *network services*.

If an Intending TNSP requests us to commence the process for making a transmission determination for a proposed prescribed transmission service, the NER affords us broad discretion in determining that request. Relevantly, clause 6A.9.2(e) of the NER provides:

In determining whether to commence the process for making a *transmission determination* requested by an Intending TNSP under [clause 6A.9.2(a)] the AER may have regard to any matters it considers appropriate, including:

- (1) whether the Intending TNSP intends to deliver an *actionable ISP project* or a project that is not an *actionable ISP project* but has been subject to the *regulatory investment test for transmission*;
- (2) the likelihood of the Intending TNSP delivering that project; and
- (3) in the case of a converting transmission system, the Intending TNSP's application to the AER to determine the service to be a *prescribed transmission service*.

Finally, we must determine whether to commence the process for making a transmission determination in a manner that will or is likely to contribute to the achievement of the NEO, and if we consider appropriate, take into account the revenue and pricing principles.<sup>7</sup>

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<sup>4</sup> NER, cl 6A.9.1(b).

<sup>5</sup> NER, ch 10.

<sup>6</sup> NER, cl 6A.9.1(b).

<sup>7</sup> NEL, ss 16(1)(a) and 16(2)(b).

## 2.3 Discussion

We have decided to commence the process for making a transmission determination for Basslink for two reasons.

Firstly, Basslink is an Intending TNSP for the purposes of rule 6A.9 of the NER. Lodging the request to convert means that Basslink's network is a converting transmission system, and that Basslink is therefore an Intending TNSP. Under clause 6A.9.2 of the NER, an Intending TNSP is entitled to request us to commence the process for making a transmission determination, and to determine the process that will be applied.

Secondly, determining whether the conversion should proceed will depend on APA Group submitting its full case for conversion, the AER properly consulting on and assessing the merits of that case and considering competing considerations. This includes:

- Assessing the benefits of conversion to consumers, how significant those benefits are, and whether the benefits outweigh any costs.
- Recognising Basslink plays a significant role in the National Electricity Market, and that this role may become more significant as the shift to renewables on the mainland increases the role of hydro and other forms of energy storage in firming up energy supplies.
- If the National Electricity Objective (NEO) is revised during our determination process to include emissions reductions benefits, we will consider the impact of the revised NEO on the costs and benefits of conversion.
- As APA Group submits:
  - were the Basslink network to operate under a merchant business model (as opposed to being regulated), it would ultimately earn revenue from and only be dispatched to exploit inter-regional price arbitrage opportunities, as opposed to being dispatched in accordance with efficiency considerations, which may not necessarily be in the interests of the market or consumers overall<sup>8</sup>
  - being regulated allows for Basslink to only recover its efficient costs, and be provided with incentives to operate efficiently through the Efficiency Benefit Sharing Scheme and the Capital Expenditure Sharing Scheme and deliver appropriate service levels through the Service Target Performance Incentive Scheme.<sup>9</sup>

Were we to conclude that regulatory conversion is in the long-term interest of consumers, a transmission determination that applies to Basslink would need to be in place.

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<sup>8</sup> APA Application, pp 3, 9 and 10.

<sup>9</sup> APA Application, p 9.

### 3. Transmission determination process

#### 3.1 APA Group proposal

APA Group has proposed that the transmission determination process should be modified by:

- running the conversion application process and the transmission determination process concurrently
- addressing matters which are the subject of framework and approach paper and proposed forecast expenditure methodologies at the same time we assess the Conversion Application and Basslink’s revenue proposal (as opposed to these matters being separate and antecedent to the revenue proposal as required by the NER).

Reflecting these modifications, APA Group has proposed the following process and timetable:

**Table 1: APA Group Proposed Transmission Determination Process**

<b>Process step</b>	<b>Proposed timing</b>
<b>Basslink submission of Revenue Proposal and Pricing Methodology under cl 6A.10.1</b>	19 July 2023
<b>Basslink submission in support of Conversion Application</b>	19 July 2023
<b>AER Issues Paper and stakeholder consultation</b>	12 September 2023
<b>AER Public Forum</b>	25 September 2023
<b>Stakeholder submissions close</b>	31 October 2023
<b>AER Draft Decision</b>	28 March 2024
<b>Basslink Revised Proposal</b>	31 May 2024
<b>AER final decision on Conversion Application and transmission determination</b>	15 November 2024

Source: APA Application, p 13.

#### 3.2 Rule requirements

Our decision to commence a transmission determination process for Basslink requires us to also publish a Commencement and Process Paper. The matters we must include in a Commencement and Process Paper are specified in clause 6A.9.3 of the NER. These matters include:

- the commencement date for Basslink’s transmission determination
- the date Basslink must submit its revenue proposal and proposed pricing methodology
- the modifications to the process we may determine in making Basslink’s transmission determination
- whether we should run the conversion application process and the transmission determination process concurrently.

We may modify the transmission determination process by changing the timetable or process for making draft decisions or final decisions, and shortening consultation periods if we are reasonably satisfied that:

- in the circumstances, the timetable or process would otherwise place a disproportionate administrative burden on the AER or the Intending TNSP, and

- there will be no material adverse impact on other stakeholders or the decision-making framework in Chapter 6A of the NER.<sup>10</sup>

If we decide to modify the process for making a transmission determination, we must specify the modified process in the Commencement and Process Paper.

### 3.3 Discussion

We have decided to modify the transmission determination process that will apply to Basslink in the way that APA Group has proposed, except for deferring the commencement of the process to 15 September 2023. This is 56 calendar days after Basslink's proposed commencement date of 19 July 2023. We have also decided to run the conversion application process and the transmission determination process concurrently.

Our reasons follow.

Firstly, the transmission determination process under Chapter 6A of the NER generally runs for 15 months between the submission of a revenue proposal and us making a final decision for a transmission determination. However, the process also involves us publishing a framework and approach paper, an issues paper and a draft decision, all of which are subject to consultation. The framework and approach paper process must commence 32 months before the final decision.

As noted above, the network services agreement between Hydro Tasmania and Basslink expires on the earlier of 30 June 2025 or the day Basslink is regulated (unless extended by mutual agreement between Hydro Tasmania and BPL). A transmission determination would need to be in place, tariffs determined and other relevant administrative matters resolved by 1 July 2025, were we to determine that Basslink's network should be converted. This is not possible if we were to follow the normal process under Chapter 6A of the NER. The normal process requires us to publish a framework and approach paper no later than 32 months prior to the commencement of Basslink's first regulatory control period. The normal process means us making a transmission determination in 2026.

Secondly, Basslink has never been subject to economic regulation. If converted, it will be the first undersea transmission cable regulated under Chapter 6A of the NER. Given the limited available precedents, and the differences between Basslink and other transmission networks, the matters dealt with by a framework and approach paper for Basslink will need to be considered afresh and together with our assessment of Basslink's revenue proposal. In this regard, we agree with APA Group's submission:<sup>11</sup>

Basslink considers that, in this case, it would be most efficient for the matters usually addressed in the F&A Paper and expenditure forecast methodology stages to be addressed as part of the AER's broader assessment of the Conversion Application and Revenue Proposal. Given that Basslink has not previously been subject to economic regulation, it may be difficult for the AER to properly consider matters such as control mechanisms, incentive schemes and forecasting methodologies in isolation – these may need to be assessed in the broader context of APA's Conversion Application and Revenue Proposal.

Thirdly, removing the requirement for us to make a framework and approach paper, and for Basslink to submit its proposed forecast expenditure methodologies before it submits its revenue proposal and proposed pricing methodology, will not place a disproportionate administrative burden on Basslink or us. Nor will there be any material adverse impact on other stakeholders given the matters the subject of a framework and approach paper and forecast expenditure methodologies would be properly assessed and consulted on as part of us making a transmission determination for Basslink.

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<sup>10</sup> NER, cl 6A.9.3(d)(2).

<sup>11</sup> APA Group Application, p 13.

Fourthly, the NER contemplates us running the conversion application and the transmission determination processes concurrently.<sup>12</sup> Some considerations relevant to a transmission determination will also be relevant to our assessment of converting Basslink. One such consideration is determining Basslink’s RAB (the NER require us to draw on the approach we adopted for Directlink in 2006, and which the Australian Competition and Consumer Commission adopted for Murraylink in 2003).<sup>13</sup> The value of the RAB is a key aspect of whether there are net benefits for consumers from converting Basslink.

Finally, on 16 December 2022, the Australian Energy Market Operator (AEMO) published the draft 2023 Inputs, Assumptions and Scenarios Report (2023 IASR). AEMO is scheduled to publish a final 2023 IASR on 28 July 2023. The details in the 2023 IASR are relevant to applying the Regulatory Investment Test for Transmission to Basslink’s network. Commencing the process on 19 July 2023 (as proposed by APA Group) means the material it submits in support of converting Basslink may eventually need to be resubmitted if the details in the final 2023 IASR differ from those in the draft 2023 IASR. Such a resubmission would complicate the process, and among other things, could result in us having to reconsult with interested stakeholders.

Accordingly, our preference is for APA Group to submit after AEMO publishes the final 2023 IASR, on 15 September 2023. This is six weeks after AEMO finalises the 2023 IASR and should be sufficient for APA Group to incorporate any relevant details that have changed between the draft and final IASRs. We have also decided to defer each of the process steps proposed by APA Group accordingly.

Our decision is to modify the transmission determination process for Basslink to:

- omit the requirement for us to make a framework and approach paper under clause 6A.10.1A of the NER
- omit the requirement for Basslink to inform us of the methodologies it proposes to use for forecasting expenditure prior to submitting its revenue proposal under clause 6A.10.1B of the NER
- defer addressing the matters the subject of a framework and approach paper, and the forecast expenditure methodologies to when we assess Basslink’s revenue proposal and proposed pricing methodology and make Basslink’s transmission determination
- run the conversion application process and the transmission determination process concurrently, and
- implement the following timetable:

Process step	Timing
<b>Basslink to submit revenue proposal and pricing methodology</b>	15 September 2023
<b>Basslink to submit further information in support of conversion</b>	15 September 2023
<b>AER issues paper and stakeholder consultation</b>	10 November 2023
<b>AER public forum</b>	22 November 2023
<b>Stakeholder submissions close</b>	16 February 2024
<b>AER draft decision</b>	14 June 2024
<b>Basslink to submit revised revenue proposal</b>	16 August 2024

<sup>12</sup> NER, cl 6A.9.3(d)(4)(i).

<sup>13</sup> NER, cl 11.6.20.



## 4. Decision

Our decision is to commence a modified transmission determination process for Basslink. The matters we are required to set out in a Commencement and Process Paper, are set out below.

Matter	Decision
<b>Commencement of a transmission determination process for Basslink</b>	Yes.
<b>Commencement date for Basslink's transmission determination</b>	1 July 2025
<b>Date by when Basslink must submit its revenue proposal and proposed pricing methodology</b>	15 September 2023
<b>The modifications to the process we may determine in making Basslink's transmission determination</b>	<ul style="list-style-type: none"><li>• We omit the requirement for the AER to make a framework and approach paper under clause 6A.10.1A of the NER.</li><li>• We omit the requirement for Basslink to inform the AER of the methodologies it proposes to use for forecasting expenditure prior to submitting its revenue proposal under clause 6A.10.1B of the NER.</li><li>• We defer addressing the matters the subject of a framework and approach paper, and the forecast expenditure methodologies to when we assess Basslink's revenue proposal and proposed pricing methodology and make Basslink's transmission determination.</li></ul>
<b>Allow the conversion application process and the transmission determination process to be run concurrently</b>	Yes.
<b>Enable information or decisions made for the conversion application process and the transmission determination process to be used, or adopted, for the other, and vice versa.</b>	Yes.

# Glossary

Term	Definition
<b>2023 IASR</b>	2023 Inputs, Assumptions and Scenarios Report
<b>AEMC</b>	Australian Energy Market Commission
<b>AEMO</b>	Australian Energy Market Operator
<b>AER</b>	Australian Energy Regulator
<b>BPL</b>	Basslink Pty Ltd
<b>DNSP</b>	Distribution Network Service Provider
<b>MNSP</b>	Market network service provider
<b>MW</b>	Megawatt
<b>NEM</b>	National Electricity Market
<b>NEO</b>	National Electricity Objective
<b>NER</b>	National Electricity Rules
<b>RAB</b>	Regulatory asset base
<b>RIT-T</b>	Regulatory test for transmission
<b>RPP</b>	Revenue and pricing principles
<b>TNSP</b>	Transmission Network Service Provider