

Basslink

Application for conversion and request to commence the process for making a transmission determination

May 19, 2023



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Executive Summary

APA Group (**APA**) has recently acquired the Basslink interconnector and has signalled its intention to convert Basslink to a regulated interconnector.

This document is a formal application and request to the Australian Energy Regulator (**AER**) to initiate a process for conversion and economic regulation of Basslink, and includes:

- an application to the AER to determine the Basslink transmission services to be prescribed transmission services (**Conversion Application**); and
- a request to the AER to commence the process for making a transmission determination relating to the proposed prescribed transmission services, and to determine the process to apply when making the transmission determination (**Request to Commence and Determine the Process**).

This document is not intended to set out all of the evidence or matters that may be relevant to the Conversion Application and transmission determination processes. Rather, this is intended to initiate the process for providing all of the relevant material to the AER, and for the AER to make its determination.

Application for conversion

Basslink Pty Ltd (**Basslink**) applies for a determination from the AER under cl 11.6.20(c) of the National Electricity Rules (**NER**) that, from 1 July 2025, the Basslink network service cease to be classified as a market network service, and instead be classified as a prescribed transmission service.

Basslink considers that classifying the Basslink network service as a prescribed service, and having this service regulated by the AER, would promote the national electricity objective (**NEO**).

Conversion of the Basslink network service to a prescribed service will create appropriate incentives both for the most efficient integration of Basslink into the overall electricity grid and for efficient long-term planning and operation of Basslink. A unique feature of the market network services projects — compared, for example, to gas pipelines—is that such projects ultimately must earn revenue from inter-regional price arbitrage, rather than relying on customers to pay for infrastructure services provided. The opportunities for inter-regional price arbitrage for electricity are only indirectly linked to the value and the benefits to the broader market of the service provided by an electricity interconnector. In fact, in many instances, the withholding of interconnector capacity can increase price arbitrage revenue while reducing its market benefit. The differences in the regulation of electricity and gas is a reflection of the differences in the physical properties, markets and economics of electricity and gas.

In this context, it is important to note that, for most of its life, Basslink has not operated under a merchant business model. Instead, under the Basslink Services Agreement (**BSA**) and now the Network Services Agreement (**NSA**) with Hydro Tasmania, Basslink has swapped its merchant revenue for 'facility fee'.

Pursuant to these contractual arrangements, Basslink has been operated in a similar way to a regulated interconnector – effectively providing an open link between Tasmania and the mainland. These contractual arrangements have in part been designed to address concerns (including from the ACCC) that the market benefits of Basslink may be circumscribed under a merchant business model. As a prescribed network service provider, Basslink would be able to maximise its benefit to the electricity market while also earning sufficient revenue to enable efficient investment in the link. Under the AER oversight of Basslink's operations, investment and pricing, the risk of a misalignment between commercial incentives and the overall market benefits of Basslink will be substantially

reduced. Through its revenue determinations, application of incentive schemes and other regulatory instruments relating to prescribed services, the AER will have a role in ensuring that the operation, use of and investment in Basslink contribute to the achievement of the NEO.

Section 2.1 briefly outlines the basis for this application. Basslink intends to provide further submissions and evidence in support of the Conversion Application in accordance with the proposed timetable set out in section 3.

Request to commence the process for making a transmission determination

Basslink also makes a request under cl 6A.9.2 of the NER that the AER commence the process for making a transmission determination relating to the proposed prescribed transmission services, and to determine the process to apply when making the transmission determination

Basslink proposes that the process for making a transmission determination for Basslink be commenced as early as practicable, in order to maximise the time available for stakeholder consultation and AER consideration of both the Conversion Application and revenue determination.

APA's intention is that Basslink be subject to economic regulation on and from 1 July 2025. To facilitate this, Basslink proposes to submit to the AER, on or before 19 July 2023:

- its submission in support of the Conversion Application (including supporting evidence); and
- a Revenue Proposal and proposed Pricing Methodology for the first regulatory control period.

Proposed process for making a transmission determination

The AER's Commencement and Process Paper for Basslink may specify modifications to the process for making transmission determinations under Chapter 6A.

Basslink proposes that the Transmission Determination process be modified in the following ways:

- The Conversion Application and the Transmission Determination Proposal will be considered at the same time. This is the most practical approach, in the event the AER approves conversion there will be a finalised transmission determination to apply.
- Consideration of the Framework & Approach (F&A) Paper and Expenditure Forecast Method to be concurrent with the Consideration of the Revenue Proposal. 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.

The proposed timetable is consistent with the timelines provided to the AER under Part 6A of the National Electricity Law for a Transmission Determination. Where a minimum time between events is required under the National Electricity Law then the proposed timeline sets a proposed time at least as long as the time taken by the AER on other resets.

These modifications are intended to facilitate early lodgement of Basslink's Revenue Proposal and increase opportunities for stakeholder consultation and AER consideration.

This timeline has been discussed with the AER and provides for sufficient time for

- The AER to fully consider Basslink's Conversion Application and Transmission Determination Proposal
- Broad stakeholder consultation by the AER and Basslink as the AER's consideration of the Basslink Conversion Application and Transmission Determination proposal proceeds.
- Flexibility to address issues as they arise.

The proposed timetable means that the decision on conversion and revenue will not be unnecessarily delayed providing greater certainty to Basslink and Tasmanian and Victoria electricity customers.

It will also mean sufficient stakeholder engagement without unnecessarily burdening stakeholders who are already having significant strain placed on their resources as a result of the significant levels of consultation by multiple levels of government and government agencies and other energy businesses being undertaken across the energy sector currently.

APA's proposed timetable for the transmission determination process is set out below, reflecting the modifications outlined above.

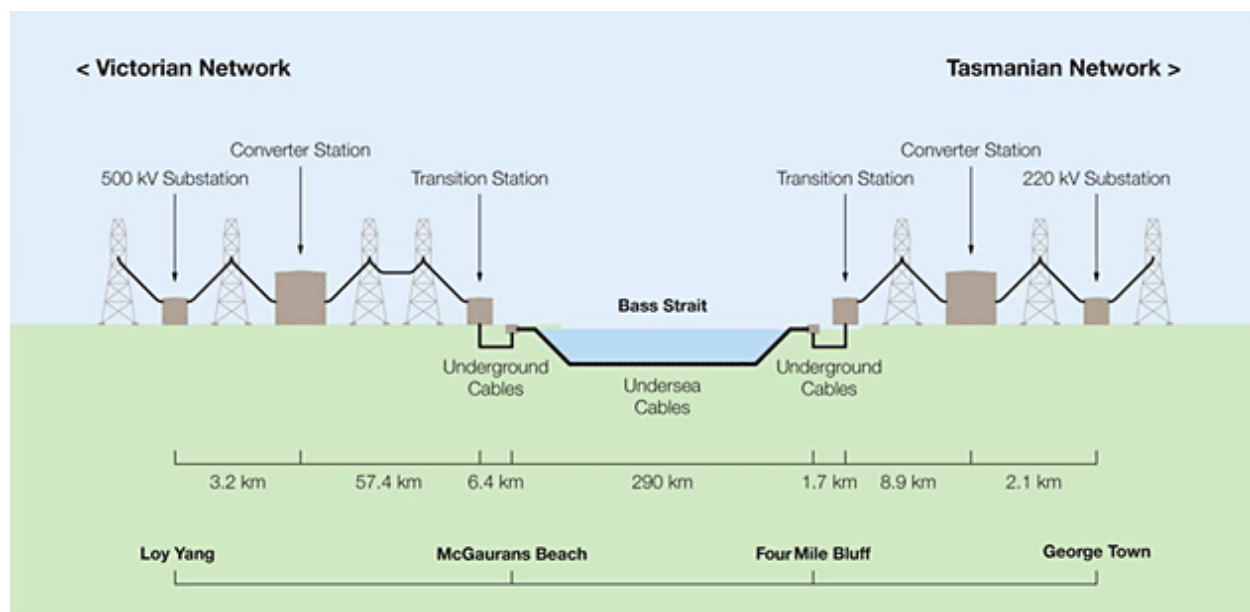
Process step	Proposed timing
Basslink submission of Revenue Proposal and Pricing Methodology under cl 6A.10.1	19 July 2023
Basslink submission in support of Conversion Application	19 July 2023
AER Issues Paper and stakeholder consultation	12 September 2023
AER Public Forum	25 September 2023
Stakeholder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

1. Background and context for this request

1.1. The Basslink interconnector

Basslink is the 370km high voltage direct current (HVDC) electricity interconnector between Victoria and Tasmania. Basslink starts from the Loy Yang switchyard in Gippsland (South East Victoria) and travels by a 61 km high-voltage overhead transmission line until it is submerged. From there it travels for 290 km under the Bass Strait at around 1.5 meters below the sea floor. It resurfaces again near George Town (Northern Tasmania) and travels another 11km via a high-voltage overhead transmission line to end up at the George Town substation.¹

Figure 1 – Assets, and location of them, that make up Basslink



Basslink was originally developed to serve the following three main purposes:

- Security of Tasmanian electricity supply – While Hydro Tasmania (**HT**) typically has sufficient generation capacity to meet Tasmanian energy demands, this depends on the amount of rainfall Tasmania receives. For example, in 2015 Tasmania experienced a record drought, leaving HT with only 13 percent remaining energy potential compared to having full dams. The concurrent failure of Basslink forced the Tasmanian Government to re-commission a gas plant and import costly temporary diesel generators.
- Access to cheaper, more stable, electricity – Basslink provides Victoria, and the NEM more broadly, with access to Tasmania’s cheaper hydropower and wind power at its peak periods or when dams are overfilled. Basslink also provides Tasmania with access to Victoria’s cheaper baseload power when water levels are low in Tasmania. Being able to ‘smooth out’ power supply and demands between Victoria and Tasmania also reduces the extent of large price variations.
- Additional revenue streams – Basslink connects Tasmania to the NEM. This provides generators across the entire NEM access to Tasmanian customers, and vice versa.

Basslink began operations in 2006 as a Market Network Service Provider (**MNSP**). A transmission MNSP is a transmission network asset that is not economically regulated by the AER. Instead, the

¹ <http://www.basslink.com.au/basslink-interconnector/maps/>

MNSP earns its revenue by trading in the wholesale electricity market, and ‘arbitraging’ wholesale electricity market prices between NEM price regions.

For most of its life, Basslink has also had a commercial service contract in place with HT. Under this service contract certain market revenue earned by Basslink is transferred to HT, in return for a facility fee. The facility fee is an annual payment for making Basslink available to HT to the required technical standards and availability factors.

Basslink is the only transmission MNSP currently operating in the NEM, and has been for some time. The revenue of all other TNSPs are regulated by the AER under the NER.

1.2. Converting Basslink to a regulated interconnector

Basslink proposes that Basslink Interconnector be ‘converted’ from a MNSP to a regulated TNSP. The purpose of transitioning Basslink to the status of being a regulated transmission asset is to ensure that it continues to provide essential market services at least cost. The combination of predictable regulatory revenue and regulatory oversight will provide a stable basis for ensuring:

- efficient investment in, operation and use of the Basslink interconnector; and
- assurance to the market that Basslink charges reflect efficient costs.

Basslink proposes that economic regulation of Basslink would commence on 1 July 2025. At this time, the commercial arrangement with HT providing for payment of the facility fee would be replaced with regulated revenues.

1.3. New rules relating to the conversion and revenue determination process

New rules relating to the process for conversion and making a transmission determination for a “converting transmission system” commenced in January 2023.

New clause 6A.9.2 of the NER allows an “Intending TNSP” to make a formal request to the AER to:

- commence the process for making a transmission determination relating to its proposed prescribed services; and
- determine the process for making the transmission determination.

An “Intending TNSP” in this context includes an MNSP “who intends to provide prescribed transmission services by means of its converting transmission system”. A “converting transmission system” is defined as one in respect of which the MNSP has applied to the AER to determine the service to be a prescribed transmission service.

Where the “Intending TNSP” is the operator of a “converting transmission system”, the new rules contemplate that the application for conversion may be determined in parallel with the transmission determination process.² The AEMC’s final determination confirms that the intent is to allow the AER to run the conversion and revenue determination processes concurrently, noting that this is likely to be efficient in the case of Basslink (and also consistent with the Directlink and Murraylink processes).

In this case, Basslink considers that the conversion and revenue determination processes should be run concurrently. Given the commonality of issues and stakeholder interests across the two processes, it would be most efficient for the two processes to commence and proceed concurrently. Our proposed timetable (section 3) reflects this.

² The AER may, in its Commencement and Process Paper, make modifications to the transmission determination process to allow the conversion application process and the transmission determination process to be run concurrently (NER, cl 6A.9.3(d)(4)).

If the AER decides to commence the conversion and transmission determination process, it must publish a Commencement and Process Paper within 40 business days of this request (this timeframe may be extended with the agreement of the Intending TNSP).

The Commencement and Process Paper is intended to provide some certainty around the date for commencement of regulation and the process steps towards that date. Among other things, the Commencement and Process Paper will need to specify:

- the commencement date for the first regulatory year of the regulatory control period to which the transmission determination will apply, which must coincide with the start of a financial year;
- the date on which Basslink must submit its Revenue Proposal and proposed pricing methodology; and
- any modifications to the process for making transmission determinations under Chapter 6A.

The AEMC's final rule determination states that the intent of the Commencement and Process Paper is to provide "regulatory certainty for the ITNSP and interested stakeholders over the process steps and timing to apply for the transmission determination, including where this may include modifications from the process that applies for existing TNSPs under chapter 6A".

1.4. Purpose of this application and request

This document includes:

- an application to the AER to determine the Basslink transmission services to be prescribed transmission services (**Conversion Application**); and
- a request to the AER to commence the process for making a transmission determination relating to the proposed prescribed transmission services, and to determine the process to apply when making the transmission determination (**Request to Commence and Determine the Process**).

This document is not intended to set out all of the evidence or matters that may be relevant to the Conversion Application and transmission determination processes. Rather, this is intended to initiate the process for providing all of the relevant material to the AER, and for the AER to make its determination.

2. Application for conversion

Basslink applies for a determination from the AER under cl 11.6.20(c) of the NER that, from 1 July 2025, the Basslink network service cease to be classified as a market network service, and instead be classified as a prescribed transmission service.

Section 2.1 briefly outlines the basis for this application. Basslink intends to provide further submissions and evidence in support of the Conversion Application in accordance with the proposed timetable set out in section 3. This further information will demonstrate that it is more consistent with the National Electricity Objective that the Basslink network service be classified as a prescribed transmission service (and be regulated by the AER as such) rather than remain a market network service.

2.1. Regulation of Basslink services as prescribed services would promote the National Electricity Objective

If the Basslink network service is classified as a prescribed transmission service, this service will become subject to economic regulation by the AER. That means that Basslink's future revenue streams will be regulated under a revenue cap set based on a Building Block Model, not dissimilar to other regulated interconnectors like Murraylink and Directlink.

There are several important implications from this model:

- Recovery of efficient costs – Basslink's revenue will be based on its forward-looking costs using the building block model, not dissimilar to regulated TNSPs. This means that Basslink will have greater confidence it can recover future expenditure, as long as it meets the AER's tests for efficiency.
- Efficiency incentives – through the Efficiency Benefit Sharing Scheme (**EBSS**) and Capex Expenditure Sharing Scheme (**CESS**), Basslink will have explicit commercial incentives to reduce expenditure levels as long as service levels are not affected.
- Service level incentives – through the Service Target Performance Incentive Scheme (**STPIS**), Basslink will also have an explicit commercial incentive to deliver service levels to the agreed standard.

The regulatory scheme, including the cost recovery and incentive elements outlined above, will be administered by the AER. As with all of its economic regulatory functions and powers, the AER will need to exercise any functions in relation to Basslink in a manner that will or is likely to contribute to the achievement of the NEO.³

2.1.1. Efficient investment in, operation and use of Basslink

To understand why converting Basslink from MNSP to TNSP is beneficial to the electricity market and will better contribute to the achievement of the NEO than the status quo, it is important to be clear about the counterfactual to regulation. At present, Basslink receives revenue under a contract with HT (the **NSA**), which has provided Basslink with a stream of revenue and incentives similar to regulated revenue. Basslink has also been required (under the NSA) to bid the capacity of the link in a way that means that is available in a similar way to a regulated transmission link

However, the continuation of this arrangement (or something similar) should not be considered to be a viable medium-term counterfactual to regulation. The contractual arrangement between HT and Basslink does not extend beyond 2025.

There are a number of realistic medium-term counterfactuals, which should be considered to include:

³ NEL, s 16.

- Basslink operating as a stand-alone MNSP, pursuing a bidding strategy designed to optimise inter-regional price arbitrage (noting that the limitations on bidding currently imposed under the NSA would not apply);
- APA selling the dispatch rights to Basslink to an energy market participant, who would hold those rights either on a stand alone basis or as part of a larger energy portfolio; and
- APA selling 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.

Compared to these counterfactuals, economic regulation by the AER would change the commercial focus of Basslink towards efficient and reliable operation of the interconnector, consistent with the long term customer interest. This is the primary objective of economic regulation, as reflected in the NEO, and would more closely replicate the manner in which Basslink has operated to date under the BSA and NSA.

APA would again note the concerns the ACCC has had in the past relation to the operation of this asset as an MNSP without the constraints that have been imposed by the combination of contractual restraints and Ministerial Directions.

The market benefits of regulation, when considered against these counterfactuals would include:

- the continued dispatch of Basslink in accordance with efficiency rather than price arbitrage. Were Basslink to remain an MNSP and one of the above counterfactuals to apply, its dispatch will be driven by the opportunities for revenue optimisation arising from price arbitrage, rather than in a manner that accords with an overall market based economically efficient outcomes. This means it will be dispatched in a manner designed to accrue benefit to a particular participant (depending on which counterfactual applies), 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;
- decisions as to capital and operating expenditure, including augmentation and repairs, will be made with reference to the benefits they will bring to the whole market rather than the interests of an individual participant.

2.1.2. Supporting the energy market transition

Basslink is increasingly playing a role in supporting the energy market transition and contributing to the achievement of emissions reduction targets.

There are at least three ways in which Basslink does this:

- First, Tasmania has significant wind resources, and the commercial feasibility of leveraging that depends on the availability of high-capacity interconnection between Tasmania and mainland Australia.
- Second, Tasmania at times receives more rain than its dam capacity allows. Any reduction in the optimal operation of the interconnection between Tasmania and Victoria would lead to the waste of that renewable energy because water will need to be spilled from the dam, rather than be used to generate energy.
- Third, HT's water storages can act as long-term energy storage that can 'firm-up' intermittent renewable generators such as wind and solar. This better enables renewable energy technologies to displace 'firm' thermal technologies such as coal and gas.

For the reasons articulated above, the operation of Basslink under a regulated regime will ensure it continues to operate in a way that provides these benefits.

2.1.3. Ensuring that Basslink operations, investment and pricing are consistent with the long-term interests of consumers

Conversion of the Basslink network service to a prescribed service will mean that the AER obtains oversight of Basslink's operations, investment and pricing. Through its revenue determinations, application of incentive schemes and other regulatory instruments relating to prescribed services, the AER will have a role in ensuring that the operation, use of and investment in Basslink contribute to the achievement of the NEO. This will ensure that Basslink is operated in the interests of its users and recovers costs from its users in the same way as every other TNSP in the NEM.

2.1.4. Regulation as applied to Basslink mitigates the risks associated with conversion

The broad discretion provided to the AER under the National Electricity Law in relation to forecast operating and capital expenditure, creation of incentive schemes and determining asset lives along with the simple nature of the services provided by Basslink strongly mitigates the risks associated with conversion for an asset like Basslink.

2.2. Basslink proposes that the conversion application process run concurrently with the transmission determination process

As noted above, Basslink proposes that the conversion and revenue determination processes be run concurrently, as contemplated by the NER.⁴

This document therefore does not include all of the material that may be required for the AER's Conversion Application. Basslink intends to provide further submissions and evidence in support of the Conversion Application in accordance with the proposed timetable set out in section 3.

⁴ The AER may, in its Commencement and Process Paper, make modifications to the transmission determination process to allow the conversion application process and the transmission determination process to be run concurrently (NER, cl 6A.9.3(d)(4)).

3. Request to commence the process for making a transmission determination

3.1. Proposal to commence the process early

Basslink proposes that the process for making a transmission determination for Basslink be commenced as early as practicable, in order to maximise the time available for stakeholder consultation and AER consideration of both the Conversion Application and revenue determination.

As previously noted, Basslink proposed that Basslink be subject to economic regulation on and from 1 July 2025.

To facilitate this, Basslink proposes to submit to the AER, on or before 19 July 2023:

- its submission in support of the Conversion Application (including supporting evidence); and
- a Revenue Proposal and proposed Pricing Methodology for the first regulatory control period.

Basslink notes that this is earlier than the date on which a TNSP would usually be required to submit a revenue proposal and pricing methodology. Basslink therefore proposes to lodge its Revenue Proposal earlier than would ordinarily be required, and to modify the regulatory process to allow additional time for AER consideration and stakeholder consultation.

3.2. Proposed modifications to the transmission determination process

The AER's Commencement and Process Paper for Basslink may specify modifications to the process for making transmission determinations under Chapter 6A.

The NER do not limit the modifications that may be made by the AER to the usual Chapter 6A process.⁵ However the NER and explanatory materials make clear that these may include:

- the AER may decide to make a transmission determination in one or more stages (e.g. the AER could determine some elements, such as the initial RAB, in an initial stage, before proceeding to a full revenue determination);
- with the consent of the Intending TNSP, the AER can omit a draft decision stage and/or shorten consultation periods;
- the AER may omit or defer the publication of a F&A paper where the AER is satisfied that the matters in the F&A paper will be addressed, or the information will be provided, in another way; and/or
- the AER may omit or defer the step where the Intending TNSP informs the AER of its expenditure forecasting methodology.

Basslink proposes that the transmission determination process be modified in two ways, as explained below. These modifications are intended to facilitate early lodgement of Basslink's Revenue Proposal and increase opportunities for stakeholder consultation and AER consideration.

3.2.1. The Conversion Application and Transmission Determination will be considered at the same time

The conversion application under rule 11.6.20(c) and the Transmission Determination under rule 6A.10.1 will be considered at the same time. Basslink considers the concurrent consideration of the conversion application and transmission determination is the most practical approach.

In the event the AER approves the conversion application it will be necessary to have a transmission determination to avoid the confusion of a TNSP without a revenue control.

⁵ NER, cl 6A.9.3(d).

The simplest and most practical way of providing a transmission determination for the TNSP is for the AER to consider the Transmission Determination at the same time as it considers the Conversion Application.

3.2.2. Omission of F&A Paper and notification of expenditure forecasting approach, to facilitate early lodgement of the Basslink revenue proposal

The NER specifically identify the F&A Paper and expenditure forecast methodology steps as ones which could be omitted for an Intending TNSP. The AEMC notes that, for a converting transmission system, the matters usually dealt with in the F&A Paper could be addressed either in the Commencement and Process Paper or Issues Paper.

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.

Omitting the F&A Paper and expenditure forecast methodology stages would also allow the AER to bring forward the date for lodgement of the Basslink Revenue Proposal and increase the time available for stakeholder consultation.

3.2.3. The proposed timeframes are consistent with the timetable post submission of a transmission determination proposal under cl 6A.10.1

The proposed timetable is consistent with the timelines provided to the AER under Part 6A of the National Electricity Law for a Transmission Determination. Where a minimum time between events is required under the National Electricity Law then the proposed timeline sets a proposed time at least as long as the time taken by the AER on other resets.

3.3. Proposed timetable

APA's proposed timetable is set out below, reflecting the modifications outlined above.

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