Final decision

Application for Basslink's network service to be classified as a prescribed transmission service

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AUSTRALIAN ENERGY REGULATOR

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1 Final decision on Basslink's conversion application

APA Group is the owner of Basslink Pty Ltd, the company that owns and operates the Basslink interconnector. For consistency and clarity, we refer to 'Basslink' throughout this decision.

On 19 May 2023, Basslink lodged an application[1] with us:

- to convert Basslink's network services from market network services (that is, unregulated services) to prescribed transmission services (that is, regulated services); and
- requesting us to commence, and specify, the process of making a transmission determination for Basslink.

1.1 Our conversion decision

Clause 11.6.20(c) of the NER provides us with discretion to determine Basslink's network service to be a prescribed transmission service. In deciding whether to exercise this discretion, we are guided by the National Electricity Objective (NEO).

Our decision is to accept Basslink's application to convert its market network service to a prescribed transmission service.

We consider that converting Basslink to a prescribed transmission service is likely to contribute to the achievement of the NEO. In assessing the possible impacts of conversion on the achievement of the NEO we have considered a range of potential future states of the world and counterfactual scenarios (states of the world with a converted Basslink and states of the world without a converted Basslink). This includes consideration of the development of Marinus Link and the likely operating arrangements for an unregulated Basslink. Our analysis recognises that the Basslink investment has already been made, that the asset is currently in operation, and that the asset will most likely continue to operate regardless of conversion.

The decision to accept Basslink's conversion application is finely balanced. Modelling indicates that the economic benefits of converting the link may be modest in certain counterfactuals to conversion and Marinus Link development scenarios. However, we have determined that converting the link and having it operate as part of the regulated transmission system is more likely to deliver such benefits and ultimately promote efficient investment in, and efficient operation and use of, electricity services for the long-term interests of consumers.

A converted Basslink will ensure that the interconnector operates with the least possible constraint, enabling the market to benefit from generation in both the Tasmanian and mainland regions of the National Electricity Market (NEM) into the future. The economic modelling, commissioned to assist our consideration of the application, supports this analysis. In nearly all modelled scenarios, economic benefits result from the conversion of

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1 APA Group, *Basslink: Application for conversion and request to commence the process for making a transmission determination*, 19 May 2023. Available at: Basslink - Determination 2025–30: Initiation

Basslink. It is only in scenarios in which the alternative to conversion is having Basslink's capacity controlled by Hydro Tasmania that these benefits do not clearly materialise.

Since we made our draft decision we have received new information and evidence, including from compulsory information notices issued to APA and Hydro Tasmania, that has led us to reassess the weight we have placed on this alternative to conversion compared to our draft decision. We have considered all submissions received prior to the date of publication of this decision.

First, there is a reduced incentive for an agreement between APA and Hydro Tasmania for Hydro Tasmania to control Basslink's available capacity should Marinus Link be developed. "Hydro Tasmania does not expect it will be commercial to contract with Basslink upon Marinus Link 1 commissioning and even less so with anticipation of Marinus Link 2."[2] Given this, a likely outcome would be for Basslink to operate as a merchant for the majority of its remaining operational life, with any agreement only likely for a short duration.[3]

Second, both APA and Hydro Tasmania have emphasised challenges in reaching mutually acceptable terms for such an agreement, which may require time to resolve and result in a potential delay to arriving at an agreement (if they reach agreement at all). It is not clear that an agreement between Basslink and Hydro Tasmania would be desired by both parties at all times and in all market conditions. Included in this assessment is consideration of whether Hydro Tasmania's shareholder, the Tasmanian Government, may mandate that it seek an agreement with Basslink – for example, to ensure unconstrained flows over the interconnector. There is no indication that the Tasmanian Government would adopt this policy position, and its submissions note that current market circumstances differ markedly from those that existed at the time that the original Basslink Services Agreement was struck.

Further, the short-term commercial attractiveness of merchant operation and the potential for Basslink to seek conversion again as market conditions and transmission developments become more certain may well act as a further disincentive to reach an agreement for control of Basslink's capacity. This has helped shape our position that an agreement between Hydro Tasmania and Basslink is unlikely for the remaining life of the asset. To the extent that it occurs at all, it is more likely to be short-term and/or delayed and this shifts the balance of outcomes. This has been a key consideration in the AER moving away from the draft decision and accepting APA's application.

In considering whether conversion would support the NEO we have also considered consumer price impacts by having regard to the possible impact of conversion on transmission charges and wholesale market prices. It is certain that conversion will impose additional regulated transmission charges on consumers. However, the extent of these price effects are unlikely to have a material impact on the efficient investment in, operation and

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2 Hydro Tasmania, Submission in response to AER draft conversion decision, February 2025, p.4.

3 Marinus Link may reduce the ability of an unregulated Basslink to increase price differentials between Victoria and Tasmania by constraining flows between the regions. Therefore, the benefits of conversion and the open link that regulation provides may be lower in the periods after Marinus Link is operational. However, Basslink is expected to retain some ability to constrain flows at certain times even after Marinus Link is operational. This incentive to constrain flows would not be ameliorated where there is no agreement in place with Hydro Tasmania.

use of the electricity system. Over the long-term, Basslink's costs, as reflected in transmission charges, may be recovered from market participants whether Basslink is converted or not. However, in most scenarios the conversion is modelled to provide some improvement to economic efficiency, and we expect this will result in a net benefit for consumers over the long-term. We also consider that conversion is unlikely to materially affect reliability or other non-price aspects of the quality of electricity services.

There does remain the potential for conversion to result in consumers paying a level of transmission charges that exceed the benefits they receive from services provided by the asset. The consequences of such a risk falling on consumers has been closely considered in this decision. Ultimately, we have concluded that the asset will continue to have value and use, which reduces the potential for this outcome. This is supported by the modelling work we have commissioned and other evidence, including from the Integrated System Plan (ISP), which points to ongoing need for this transfer capacity across Bass Strait. We will carefully consider the value of the services provided by the Basslink interconnector, and the risks transferred to consumers, when considering the value of Basslink's regulatory asset base as part of our revenue determination. The important consideration for our conversion decision is that we expect the Basslink interconnector to continue to be of benefit to the market, and that we expect the benefits it may provide to be greater if converted.

Our decision is therefore to determine under clause 11.6.20(c) of the NER that Basslink's market network service will be a prescribed transmission service. This decision takes effect from the time it ceases to be classified as a market network service. This decision will lapse if Basslink's network service does not cease to be classified as a market network service before 1 July 2026.

Our approach to, and reasons for, the decision are outlined in the following chapters.

1.2 Next steps

If Basslink ceases to be registered with AEMO as a Market Network Service Provider then this decision, to convert the interconnector and classify Basslink's network services as prescribed transmission services, will take effect on 1 July 2026. The National Electricity Rules require us to make revenue determinations for TNSPs in respect of prescribed transmission services.[4]

We also note that the allocation of regulated revenue attributable to the Basslink interconnector in each of Victoria and Tasmania would determine the regulated revenue to be recovered from consumers in each region. The NER does not empower the AER to approve a cost allocation methodology.[5] Rather, if converted, Basslink would determine the allocation of its aggregate annual revenue requirement (and consequently allocation of regulated transmission charges) between Victoria and Tasmania based on the use of the interconnector. In its revenue proposal Basslink revised its initial allocation of revenue

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4 NER cl.6A.2.1.

5 We had previously stated in our issues paper that cost allocation was an important decision we would make in any revenue determination. Further, we considered that Basslink's revenue allocation methodology is permissible and is supported by the NER given it is consistent with allocating based on 'use' of a TNSPs assets to provide prescribed services within a region. In considering this matter further, we now understand that the NER does not empower the AER to approve a cost allocation methodology.

between Victoria and Tasmania to allocate 75% of regulated revenue to the Victorian region and 25% to the Tasmanian region. It is also possible for affected jurisdictions to negotiate an approach to the revenue allocation with the new interconnector rule change commencing on 3 July 2025.

When Basslink submitted its application to convert to a prescribed transmission service we commenced a revenue determination process to apply if Basslink's application was accepted. The revenue determination process was put on hold when we published our draft conversion decision not to convert Basslink. Alongside this decision we have published a consultation paper on amending the Commencement and Process Paper (CPP) to continue Basslink's revenue determination. The amended Commencement and Process Paper will set out the stages and timeline for finalising Basslink's revenue determination.

In our consultation paper on the CPP we have proposed that our revenue determination take effect on 1 July 2026, but this will be conditional on Basslink ceasing to be classified as a Market Network Service Provider before that date.

2 Framework for assessing conversion

Under clause 11.6.20(c) of the NER, Basslink may apply to us to determine that the network services it provides should be classified as prescribed transmission services (in other words, conversion of Basslink to a regulated service provider). Specifically, that clause 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.*

The NER gives us discretion to determine if Basslink will be converted to a prescribed transmission service. The NER are made under the National Electricity Law (NEL), which provides that the objective of the NEL is the National Electricity Objective (NEO). In making this decision we have had regard to whether Basslink's conversion would be likely to contribute to the achievement of the NEO.

Basslink submitted that being guided by the NEO provides a higher threshold for conversion than the previous approach of the AER and ACCC in the Directlink and Murraylink conversion decisions and is at odds with the original intent of the conversion framework. Basslink and the Tasmanian Government submitted that by deviating from this established framework we risk undermining future investment and customer confidence in the regulatory process.[6]

The Murraylink and Directlink conversion decisions were made in 2003 and 2006 respectively under different legislative frameworks than that which applies today to Basslink. We note that the NEO guides the performance and exercise of our regulatory powers and functions under the NEL and NER. Further, it is clear that clause 11.6.20(c) provides discretion to the AER on the question of conversion. It is only in relation to the regulatory asset base, that there is a requirement to apply the "previous regulatory approach," which refers to the approach used for Directlink and Murraylink.[7]

Submissions from Basslink, Mr. Pauley (member of Basslink's Regulatory Reference Group), the Tasmanian Small Business Council, and the Tasmanian Government commented on the consistency of regulatory treatment between Basslink and Marinus Link.[8] The legislative framework for the regulation of Marinus Link differs from the legislative framework for the conversion of Basslink. Marinus Link is being delivered as an actionable project as identified

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6 APA, Submission in response to AER draft conversion decision, January 2025, pp.3,31. Minister Duigan, Submission in response to AER draft conversion decision, January 2025, p.1.

7 National Electricity Rules, clause 11.6.20 (e)

8 APA, Submission in response to AER draft conversion decision, January 2025, p.34; Mr Pauley (RRG member), Submission in response to AER draft conversion decision, January 2025, pp.2-3; Tasmanian Small Business Council, Submission in response to AER draft conversion decision, January 2025, p.5; Minister Duigan, Submission in response to AER draft conversion decision, January 2025, pp.3,9.

in AEMO's Integrated System Plan, which will result in a prescribed transmission service. The Integrated System Plan framework, and the Intending Transmission Network Service Provider framework both apply to Marinus Link, and together set out the considerations for that regulatory process. In contrast, the conversion of Basslink is a decision on whether Basslink will be classified as a prescribed transmission service or not. This decision is governed by clause 11.6.20 of the rules and provides discretion to the AER in its consideration of conversion. We consider that having regard to the NEO in exercising the discretion provided under clause 11.6.20(c) of the NER is the most appropriate guide for the decision before us.

2.1 The National Electricity Objective

The NEO is to promote efficient investment in, and efficient operation and use of, electricity services for the long-term interests of consumers of electricity with respect to:

(a) price, quality, safety, reliability and security of supply of electricity; and

(b) the reliability, safety and security of the national electricity system; and

(c) the achievement of targets set by a participating jurisdiction—

(i) for reducing Australia's greenhouse gas emissions; or

(ii) that are likely to contribute to reducing Australia's greenhouse gas emissions.[9]

2.2 Our approach to the conversion decision

In assessing Basslink's conversion application we considered evidence available on whether conversion of Basslink better supports the NEO against the alternative where Basslink operates as a market network service provider (MNSP), taking into account reasonable future scenarios.

In being guided by the NEO, we have had regard to a number of matters to inform our assessment of the conversion decision:

1. Whether or not conversion supports net economic benefits through improvements to economic efficiency
   - The NEO is premised on enhancements to economic efficiency as the mechanism that supports the long-term interests of consumers.
2. Achieving greenhouse gas emissions reductions
   - With a value of emissions reduction now established in the regulatory framework for energy, it is possible to model the benefits to the market resulting from greenhouse gas emissions reductions in different scenarios.
3. The price impacts of conversion
   - The impact on consumers through transmission charges, where there are certain increases to the charges paid by consumers

9 Section 7 of the NEL.

- The impact on consumers through wholesale energy price changes and offsets to transmission charges from settlement residue auctions enable us to consider the more immediate price impacts of the decision

4. Reliability and other non-price impacts of conversion
   - We have had regard to the extent to which conversion may impact reliability and security to consumers
   - We have also had regard to how conversion may impact on risk allocation between consumers and market participants.

Stakeholder submissions

A range of stakeholders' views were provided on the approach taken to the draft conversion decision.

One theme was that the impact of consumer prices on the achievement of the NEO should not be discounted. Basslink submitted that 'fundamental weight must be given to the consumer benefits of conversion'.[10] Basslink also submitted that the consumer benefits are central to the consideration of whether or not conversion achieves the NEO as 'the NEO requires conversion to be in the long-term interest of consumers and identifies price as one of the three key factors relevant to such interest'.[11] The Tasmanian Government submitted that "efficiency is the means to an end, and the end is the interest of consumers".[12] The Victorian Government submitted that "conversion will result in Basslink's costs being shifted to Victorian and Tasmanian consumers, recovered via Transmission Use of System (TUOS) charges", and that "any additional cost increases without clear and corresponding benefits would be inconsistent with the long-term interests of electricity consumers in the NEM and conflicts with the National Electricity Objective".[13]

A second issue was the extent to which the certainty afforded by regulating the link may promote efficient investment in upstream and downstream markets. Hydro Tasmania and the Tasmanian Government submitted that uncertainty resulting from merchant operation of Basslink would discourage efficient investment in generation and storage infrastructure supporting the energy transition. Hydro Tasmania noted "AEMO's integrated system plan highlights the $142 billion investment challenge facing the NEM's transition", and submitted that this investment and the timely transition may be impacted by uncertainty that may result from a merchant Basslink.[14]

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10 APA Group, Submission in response to AER Conversion Consultation Paper, 20 September 2024, p. 6.

11 APA Group, Submission in response to AER Conversion Consultation Paper, 20 September 2024, p. 8; APA, Submission in response to AER draft conversion decision, January 2025, pp3,31-32.

12 Minister Duigan, Submission in response to AER draft conversion decision, January 2025, p.7.

13 Minister d'Ambrosio, Submission in response to AER conversion consultation paper, 30 September 2024, p. 1.

14 Hydro Tasmania, Submission in response to AER draft conversion decision, February 2025, pp.9-10. Minister Duigan, Submission in response to AER draft conversion decision, January 2025, pp.2,9-11.

A final issue raised by Basslink was the extent to which conversion could support the consistent regulatory oversight by the AER of all interconnectors in the NEM and would enhance consumer engagement in the operation of Basslink.[15]

Our response and approach

Consistent with our draft decision, we have placed considerable weight on the extent to which conversion will support the efficient investment in, operation and use of, the electricity system. Efficiency promotes consumer outcomes by supporting energy provision at the lowest cost, to those that value it most and to enable investment that adapts to evolving needs. To understand the extent to which converting Basslink may support economic efficiency, we have had regard to market modelling of economic benefits of conversion in our assessment of conversion against the NEO. To estimate potential improvements to economic efficiency we examine the modelled total cost to produce, transport, and consume electricity in the NEM. We compare this total cost outcome that is modelled to occur given a converted Basslink against the total cost outcome that is modelled to occur with an unregulated Basslink. To the extent that costs are lower with a converted Basslink then we can consider that conversion improves economic efficiency. The modelling included estimates of the total system costs and benefits of greenhouse gas emissions reductions. We commissioned ACIL Allen to undertake the modelling on behalf of the AER.

The modelling also estimated the extent to which Basslink may lead to the efficient investment in upstream and downstream markets. The market modelling forecasts whether conversion would lead to different patterns of generation and transmission development in the NEM. The modelling results indicate that conversion would not impact wholesale prices sufficiently to induce generator entry or exit.

Energy market modelling provides an informative input to our assessment of the effect that converting Basslink would have on economic efficiency. It is widely used for similar regulatory analyses such as in the Regulatory Investment Test. We have used it to understand the market dynamics that drive efficiency outcomes and consumer impacts in different scenarios. It has supported our consideration of this decision by enabling us to explore future states of the world and scenarios.

However, we also acknowledge the inherent uncertainty in modelling and the positions of stakeholders that it should not be the singular determinant of our decision. We have, therefore, sought to consider modelling results alongside our assessment of other evidence, including that presented in stakeholder submissions, of the likely future operation of the link depending on whether it is converted or not.

Also consistent with our draft decision, we consider the price changes (or consumer benefits) resulting from conversion as an important consideration. However, we see them as less informative in determining whether the conversion of Basslink will result in efficiency benefits in accordance with the NEO. This is because these price changes may represent changes in payments between producers, transporters and consumers of electricity, but may not be indicative of an overall efficiency gain. We also note that price changes are likely to be small in the context of the overall electricity system and that demand for electricity is relatively price

[15] APA, Submission in response to AER draft conversion decision, January 2025, pp.18,21,23.

inelastic in the short term. Accordingly, we would not expect the price changes to materially shift consumption and drive efficiency improvements.[16] Our consideration of the issue of price is further set out in section 3.4.

We note that the NER provide operating standards for transmission and distribution networks that ensures appropriate performance of these networks regardless of their regulatory status. As set out in section 3.6, we consider that reliability and other non-price aspects of service quality are unlikely to be materially impacted by conversion.

16 Noting that electricity demand is relatively inelastic, particularly in the short-term. Infrastructure Victoria, Lorraine Conway and David Prentice, How Much Do Households Respond To Electricity Prices? Evidence From Australia And Abroad, Technical Paper No. 1/19, September 2019.

3 Assessment of outcomes

This section sets out the possible outcomes of conversion including our consideration of possible future states of the world should Basslink convert or otherwise. These possible states of the world will impact on whether benefits are likely to be realised from conversion and could impact the price and reliability effects of conversion compared to the different possible outcomes without conversion. It addresses the likely outcomes against the 4 matters set out in section 2.

If Basslink is converted it would operate as a fully available interconnector. Flows across the interconnector would be determined by the Australian Energy Market Operator (AEMO) central dispatch without economic constraint from Basslink.[17] In this circumstance we expect flows across the Basslink interconnector to be maximised.[18]

If Basslink is not converted it would remain as an MNSP. Basslink would earn revenue from price differentials between Tasmania and Victoria.[19] We expect that if Basslink remained as a MNSP this may result in different dispatch outcomes compared to a converted Basslink. If the dispatch patterns of a converted Basslink result in lower overall costs to produce and transport electricity in the NEM, or lower emissions, then there may be benefits from conversion.[20] Conversely, if the dispatch patterns of a converted Basslink result in higher costs to produce and transport electricity, or higher emissions, then there may be detriments from conversion.

3.1 Future states of the world

Assessing the likely benefits of conversion is helped by considering potential future states of the world that will have an impact on the realisation of benefits. For the purposes of this decision there are two particular issues of relevance.

1. The future development scenarios for Marinus Link.
2. The way in which Basslink is likely to operate should it not be converted – the counterfactuals to conversion.

These issues are discussed in the subsections below.

Marinus Link scenarios

Marinus Link is a proposed interconnector between Tasmania and Victoria with a capacity of 1500MW consisting of two separate cables. It involves approximately 255 kilometres of undersea High Voltage Direct Current (HVDC) cable and approximately 90 kilometres of underground HVDC cable in Victoria. It also includes converter stations in Tasmania and Victoria. The 2024 AEMO Integrated System Plan (ISP) includes the Marinus Link cables as an actionable project that form part of the system's Optimal Development Path (ODP). The

17 Subject to losses and other system constraints, and outages for planned or unplanned maintenance.

18 To the limit of efficiency, taking into account regional prices and transmission losses.

19 Or from the supply of derivative instruments settled against those differentials.

20 That is, benefits of contributing to the achievement of the National Electricity Objective (NEO).

Marinus Link interconnectors would serve a similar purpose to Basslink, connecting the Tasmanian and Victorian National Electricity Market regions.

The timing and number of cables that are developed as part of the Marinus Link project may have an impact on the expected benefits of converting Basslink to a regulated interconnector. As a substitute to Basslink for the transfer of energy between Tasmania and Victoria, Marinus Link cables coming into operation may reduce the level of demand for Basslink's interconnector services. Consequently, the timing and number of Marinus Link cables may impact the amount of opportunities for an unregulated Basslink to constrain its flows with the aim of increasing price differentials.

The market modelling undertaken by ACIL Allen adopts the optimal timings of the Marinus Link cables as identified in the draft 2024 ISP, which was the most recent assumptions available at the time of the modelling. The draft 2024 ISP identified the optimal timing was for the first Marinus Link cable to be operational in 2029 and the second cable operational in 2036. In the final 2024 ISP, the optimal timing for cable 1 was adjusted to 2030-31 under all scenarios. For the second cable the optimal timing was 2036-37 under the progressive change scenario, 2037-38 under the step change scenario, and 2032-33 under the green energy exports scenario.

The final 2024 ISP also notes the timing that is proposed by the proponent of the project (Marinus Link Pty Ltd in this case), as distinct from the timing identified as optimal for the ISP. The proponent-advised timing, as reported in the final 2024 ISP, for cable 1 is December 2030 and for cable 2 is December 2032.[21] In subsequent ISPs there will be an opportunity to reassess the optimal timing of any second Marinus Link cable.

There remains uncertainty about the timing of any Marinus Link cables. The modelled scenarios act as sensitivities in that the result of a cable becoming operational later than these assumed dates can be estimated by placing more weight on the scenario where that cable is not delivered. In effect, the benefit from the intervening years would be taken from the scenario without the cable.

Counterfactuals

The way in which Basslink operates should it remain unregulated is also an important factor in whether market benefits from conversion may eventuate. Essentially, there are five counterfactuals to conversion that are of particular relevance to the decision.

1. Basslink operates as a Market Network Service Provider bidding in its transport capacities to the wholesale market (similar to a generator bidding into the market) on a merchant basis, i.e. without a contract or hedge in place (the 'Merchant Interconnector' counterfactual).
2. Basslink operates under a contract with Hydro Tasmania whereby Hydro Tasmania bids the transport capacity and pays a fee to the operator of Basslink in return (the 'HT Agreement' counterfactual).
3. Basslink operates under a contract with another counterparty, whereby that counterparty bids the transport capacity of Basslink and pays a fee to Basslink in return.

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21 See: AEMO, 2024 Integrated System Plan: Appendix 5 – Network Investments, June 2024, p. 37.

4. Basslink operates under an agreement with Hydro Tasmania, whereby Basslink must operate as an 'open link', with its transport capacity bid at $0 (in most circumstances), and Hydro Tasmania accesses the interconnector's inter-regional revenue in exchange for a fixed fee. This type of agreement would be similar to the Network Services Agreement currently in place between Basslink and Hydro Tasmania. [22]
5. Basslink fails to cover its stay-in-business costs and ceases to operate.

In some of these counterfactuals Basslink, or the contract counterparty that may bid Basslink's capacity, may have an incentive to constrain flows over the interconnector at times with the aim of putting upward pressure on prices in one of the regions and creating a larger price differential. Basslink may constrain flows over the interconnector by either:

- bidding substantial margins on the transfer of power, or
- economically withdrawing capacity, or pricing capacity at or close to the market price cap.

Under the second and third counterfactuals, if the contract counterparty is a generator in the NEM it may bid Basslink's transport capacity in a manner that benefits that counterparty's existing energy portfolio – for example, by constraining Basslink's availability to the market, reducing the available energy in a particular region and putting upward pressure on prices in that region. Different behaviour may be expected depending on the prevalence of the counterparty's energy portfolio on either side of the Basslink interconnector (Tasmania or mainland Australia).

We engaged ACIL Allen to undertake market modelling of the impact of the Merchant Interconnector and HT Agreement counterfactuals, but not the third counterfactual of a mainland contract counterparty. As Hydro Tasmania has a large share of total generation in Tasmania we are able to model the impact of a counterfactual that aligns this generation portfolio with Basslink's capacity. On the mainland, however, there are many varied energy portfolios that may have very different complementarities with the Basslink interconnector. Understanding each of these possible counterfactuals would require modelling a large number of scenarios. Further, market share is much less concentrated in the mainland NEM regions, which may reduce any ability for a contract counterparty to utilise its contracted Basslink capacity to influence prices and earnings on its existing energy portfolio.

Instead, we sought to understand the impacts of the third counterfactual of a mainland contract counterparty through examining conceptually how the model results for the Merchant Interconnector counterfactual may vary if aligned with various mainland energy portfolios. In this task we have been guided by expert advice and our own internal analysis.

The fourth counterfactual, an agreement between Basslink and Hydro Tasmania on the same terms as the current Network Services Agreement, would provide market outcomes that are similar to a regulated Basslink. On this basis, we assume that any benefits to the market from efficiency gains from converting are zero during years covered by this type of agreement. We note though that while this type of agreement may not result in more or less

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22 See: Hydro Tasmania, Update regarding Basslink contract arrangements, 24 October 2022, available at: https://www.hydro.com.au/docs/default-source/about-us/our-governance/esi-compliance-plan_notices/voluntary-enhancement-compliance-plan-notice-update-regarding-basslink-contract-arrangements_24-oct-2022.pdf?sfvrsn=864e6d29_3

efficient outcomes than would result under conversion, it would lead to different levels of regulated transmission charges for consumers.

3.2 Market benefits of conversion

In estimating the benefits or detriments of conversion under different scenarios, we have been informed by market modelling, as well as analysis of energy market dynamics and the sensitivity of regional prices to changes in available capacity of Basslink.

Table 3.1 shows the estimated benefits of conversion for a range of possible future states of the world as described in section 3.1. The columns are the Marinus Link development scenarios, and the rows are counterfactuals reflecting the different assumptions about the way Basslink may operate should it not be converted.

We received a range of stakeholder input on the approach taken to modelling by ACIL Allen.

This table illustrates how benefits of conversion to the market as modelled by ACIL Allen are estimated to range from positive to negative values in various possible future states of the world. The modelling indicates there may be benefits from conversion if the counterfactual is a Merchant Interconnector, but detriments to conversion if the counterfactual is a HT Agreement. Greater interconnection provided by Marinus Link decreases the expected benefits of conversion under both counterfactuals. However, the modelled results of benefits under the Merchant Interconnector counterfactual and detriments under the HT Agreement counterfactual remains constant.

Table 3.1 Modelled Market Benefits of conversion in different Marinus Link development scenarios and counterfactuals

Counterfactual	Benefit of conversion over the counterfactual (NPV, $million)		
	Marinus Link does not proceed	1 Marinus Link cable proceeds, operational in 2029	2 Marinus Link Cables proceed, operational in 2029 and 2036
Merchant interconnector	380	340	229
HT agreement	-46	-103	-155

Notes: Benefits include both (1) lower costs to produce, transport, and consume electricity; and (2) lower greenhouse gas emissions.
The HT agreement counterfactual is where Basslink operates under a contract with Hydro Tasmania whereby Hydro Tasmania bids the transport capacity and pays a fee to Basslink in return.
The counterfactuals are assumed to be in place over the entire modelled time horizon of 2025-50.

Source: ACIL Allen, *Basslink Conversion: Modelling and Analysis of Benefits*, p. 35

Drivers of modelled conversion benefits

As noted above, benefits from conversion arise when conversion would result in more efficient generator dispatch patterns across the NEM than would otherwise occur in the

counterfactual. These more efficient dispatch patterns are driven by greater utilisation of the Basslink interconnector if converted (regulated).

Under the merchant interconnector counterfactual, the market modelling finds that Basslink constrains the interconnector's flows at times, as doing so decreases the available energy in one of the interconnected regions (Victoria or Tasmania) during those times, putting upward pressure on prices and resulting in larger price differentials between the regions (price differentials being the merchant Basslink's main source of revenue). A regulated link would operate freely without being constrained by the operator of the link for strategic economic reasons. The greater utilisation of the Basslink interconnector under regulation than under the counterfactual allows lower cost and lower emission electricity generation to be dispatched, resulting in efficiencies from reduced costs to produce and transport electricity and/or lower greenhouse gas emissions.[23]

Under the HT Agreement counterfactual the market modelling also finds that Basslink interconnector's flows would be constrained at times, though less often than is modelled to occur under the merchant interconnector counterfactual. Accordingly, the modelling forecasts lower benefits of conversion under the HT Agreement than the merchant counterfactual, to the point where benefits in some years are negative (that is, there are detriments to conversion). The detriments in these years outweigh the benefits on other years, and overall the model forecasts detriments to conversion under the HT Agreement counterfactual.

The market modelling finds that, under the HT Agreement counterfactual, Basslink's flows into Tasmania would be constrained more often than Basslink's flows out of Tasmania. Hydro Tasmania has an incentive to constrain Basslink flows into Tasmania and increase its own generation to meet Tasmanian demand. Hydro Tasmania's constraining of imports over Basslink may at times create efficiency gains, as Hydro Tasmania's increased generation displaces imported generation that has a higher marginal cost and generates higher emissions. Under this counterfactual, conversion would prevent these efficiency gains from being achieved, leading to the modelled result of detriments to converting in some years.

Hydro Tasmania submitted that the "modelling assumes that Hydro Tasmania's generation revenue would offset the value of strategic link bidding, creating an artificially efficient outcome. In reality, Hydro Tasmania has strong commercial incentives to maximise price separation rather than prioritise full link utilisation".[24] Conversely, the Victorian government submitted that in the HT Agreement counterfactual Hydro Tasmania will be exposed to the Victorian regional reference price and will be incentivised to operate its generation assets in a way that that will maximise revenue from energy flows over the link.[25] We have set out above how the market modelling forecasts Hydro Tasmania to constrain Basslink utilisation to create price separation in a manner that drives the efficiency outcomes.

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23 Basslink also submitted that these efficiency gains are likely to result from the increased utilisation of the link that could be expected under conversion compared to a merchant counterfactual (APA Group, Submission in response to AER draft conversion decision, January 2025, pp.18, 21-23).

24 Hydro Tasmania, Submission in response to AER draft conversion decision, February 2025, p.6.

25 Minister d'Ambrosio, Submission in response to AER draft conversion decision, February 2025, p.1.

Benefits of converting under the mainland counterparty counterfactual

Model results were not generated for the counterfactual of Basslink contracting with another counterparty (where that counterparty is able to determine Basslink's availability and bid Basslink's transport capacity into the wholesale market). We would not expect a contract counterparty to have different results than the Merchant Counterfactual (that is, different availability of Basslink and market dispatch) unless the counterparty has a complementary energy portfolio in the NEM.

A contract counterparty with large baseload generation or large peak load generating capacity may have incentive to constrain Basslink's flows to a greater extent than modelled in the Merchant Interconnector counterfactual. The counterparty's complementary portfolio may then be used to leverage the higher prices that may result from the constraints on Basslink's flows. On the other hand, a counterparty with a complementary generation portfolio may require firm generation to hedge its retail contracts, may seek to obtain this (at least in part) from Hydro Tasmania and Basslink, and may therefore have less incentive to constrain Basslink's flows.

Overall, we consider that the benefits of conversion under the counterfactual of a contract with a mainland counterparty are likely to be similar to the benefits modelled under the Merchant Interconnector counterfactual, noting that they may be slightly greater or lesser than the Merchant Interconnector results but are unlikely to be negative.

Other possible benefits of converting not reflected in the model results

There may be additional efficiency implications of conversion not reflected in the market modelling. The Victorian government submitted that under the counterfactuals to conversion the operator of Basslink (whether Basslink itself, Hydro Tasmania, or another contract counterparty) would have incentives to operate the link to minimise counter-price flows. Therefore, conversion may result in increased counter-price flows and the modelled benefits may be over-stated if these counter-price flows are inefficient.

Ordinarily, energy will flow over an interconnector from a lower priced region to a higher priced region. Occasionally, often due to network constraints in the lower priced region, counter-price flows occur and energy will flow in the opposite direction: from a higher priced region to a lower priced region. Under the National Electricity Rules, generators receive the price of the region they are located in, while customers pay the price of the region they are located in. Therefore, when counter price flows occur the prices paid by consumers (who are in the lower priced region) will not be sufficient to compensate the prices owed to generators supplying the energy flowing over the interconnector (who are in the higher priced region). As an unregulated interconnector (that is, MNSP) Basslink incurs the cost of funding the shortfall. If converted, the shortfall would be funded by the TNSP in the importing region, and ultimately passed on to electricity consumers.[26]

[26] There may also be indirect costs associated with counterprice flows, caused by less efficient dispatch, lessened ability for market participants to hedge high price events, and lower returns on auctions of settlement residues.

The Victorian Government submitted that it would be difficult to estimate the impact of counter-price flows if the operator of Basslink no longer had the incentive to minimise them.[27] We acknowledge the potential incentive issues regarding counter price flows and the difficulty in estimating whether conversion would impact the instances of counter-price flows over Basslink. It is also not clear that any counter-price flows across Basslink would represent a decrease in economic efficiency, or that conversion would materially improve efficiency in relation to counter-price flows. For these reasons, we have not discounted the modelled benefits of conversion on the basis of possible detriments from counter-price flows.

Impact of a delayed start to a HT Agreement on modelled conversion benefits/detriments

The modelling results shown in Table 3.1 reflect a single counterfactual applying for the entire modelled time horizon (2025-50). However, there may not be an agreement between Basslink and Hydro Tasmania in place for this entire time period. The current Network Services Agreement between Basslink and Hydro Tasmania has a term to 30 June 2025, and a new agreement – of the kind modelled by ACIL Allen[28] – may not be in place by 1 July 2025.

If a HT Agreement is not in place, there are a number of scenarios that may occur. Basslink may operate as an unhedged merchant interconnector until a HT Agreement is in place. Alternatively, Basslink may seek an interim hedge agreement to mitigate revenue volatility that may occur under merchant operation. This may be achieved through an extension to the current Network Services Agreement, or through an agreement with another counterparty. Should an interim agreement be established faster than a HT Agreement, the term of an interim agreement may also influence the length of delay to the establishment of a HT Agreement.

Table 3.2 shows the model results for the HT Agreement counterfactual if there is a delay to its commencement, with two options considered during the delay: that Basslink operates as a merchant interconnector, or that Basslink operates under an extension of the current Network Services Agreement.[29]

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27 Minister d'Ambrosio, Submission in response to AER draft conversion decision, February 2025, pp.1-2.

28 That is, an agreement whereby Hydro Tasmania is able to determine Basslink's availability and is not constrained by the current Transport Bidding Protocol that applies to the current Network Services Agreement.

29 These benefit estimates are derived by removing the benefit modelled under the HT Agreement during the delay years of delay, and adding to those years the benefit modelled for the counterfactual that is assumed to apply (either merchant Basslink of extension of the NSA). Where the counterfactual during the delay is an extension to the NSA, the benefit of conversion is assumed to be zero.

Table 3.2 Modelled Market Benefits of conversion – impact of reduced length of HT Agreement (delay to commencement)

Counterfactual	Benefit of converting over the counterfactual (NPV, $ million)		
	Marinus Link does not proceed	1 Marinus Link cable proceeds, operational in 2029	2 Marinus Link Cables proceed, operational in 2029 and 2036
HT Agreement 2025-50	-46	-103	-155
Delay to HT Agreement – with Merchant Interconnector during delay			
One year delay: Merchant Interconnector in 2025-26, HT Agreement 2026-50	63	6	-46
Two year delay: Merchant Interconnector in 2025-27, HT Agreement 2027-50	158	103	51
Delay to HT Agreement – with extension to current Network Services Agreement during delay			
One year delay: NSA extension in 2025-26, HT Agreement 2026-50	64	7	-45
Two year delay: NSA extension in 2025-27, HT Agreement 2027-50	144	85	33

Notes: Benefits include both (1) lower costs to produce, transport, and consume electricity; and (2) lower greenhouse gas emissions.
The HT Agreement counterfactual is where Basslink operates under a contract with Hydro Tasmania whereby Hydro Tasmania bids the transport capacity and pays a fee to Basslink in return.

Source: AER analysis of ACIL Allen model results - see ACIL Allen, *Basslink Conversion: Modelling and Analysis of Benefits*, p. 35.

There are two notable implications from the results in Table 3.2:

- A delay to the commencement of a HT Agreement increases the modelled benefits of converting, and a longer delay results in a greater increase in modelled benefits.
- A one-year delay moves the model results from conversion being detrimental to conversion producing negligible benefits or detriments (when considered across the three Marinus Link scenarios). A two-year delay results in conversion being beneficial across all Marinus Link scenarios (though modelled benefits are marginal in the scenario where both Marinus Link cables are constructed).

These implications are predominantly driven by the effects outlined above of Hydro Tasmania constraining Basslink imports under the HT Agreement counterfactual. This constraint is more likely to occur in earlier years, as prices in later years discourage Hydro

Tasmania constraining Basslink's flows, while Marinus Link may also enter the market and import energy into Tasmania. This constraint is also more likely to result in efficiency gains in earlier years before coal generator retirements and growth in renewable generation.

Impact of reduced length of HT Agreement on modelled conversion benefits/detriments

Another reason why a HT Agreement may not be in place for the entire modelled time period (2025-50) may be the influence of any Marinus Link cables that may be constructed.[30]

Table 3.3 shows the modelled market benefits if the length of the HT Agreement does not extend past the timing of the first Marinus Link cable commencing operations.

Table 3.3 Modelled Market Benefits of conversion – impact of reduced length of HT Agreement (limited by Marinus Link timing)

Counterfactual	Benefit of conversion over the counterfactual (NPV, $million)	
	1 Marinus Link cable proceeds, operational in 2029	2 Marinus Link Cables proceed, operational in 2029 and 2036
HT Agreement 2025-50	-103	-155
HT Agreement length limited by timing of Marinus Link: HT Agreement 2025-2029, then Merchant Interconnector 2029-2050	65	-45
HT Agreement length limited by timing of Marinus Link – plus one year delay to start of agreement: Merchant Interconnector 2025-26, then HT Agreement 2026-29, then Merchant Interconnector 2029-50	174	65

Notes: Benefits include both (1) lower costs to produce, transport, and consume electricity; and (2) lower greenhouse gas emissions.
The HT Agreement counterfactual is where Basslink operates under a contract with Hydro Tasmania whereby Hydro Tasmania bids the transport capacity and pays a fee to Basslink in return.

Source: AER analysis of ACIL Allen model results, see ACIL Allen, *Basslink Conversion: Modelling and Analysis of Benefits*, p. 35.

Table 3.2 and Table 3.3 indicate that there are benefits of conversion in most scenarios if the counterfactual does not involve a HT Agreement for the entire modelled time period (or an extension to the NSA for the entire period, which would result in neither benefits nor detriments to conversion). Detriments from converting, in relation to a reduced length HT

[30] Hydro Tasmania, Submission in response to AER draft conversion decision, February 2025, p.4.

Agreement counterfactual, were only modelled to occur in scenarios where both Marinus Link cables are constructed (though not in every scenario with both Marinus Link cables).

Updated benefit estimates for conversion taking effect 1 July 2026

If Basslink is converted to a prescribed transmission service we will need to make a revenue determination in relation to the service. We would not be able to make a revenue determination for Basslink in time for it to take effect on 1 July 2025. Rather, it is likely that the earliest a revenue determination may come into effect is 1 July 2026. Therefore, the modelled benefits of converting in the first year cannot be achieved. Table 3.4 shows the impact on modelled benefits with the benefits of the first year removed. Table 3.4 shows that the removal of benefits of conversion in the first year does not materially impact our conversion decision, as:

- Benefits from converting under the merchant interconnector counterfactual are lower but still positive. We also infer from these results that benefits from converting under the counterfactual of a mainland contract counterparty would similarly be lower but positive.
- The detriments from converting under the HT Agreement counterfactual are lower, and become benefits in the scenario where no Marinus Link is constructed.
- The key consideration remains the likelihood of a HT Agreement being in place for the entire forecast period (2026-50).

Table 3.4 Modelled Market Benefits of conversion – impact of delay to conversion taking effect

Counterfactual	Benefit of conversion under counterfactual (NPV, $million)		
	Marinus Link does not proceed	1 Marinus Link cable proceeds, operational in 2029	2 Marinus Link Cables proceed, operational in 2029 and 2036
Merchant interconnector 2025-50	380	340	229
Merchant interconnector 2026-50	381	341	230
HT agreement 2025-50	-46	-103	-155
HT agreement 2026-50	64	7	-45

Notes: Benefits include both (1) lower costs to produce, transport, and consume electricity; and (2) lower greenhouse gas emissions.
The HT agreement counterfactual is where Basslink operates under a contract with Hydro Tasmania whereby Hydro Tasmania bids the transport capacity and pays a fee to Basslink in return.
Source: ACIL Allen, *Basslink Conversion: Modelling and Analysis of Benefits*, p. 35

3.3 Our assessment of future scenarios

Marinus Link

We note that Marinus Link is an actionable ISP project and consider that at least one cable is likely to proceed. However, we note that some transmission projects have historically been

subject to development delays. The 2024 ISP forecasts the optimal timing for the first Marinus Link cable to be in operation in 2030-31. Marinus Link Pty Ltd reached a positive recommendation on the final investment decision for the first Marinus Link cable in June 2025, though Marinus Link Pty Ltd has not provided to us an updated forecast of when it expects the cable to be operational. All stakeholders that commented on the possible timing of Marinus Link submitted that the timings are likely to be later than assumed in ACIL Allen's modelling.[31] Further, Basslink,[32] along with the Tasmanian Government,[33] suggested that some weighting should still be given to the possibility of Marinus Link not proceeding when considering the likely outcomes of conversion, given project delays and the fact that the project had not yet reached the point of a final investment decision.

While Project Marinus is an actionable ISP project for which the RIT-T concluded that 2 cables are preferred over one, the timing of a second Marinus Link cable is relatively less certain. The 2024 ISP notes that Marinus Link Pty Ltd forecasts the second cable coming online in 2032, while the ISP identifies the optimal timing for the second cable ranging from 2032-33 to 2037-38, depending on market scenarios. We also note the first cable is a prerequisite for the second cable. Concerns about delays to transmission development apply to the second cable as well as the first cable, and we note that the values for the 'two Marinus Link cables' scenario in Table 3.1 reflect both the first and second cable coming online by the assumed timings. On this basis we believe that either the one or two Marinus Link cable scenarios are reasonably foreseeable.

We also continue to place some weight on the no Marinus Link scenario given that the timing of the first Marinus Link cable is still unknown. The 'no Marinus Link' scenario helps us consider the impact on modelled benefits of delays to the commissioning of Marinus Link.

Counterfactuals to conversion

The outcomes of the market modelling indicate that there may be benefits of conversion in most scenarios if the counterfactual does not involve an agreement between Basslink and Hydro Tasmania that is in effect for the entire modelled time period (from the expiry of the current Network Services Agreement on 30 June 2025 to the end of Basslink's asset life[34]). A key consideration for our conversion assessment is therefore the likelihood of an agreement

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31 APA Group, Submission in response to AER Conversion Consultation Paper, 20 September 2024, pp. 21-23; Tasmanian Government (Renewables, Climate, and Future Industries Tasmania - ReCFIT), Submission in response to AER Conversion Consultation Paper, 23 September 2024, pp. 2-3; Victorian Government Department of Energy, Environment and Climate Action (DEECA), Submission in response to AER Conversion Consultation Paper, 30 September 2024, pp. 2-3; Mr. J Pauley, Submission in response to AER Conversion Consultation Paper, 30 September 2024, pp. 7-8; MR J Pauley, Submission in response to AER draft conversion decision, January 2025, p.4; APA Group, Submission in response to AER draft conversion decision, January 2025, pp.42-44; Hydro Tasmania, Submission in response to AER draft conversion decision, February 2025, p.1.

32 APA Group, Submission in response to AER Conversion Consultation Paper, 20 September 2024, p. 22. APA Group, Submission in response to AER draft conversion decision, January 2025, pp.42-43.

33 Tasmanian Government (Renewables, Climate, and Future Industries Tasmania - ReCFIT), Submission in response to AER Conversion Consultation Paper, 23 September 2024, pp. 2-3.

34 The engineering life of the Basslink interconnector is 40 years, 2006 to 2046. It may be possible that the asset can continue to provide services beyond 2046. The market modelling was undertaken to 2050.

between Basslink and Hydro Tasmania being in effect over the full span of this time period, relative to other possible counterfactuals (set out in section 3.1).

For some of the modelled scenarios in which an agreement between Basslink and Hydro Tasmania does not span the full model period, the benefits or detriments forecast by the modelling are relatively small, and near zero when considered on average across different Marinus Link eventualities. Given the possibility of conversion transferring risk from Basslink to consumers as considered in section 3.5, we consider conversion would promote the achievement of the NEO in scenarios with positive benefits materially different from zero, but not where benefits are around zero.

Stakeholder submissions

Submissions from stakeholders have provided a range of views on the likely counterfactuals should Basslink not be converted.

Basslink submitted that "without conversion, it is extremely likely that the Basslink interconnector will be used for merchant trading either by APA or a non-Tasmanian generator". Basslink noted APA's December 2024 announcement to the Australian Stock Exchange that "it would progress its plans to trade Basslink as an unhedged MNSP, plans which are well underway". Basslink submitted that "ACIL Allen modelling indicates merchant trading will deliver the highest returns across most scenarios". Mr Pauley similarly submitted that ACIL Allen modelling results indicate "merchant trading offers APA a superior benefit than continuing the arrangement with Hydro Tasmania". We note though that these merchant returns may be volatile – Basslink did not state whether it would prefer, on a risk-adjusted basis, to operate Basslink as an unhedged merchant.[35]

Basslink also submitted that since the ASX announcement "multiple mainland participants have expressed an interest in acquiring the capacity with the purpose of trading the asset". Basslink submitted that selling its capacity to a third party (other than Hydro Tasmania), who would then trade that capacity in a manner designed to optimise financial outcomes, must be considered a very credible counterfactual.[36]

Hydro Tasmania submitted that an unhedged merchant Basslink is the "most appropriate counterfactual" to conversion, while also acknowledging that "Hydro Tasmania and Basslink would have some incentives to contract with each other under continued merchant operation, to increase mutual certainty of market revenues and reduce commercial risks."[37] However, in response to our draft conversion decision Hydro Tasmania submitted that "Hydro Tasmania has no plan to extend the current NSA" and that "the parties' incentives and assessments of value in any hypothetical future contract will differ, which may result in no commercial 'meeting of the minds' sufficient to result in any agreement, or only in short term contracts

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35 APA Group, Submission in response to AER draft conversion decision, January 2025, pp.3,36,38. Mr Pauley (member of Basslink's Regulatory Reference Group), Submission in response to AER draft conversion decision, January 2025, p.4.

36 APA Group, Submission in response to AER draft conversion decision, January 2025, pp.3,36,38.

37 Hydro Tasmania, Submission in response to AER Conversion Consultation Paper, 30 September 2024, p. 2.

addressing a specific risk, strategy or market opportunity".[38] Hydro Tasmania also submitted that it "does not expect it will be commercial to contract with Basslink upon Marinus Link 1 commissioning and even less so with anticipation of Marinus Link 2".[39]

The Victorian Government submitted that the "Merchant counterfactual is not plausible in the long term, due to the overriding compelling case for both parties to sign another hedge agreement. It is therefore more appropriate to compare costs and benefits under the [Hydro Tasmania] Agreement counterfactual."[40] In response to our draft conversion decision the Victorian Government submitted that "given that the case for conversion is maximised by downplaying the likelihood of arriving at such an agreement…limited weight should be given to comments from APA Group to the effect that an agreement is unlikely". The Victorian Government also submitted that "were Hydro Tasmania to lose access to the Victorian RRP [regional reference price], it would have a complex challenge in managing its electricity portfolio and optimising its bidding into the NEM".[41]

The Tasmanian Government on the other hand submitted that the Hydro Tasmania agreement scenario was less likely, primarily because the primary drivers of previous agreements – to underpin the original development of Basslink and Tasmania's entry to the NEM, and to provide a path out of administration – no longer apply.[42] The Tasmanian Government also emphasised potential competition concerns associated with a new agreement that may not be approved by the ACCC. In response to our draft conversion decision the Tasmanian Government submitted that the likelihood of Hydro Tasmania entering into a new agreement with APA over Basslink is very low, as is the likelihood of the Tasmanian Government intervening to ensure such an agreement.[43]

Stakeholders also submitted that we should consider the possibility that Basslink ceases to operate if not converted, particularly in scenarios where Marinus Link is built, and the benefits that conversion may provide under that counterfactual. Mr Pauley submitted that "once Marinus Link is operational there will be limited value left in Basslink and it is highly likely it will become a stranded asset… One of the key reasons for adopting a regulated asset approach to long term infrastructure such as transmission cables is to maximise their life and to also ensure consumer benefits associated with reliability and security are maximised".[44]

The Tasmanian Government submitted:[45]

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38 Hydro Tasmania, Submission in response to AER draft conversion decision, February 2025, pp.3-4.

39 Hydro Tasmania, Submission in response to AER draft conversion decision, February 2025, p.4.

40 Victorian Government Department of Energy, Environment and Climate Action (DEECA), Submission in response to AER Conversion Consultation Paper, 30 September 2024, p. 2.

41 Minister d'Ambrosio, Submission in response to AER draft conversion decision, February 2025, p.1.

42 Tasmanian Government (Renewables, Climate, and Future Industries Tasmania - ReCFIT), Submission in response to AER Conversion Consultation Paper, 23 September 2024, p. 4

43 Minister Duigan, Submission in response to AER draft conversion decision, January 2025, pp.4-5.

44 Mr Pauley (member of Basslink's regulatory reference group), Submission in response to AER draft conversion decision, January 2025, p.4.

45 Minister Duigan, Submission in response to AER draft conversion decision, January 2025, p.8.

> *By rejecting the conversion application, the AER is forcing Basslink to remain a MNSP, with its only commercial model being monetising the value of IRRs [inter-regional revenues] between Tasmanian and Victoria. To the extent that Marinus, operating as a TNSP, materially erodes the value of IRRs to the point that it is no longer profitable for the Basslink owner to operate the link (from the perspective of stay-in-business capital expenditure and operational expenditure), the clash of commercial models between the two interconnectors will lead to the cessation of Basslink….The Tasmanian Government is unaware of any modelling that suggests the combination of the physical capacity of Project Marinus (either one or two links) together with an open-flowing Basslink leads to an 'oversupply' of transmission capacity and an underutilisation of it. The risk of stranding is not one of whether the physical transfer capacities are no longer required, rather it is a commercial stranding arising from the mismatch of commercial models between regulated interconnectors and a MNSP.*

Our assessment

We consider it is unlikely that Basslink will cease operating after the commencement of the first Marinus Link cable should it not be converted. However, we acknowledge there remains some possibility of this counterfactual, particularly if both Marinus Link cables are built. We note, as submitted by the Tasmanian Government, that modelling undertaken in AEMO's ISP, in Marinus Link Pty Ltd's RIT-T, and by EY for Basslink all indicate that the combined transfer capacity of Basslink and both Marinus Link cables is forecast to provide a net benefit to the NEM. ACIL Allen's market modelling indicates that Basslink is likely to cover its stay in business costs after the first Marinus Link cable begins operating, but that revenue sufficiency is less certain in scenarios with both Marinus Link cables. We also note that an unregulated Basslink would have the option of submitting a further conversion application at any time, which may mitigate these risks. Therefore, on the basis that this counterfactual is relatively less likely to occur and, if it were to occur, could be mitigated by a further conversion application, we do not place any material weight on this counterfactual.

However, the manner of Basslink's continued operation if not converted is subject to significantly greater uncertainty. We consider there is likely to be value to both Basslink and Hydro Tasmania in an agreement, at least prior to any Marinus Link cables commencing operations. This is supported by the results of ACIL Allen's market modelling. That said, it is not clear that more preferable contract options are not available to Basslink, that Basslink and Hydro Tasmania would be able to agree to terms that would unlock value for both parties, or that an agreement between Basslink and Hydro Tasmania would be desired by both parties at all times and in all market conditions. We also note that an agreement on terms similar to the current Network Services Agreement, under which Basslink effectively operates as an open link, may require Tasmanian Government policy that mandates such terms. There is no indication that the Tasmanian Government would adopt this policy position, and its submissions note that current market circumstances differ markedly from those that existed at the time that the original Basslink Services Agreement was struck.

Based on the information received from Basslink and Hydro Tasmania, we consider there is unlikely to be a replacement agreement, of any kind, that would take effect at the expiry of the current network services agreement on 30 June 2025. We also consider it is unlikely that

an agreement between Basslink and Hydro Tasmania would be forthcoming or an agreement between Basslink and another counterparty will be struck in the near term.

Overall, all counterfactuals remain possible: unhedged merchant operation of Basslink, an agreement with Hydro Tasmania, or an agreement with another counterparty. The diversity of views expressed by stakeholders on the possible counterfactuals highlights the uncertainty associated with the decision on conversion. However, we consider there is a strong likelihood that no agreement between Hydro Tasmania and Basslink would be in effect once Marinus Link is commissioned given the stated position of Hydro Tasmania and the diminished economic incentives illustrated by the modelling. Further there are reasons to believe that it would take time to arrive at an agreement between Hydro Tasmania and Basslink. Both APA and Hydro Tasmania have emphasised challenges in reaching mutually acceptable agreement terms, which may require time to resolve and result in a potential delay to arriving at an agreement (if they reach agreement at all). Further, the short-term commercial attractiveness of merchant operation and the potential for Basslink to seek conversion again as market conditions and transmission developments become more certain may well act as a further disincentive to reach an agreement. This has helped shape our position that an agreement between Hydro Tasmania and Basslink is unlikely for the remaining life of the asset. To the extent that it occurs at all, it is more likely to be short-term and/or delayed and this shifts the balance of outcomes. This has been a key consideration for the AER in moving away from the draft decision and accepting APA's application.

3.4 Price impacts of conversion

Should Basslink be converted, consumers will be faced with increases in regulated transmission charges that are relatively certain, balanced by much less certain decreases in wholesale prices and an uncertain value of proceeds from interregional settlement residue auctions.

ACIL Allen modelled wholesale price outcomes under the same set of scenarios and counterfactuals used in modelling of market benefits. Different wholesale prices may occur under conversion than would occur without conversion, and to the extent that these differences in wholesale prices exceed the additional transmission charges arising from a regulated Basslink, they may be indicative of efficiency gains beyond a re-organisation of payments between consumers, producers, and transporters of electricity.

Based on APA's proposed asset value and APA's forecast of ongoing operating costs, we estimate that the value (over the remaining life of the Basslink interconnector) of additional transmission charges resulting from Basslink's conversion would be around $1.341 billion.[46] The value of these charges would be subject to adjustment following the completion of a revenue determination that will take place in advance of conversion. We note that there is much greater certainty associated with these additional charges than there is associated with

[46] Regulated transmission charges over the life of the asset are based on the repayment of the regulatory asset base (RAB) (via the return on capital and return of capital (depreciation) building blocks) plus ongoing operating costs. For the purposes of considering the costs and benefits of conversion in this decision, we have used Basslink's proposed values for its opening asset value ($752m) and ongoing operating costs ($589m). Should the final decision be to convert Basslink, the AER would need to consult on the revenue Basslink would be entitled to as a regulated transmission service.

market or price benefits modelled against potential Marinus Link operating scenarios or possible counterfactuals to conversion.

Proceeds from settlement residue auctions would act to reduce the amount of transmission charges ultimately paid by consumers. The energy market modelling we commissioned from ACIL Allen estimates the value of inter-regional settlement residue auction proceeds could range from $536 million to $712 million.[47] These auction proceeds could reduce the present value of Basslink's transmission charges faced by consumers from $1.341 billion to between $629 million and $805 million. We note, however, that the market size and concentration may not support proceeds from the settlement residue auctions being this high.

We also note that, if Basslink were converted, the allocation of revenue attributable to the Basslink interconnector in each of Victoria and Tasmania would determine the regulated revenue to be recovered from consumers in each region – that is, the portion of the estimated $1.341 billion of additional transmission charges that would be recovered from consumers in Victoria and Tasmania respectively.

The NER does not empower the AER to approve a cost allocation methodology. We had previously stated in our issues paper that cost allocation was an important decision we would make in any revenue determination. Further, we considered that Basslink's revenue allocation methodology is permissible and is supported by the NER given it is consistent with allocating based on 'use' of a TNSPs assets to provide prescribed services within a region. In considering this matter further, we now understand that the NER does not empower the AER to approve a cost allocation methodology. Rather, if converted, Basslink would determine the allocation of its aggregate annual revenue requirement (and consequently allocation of regulated transmission charges) between Victoria and Tasmania based on the use of the interconnector. In its revenue proposal Basslink revised its initial allocation of revenue between Victoria and Tasmania to allocate 75% of regulated revenue to the Victorian region and 25% to the Tasmanian region. It is also possible for affected jurisdictions to negotiate an approach to the revenue allocation with the new interconnector rule change commencing on 3 July 2025.

Table 3.5 reflects the range of estimated value of wholesale price impacts from conversion for each of the scenarios for Marinus Link, where the range covers the spread of the modelled counterfactuals to conversion.

[47] Assuming auction proceeds reflect approximately 75% of the value of the settlement residues.

Table 3.5 Modelled reduction in consumer energy costs resulting from conversion – compared against different counterfactuals and Marinus Link scenarios

	Reduction in consumer energy costs (NPV, $million)		
	Marinus Link does not proceed	**1 Marinus Link cable proceeds, operational in 2029**	**2 Marinus Link Cables proceed, operational in 2029 and 2036**
Highest modelled energy cost impact	4,824	3,511	1,677
Lowest modelled energy cost impact	2,578	-164	23

Notes: Energy costs refers to modelled load-weighted price multiplied by regional energy demand, reduction represents net present value of the aggregate difference, over modelling period 2025-50, of energy costs under conversion compared to the counterfactual.
Source: ACIL Allen, Basslink Conversion: Modelling and Analysis of Benefits.

Greater wholesale price impacts from conversion are estimated when there is less available capacity from Marinus Link. The model results also indicate a wide range of possible wholesale price impacts. Hydro Tasmania submitted that it had undertaken its own analysis of potential spot market impacts of a merchant Basslink, with results also indicating potential significant price increases (relative to a regulated Basslink).[48] Similarly, Basslink submitted that optimised bidding of a merchant Basslink need only lift wholesale prices by an annual average of $1 per MWh in Victoria and Tasmania before residential customers are paying more through increases in the wholesale cost components of their bill than they would have in transmission costs under regulation.[49]

Overall, the market modelling results generally align with the modelling of market benefits of conversion and indicate that:

- The present value of increases in regulated transmission charges, taking into account possible proceeds from settlement residue auctions, ranges from $629 million to $805 million.
- The present value of changes to energy costs (resulting from changes to wholesale prices) ranges from an increase of $164 million to a decrease of $4.82 billion.

However, this modelling of wholesale electricity prices is highly sensitive to changes in inputs and assumptions. Further, while it suggests that consumers may experience price benefits from conversion, we have placed considerable weight on the conclusion from ACIL Allen that:

> *"We consider that less weight should be placed on the assessment of consumer benefits than market benefits because the results are less consistent across the*

48 Hydro Tasmania, Submission in response to AER draft conversion decision, February 2025, pp.5-6.

49 APA, Submission in response to AER draft conversion decision, January 2025, pp.33-34.

scenarios modelled, and the results are highly sensitive to the projected wholesale electricity prices and the ability of Hydro Tasmania to exercise market power."

Basslink submitted that the magnitude of the modelled price impacts is significant and should outweigh any perceived uncertainties or risk.[50] However, the uncertainty pertains not just to the scenarios modelled but also to the model results themselves. Accordingly, we consider modelling of price changes to be less reliable than modelling of market benefits. Further, while we are not able to quantify the extent to which price changes represent a wealth transfer between producers and consumers, it is likely that some of the price changes would reflect such a transfer. To the extent to which this is the case, these would not reflect an overall reduction in cost. Therefore, the price impacts over the long term should ultimately align with the lower system costs modelled as part of the market benefits.

We also note that the AER will now undertake a revenue determination for a converted interconnector. This revenue determination process will provide regulatory oversight and stakeholder scrutiny of Basslink's costs, including its asset value, and regulated transmission charges.

3.5 Impacts of conversion on risk allocation

In response to our conversion consultation paper the Justice and Equity Centre (JEC) submitted that "the Marinus project produces a risk of Basslink becoming, in a partial sense, a stranded asset. This is particularly the case if both proposed Marinus cables eventuate." The JEC also submitted that "the performance record of Basslink indicates substantial additional risk".[51]

If an outcome of conversion is that consumers pay transmission charges for an asset that does not provide services of commensurate value (for example, because the link is underutilised and may have otherwise, without conversion, ceased to operate), that may suggest that both the economic efficiency and wholesale price benefits of conversion are unlikely to be great, or even positive. If so, this could represent an undesirable transfer of risk from the owners of Basslink to consumers.

In contrast, Basslink submitted that "stranding is a risk to the investment after it has been made and has zero value in economic efficiency assessments".[52] While the Basslink investment is sunk, we may still have regard to the efficiency of its operation and whether converting Basslink is likely to promote efficient operation and use of electricity infrastructure. Where conversion is expected to result in improved efficiency, we may have regard to the magnitude and certainty of those efficiency gains, relative to the magnitude and certainty of the additional transmission charges that would also result from conversion.

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50 APA, Submission in response to AER draft conversion decision, January 2025, p.18.

51 Justice and Equity Centre, Submission in response to AER Conversion Consultation Paper, 20 September 2024, p. 1.

Basslink's submission noted that asset stranding risk (or the transfer of this risk to consumers) is reduced with every delay to Marinus Link (APA, Submission in response to AER draft conversion decision, January 2025, p.23).

52 APA, Submission in response to AER draft conversion decision, January 2025, p.48.

While the opening Regulatory Asset Base (RAB) for Basslink will be determined through the subsequent revenue determination process, it is clear that it will be a positive value and, therefore, will have an impact on regulated transmission charges. Regulated transmission charges reflect the costs consumers pay to continue the operation of the asset while at the same time taking on the economic risks that the conversion of the asset to regulated status will deliver lower consumer benefits than costs. We also note that while consumers are certain to pay increased transmission charges (though the level of any increase is not yet known), wholesale price reductions as well as offsets to transmission charges from the proceeds of settlement residue auctions are much more uncertain.

Basslink submitted that the cost of a regulated Basslink is small when compared to total market costs, and that additional transmission charges associated with a regulated Basslink would only increase annual bills for a Victorian customer by about two dollars and about three dollars for Tasmanian customers.[53] We note that the market benefits modelled by ACIL Allen are also relatively small on a per customer per year basis.

We contrast the relative certainty of this increase in transmission charges to the uncertainty of the benefits of conversion. There is a degree of uncertainty associated with market modelling, which is the basis for estimates of benefits from lower market costs and greenhouse gas emissions.

In approaching the issue of conversion and the associated risk transfer, we have also been mindful of the permanence of the decision. Should Basslink be converted consumers will pay for the asset over the life of the asset through transmission charges. Conversely, as submitted by Basslink and the Tasmanian government, a decision to not convert may also have permanent outcomes, as any efficiency losses from restricted flows across a merchant Basslink are also irreversible.[54]

The likelihood that Basslink will cease operations is low but cannot be ruled out, since modelled Basslink revenues may be weaker for a time should Basslink remain a merchant link and both Marinus Link cables be commissioned. In making this assessment we have had regard to our consideration of Marinus Link development scenarios that identify both one and two cable scenarios as possible outcomes.

Consequently, we have concluded that the transfer of risk to consumers associated with requiring them to pay transmission charges for Basslink's services may be material, given the uncertainty of identified market benefits. Nonetheless, though the magnitude of any market benefits resulting from conversion is uncertain, our modelling analysis indicates that conversion is likely to result in some degree of market benefits in most scenarios. We note that Basslink's capital costs are sunk and unlikely to impact economic efficiency. Further, Basslink's total costs, as reflected in transmission charges, may be recovered from market participants in either the converted or merchant Basslink scenarios. As such, we expect any market benefits from conversion would reflect efficiency improvements and would, in the

53 APA, Submission in response to AER draft conversion decision, January 2025, pp.19,33.

54 APA, Submission in response to AER draft conversion decision, January 2025, p.48. Minister Duigan, Submission in response to AER draft conversion decision, January 2025, pp.1-2.

long-term, be reflected in consumer prices, and this has informed our decision to approve the application from Basslink on conversion.

3.6 Impacts of conversion on reliability and other aspects of service quality

In addition to price and emissions, consumers also value other aspects of their electricity supply, for example, reduced frequency and duration of supply outages.[55] This is explicitly identified in the NEO. It is possible that conversion of Basslink may affect these non-price aspects of service quality.

The main way that Basslink may affect end user service quality is through reduced availability of the interconnector. We therefore have considered the possible differences in the availability of the interconnector if it were converted compared to if it were not converted.

We consider that if Basslink is not converted it will have incentives to ensure the asset is available – to maximise revenue by taking advantage of interregional price differentials when they arise. We consider that this incentive is likely to persist in both the 'merchant Basslink' and 'Basslink agreement with Hydro Tasmania' counterfactuals, as well as in the shorter term under an extension of the current network services agreement with Hydro Tasmania.[56]

If Basslink were converted, then a service target performance incentive scheme would apply to Basslink. This scheme provides rewards and penalties for improved and deteriorating reliability performance, respectively. This recognises that businesses operating a regulated service do not otherwise bear revenue risk related to service performance and so may not face the consequences of poor service performance compared to a business that operates commercially. This is because a regulated business receives a regulated revenue allowance providing revenue certainty associated with the recovery of its costs. The scheme is intended to counteract the incentive for a regulated business to reduce expenditure at the expense of reliable performance.

Basslink submitted that if not converted then reliability outcomes may steadily deteriorate if investment in the interconnector for the longer-term becomes uneconomic.[57] We note that, if converted, investment in the interconnector is not guaranteed but rather would be subject to the regulatory investment test for transmission (RIT-T). Investment that is uneconomic and does not satisfy the cost-benefit test in the RIT-T would also not occur under regulation. Therefore, this issue would only arise in relation to investment that would satisfy the RIT-T but may be uneconomic for an unregulated Basslink. Though such situations may be

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55 The frequency and/or duration of outages is often referred to as reliability. The ability of the system to quickly respond and remain stable when unexpected events occur (such as transmission lines failing or generators breaking down), thereby preventing these events from resulting in outages, is often referred to as system security. Increased system security is likely to result in improved reliability.

56 Hydro Tasmania submitted that Basslink's full capacity is only possible with the continued operation of the Frequency Control System Protection Scheme (FCSPS), and that the AER should not necessarily assume that the FCSPS will continue to operate in the same way in non-regulated scenarios (Hydro Tasmania, Submission in response to AER draft conversion decision, February 2025, p.9). We acknowledge that the scheme may be provided in a different manner if Basslink were not converted. Nonetheless, we consider that Basslink will have sufficient incentive to ensure a functioning FCSPS remains in place.

57 APA Group, Submission in response to AER draft conversion decision, January 2025, p.21-23.

unlikely, we also note that an unregulated Basslink may submit a conversion application at any time, which may mitigate the possibility of adverse outcomes.

Overall, we consider that there are unlikely to be material differences in the reliability of supply if Basslink is converted compared to Basslink remaining as a merchant link – so long as revenues exceed stay-in-business costs.

Glossary

Term	Definition
ACCC	Australian Competition and Consumer Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulatory
DEECA	The Victorian Government Department of Energy, Environment and Climate Action
HVDC	High Voltage, Direct Current
ISP	Integrated System Plan, published by AEMO
MNSP	Market Network Service Provider
MW	Mega-watts (one million watts)
MWh	Mega-watt hour
NEL	National Electricity Laws
NEM	National Electricity Market
NEO	National Electricity Objectives
NER	National Electricity Rules
RAB	regulated asset base
ReCFIT	Renewables, Climate and Future Industries Tasmania
RIT	Regulatory Investment Test
RIT-T	Regulatory Investment Test for Transmission
TNSP	Transmission Network Service Provider