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Dear Sir/Madam

Regulatory Impact Statement - COAG commitment to separate generation and transmission

We thank the MCE for the opportunity to comment on the Regulatory Impact Statement (**RIS**) released by the MCE in relation the COAG commitment to separate generation and transmission.

Basslink Pty Ltd (**Basslink**) does not object to the reforms proposed by the MCE provided that these reforms do not affect the existing arrangements in place between Basslink and Hydro Tasmania in relation to the Basslink interconnector (**Interconnector**). Furthermore, Basslink is confident that this should not create any difficulty as the competition concerns about vertical integration identified in the RIS as the rationale for the proposed separation of generation and transmission are unlikely to arise in respect of the operation of Basslink for the reasons discussed below.

Background

As you will be aware, Basslink owns and operates the Interconnector which provides transmission services between Victoria and Tasmania.

In respect of the Interconnector, Basslink and Hydro Tasmania are party to an agreement known as the Basslink Services Agreement (**BSA**). The BSA provides Hydro Tasmania with a very limited ability to make decisions as to the operation of the Interconnector. This ability is primarily confined to the ability to set minimum performance standards for the Interconnector and to direct the making of network dispatch offers for the Interconnector.

Furthermore, as you will also be aware, Hydro Tasmania is the owner of a number of generators and has a generating capacity of over 2500MW.

Basslink therefore considers there is a risk that, if loosely framed, the proposed reforms could have the effect that the existing arrangements between Basslink and Hydro Tasmania breach the National Electricity Law (**NEL**) or the Trade Practices Act (**TPA**).

Reason why the BSA does not create competition concerns

The RIS identifies a potential problem where the same person owns both transmission and generation assets:

'When the owner of essential infrastructure also competes in a competitive segment it typically has the ability and the economic incentive to restrict the level of competition in the competitive segment. It has the ability to restrict competition by restricting access to the essential facility – by raising price, lowering the quality or reducing the timeliness of the essential service it provides, relative to the services the regulated firm provides to its own affiliate, limiting access by constraining the generator. It has the incentive to restrict competition when the natural monopoly facility is tightly regulated, but the competitive activity is not. In this instance, the owner of the natural monopoly has a strong incentive to provide the competitive activity itself, restrict competition in this activity, thereby capturing some of the monopoly rents that it would otherwise lose to regulation.'

Basslink observes that the Interconnector is not a regulated transmission asset but is an entrepreneurial interconnector. Entrepreneurial interconnectors earn revenues generated by differences in the energy prices of the relevant interconnected regions. They do not earn a regulated return and, accordingly, they neither lose monopoly rents to regulation nor have an incentive to capture those rents through restricting competition in any competitive activity in which they have an interest. For this reason, Basslink submits that the MCE's competition rationale for the proposed separation of generation and transmission does not have any application to the joint ownership and/or control of generation and an entrepreneurial interconnector, such as the Interconnector.

In addition, the BSA does not provide Hydro Tasmania with the ability to restrict competition in the manner referred to in the quotation set out above. In particular, we draw the MCE's attention to the restrictions on non-zero bidding of the Interconnector established by the Ministerial Notice under section 36 of the *Electricity Supply Industry Act 1995* (Tas). Basslink submits that these restrictions suffice to ameliorate any ability that Hydro Tasmania may otherwise have under the BSA to raise price.

Further, Hydro Tasmania's very limited ability to control certain of the operations of the Interconnector under the BSA does not confer on it the ability to lower the performance of the Interconnector to competing generators or reduce the timeliness of service provision by the Interconnector to those generators.

On the assumption that the MCE agrees that the proposed separation of generation and transmission should not encompass the existing arrangements between Hydro Tasmania and Basslink in relation to the Interconnector, this could be achieved by means of the notions of 'ownership' and 'control' on which options 2, 3, 4 and 5 in the RIS are premised or by means of the proposed Crown exception. We would welcome the opportunity to make further submissions on the notions of 'ownership' and 'control', if this would be of assistance to the MCE. We make brief submissions on the framing of the proposed Crown exception below.

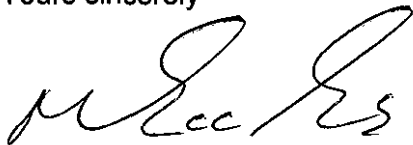
Crown exception

Options 2 and 5 in the RIS contemplate an express exception in respect of 'current direct crown ownership'. Basslink agrees that it is appropriate to establish an express exception for existing vertical arrangements to which the Crown is a party. In this respect Basslink submits that:

- If the reforms are to expressly exempt Crown arrangements, this exemption should apply back to back with the prohibition that is created. In particular, if there is a prohibition on control of the operation of both a transmission asset and a generation asset (absent ownership of one or both), then the exemption on Crown arrangements should be drafted so as to exempt existing Crown arrangements that confer control of the operation of those assets on it. That is, if there is a prohibition on control of the operation of both a transmission asset and a generation asset (absent ownership of one or both), the exception should not be confined to current direct Crown *ownership*; and
- The reforms should clarify the meaning of the term 'crown' to ensure that there is not uncertainty as to who is entitled to avail themselves of this exemption. As one example, the reforms may expressly state that for the purposes of the relevant provision, a reference to the Crown should be taken to be a reference to entities including government business enterprises owned by State Governments.

Please do not hesitate to contact us should you have any queries.

Yours sincerely



Malcolm Eccles
Acting Chief Executive Officer