

AER guidance on amended National Energy Objectives

Draft guidance for consultation

July 2023

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Tel: 1300 585 165

AER reference: 15391350

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Have your say

Interested parties are invited to make written submissions to the AER regarding our draft guidance on the amended national energy objectives by close of business, **18 August 2023**. Submissions should be sent electronically to aer inquiry@aer.gov.au.

Alternatively, you may mail submissions to:

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

We ask that all submissions sent in an electronic format are in Microsoft Word or other text readable document form.

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. We will treat submissions as public documents unless otherwise requested. All non-confidential submissions will be placed on the AER's website.

For further information regarding the AER's use and disclosure of information provided to it, see the ACCC/AER Information Policy.

We request parties wishing to subject confidential information:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

If you have enquiries about this paper, lodging a submission or would like to meet with us to discuss issues raised in this paper, please contact Robyn Pickering, Executive Director (a/g), Network Regulation on robyn.pickering@aer.gov.au.

1 Introduction

The Australian Energy Regulator (AER) exists to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable, and affordable energy future for Australia.

On 12 August 2022, Energy Ministers agreed to fast track the introduction of an emissions reduction objective into the national energy objectives, consisting of the national electricity objective, national gas objective and national energy retail objective. On 14 June 2023 the *National Energy Laws Amendment (Emissions Reduction Objectives) Bill 2022* (Bill)¹ was introduced into South Australian Parliament and passage is expected to occur in September.

The AER supports clarity around the changes to the national energy objectives to refer to government emission reduction targets and their application to AER decisions. As the independent regulator, the national energy objectives guide our work to promote the long-term interests of consumers with respect to achieving emission reduction targets, alongside our existing considerations including price, quality, safety and reliability of energy supply.

The purpose of this document is to set out the AER's draft guidance on:²

1. the matters the AER is likely to have regard to in considering whether to apply the amended energy objectives to processes which are underway at the time the amendments take effect.
2. how we may operationalise the amended electricity objective to Ausgrid, Endeavour Energy, Essential Energy, Evoenergy, TasNetworks Distribution, TasNetworks Transmission and Power and Water Corporation (NT) (network service providers) for the 2024–29 regulatory determinations.

1.1 What are the changes to the objectives?

A new emissions reduction objective will be added to the existing economic efficiency framework in all three energy objectives: National Electricity Objective, National Gas Objective and National Electricity Retail Objective.

The long-term interests of consumers will extend to the achievement of Commonwealth, State and Territory targets:

- for reducing Australian's greenhouse gas emissions, or
- that are likely to contribute to reducing Australia's greenhouse gas emissions.

¹ [National Energy Laws Amendment \(Emissions Reduction Objectives\) Bill 2022](#).

² We may separate this document into separate guidance notes later to ensure we meet the 45-day legislative deadline for the first guidance and publish the second guidance in parallel to the AER's draft determinations for the network service providers.

Note: This is based on the final version of the Bill introduced to the South Australian Parliament on 14 June 2023. We will update this guidance if there are any changes when the Act is passed by the South Australian Parliament.

1.2 Governments set strategic policy for energy and emission reduction targets

Governments, via Energy Ministers, have responsibility for the strategic direction of the energy transition in the national energy markets. Governments also set emission reduction targets and update them from time to time. The Australian Energy Market Commission will be responsible for maintaining a document (the targets statement) that states the targets set by participating jurisdictions.

After emissions are included in the energy objectives, the AER and other market bodies will take these targets into account when applying the relevant objective in the jurisdictions in which they have responsibility.

When each of the energy objectives change, emission reductions will no longer be part of the external context for our decision making, but one of the central considerations in determining if our decisions are in the long-term interest of consumers. Essentially, our decisions will shift to internalising the emissions impacts rather than treating them as an external factor.

1.3 Balancing the new emissions objective

As the Commonwealth's consultation paper on the draft Bill³ explained, consistent with the current approach to applying the energy objectives, the emission reductions objective will be one of several objectives (alongside, price, quality, safety, reliability and security of supply) that the AER will be obliged to consider and will have discretion to balance in making its decisions.

We will consider and balance the emission reduction objective alongside the other existing objectives, in a way that maximises the achievement of the overall energy objectives in the long-term interest of consumers.

The following sections are intended to provide guidance on how we will approach this in cases where functions or powers under the energy laws expressly require us to consider or apply the relevant energy objectives – these include exercising our economic regulatory decision-making functions and otherwise exercising our economic regulatory functions and powers.⁴ It does not extend to other AER roles, such as taking compliance or enforcement action.

³ Commonwealth Government, *Incorporating an emissions reduction objective into the national energy objectives, Consultation paper*, 20 December 2022, p. 2.

⁴ *National Energy Laws Amendment (Emissions Reduction Objectives) Bill 2022*, proposed section 40(1)(c) of Part 18 of Schedule 3 of the National Electricity Laws and the equivalent proposed sections for the National Gas Laws and National Electricity Retail Laws.

1.4 AER guidance

The amended energy objectives will start two months after the commencement of the Act. The Bill requires the AER, within 45 days after commencement of the Act:

‘...to issue administrative guidance about the matter the entity [being the AER] is likely to have regard to in deciding whether to consider or apply the amended objective in doing a thing.’⁵

That is, our guidance must set out how we will use our discretion as to whether to apply the amended objectives after the legislation commences to our own processes which are already underway at the time the amendments take effect (likely November 2023). For example, we may receive a cost pass-through application, an access dispute, or an application for a regulatory exemption, between now and the amendments taking effect.

The Bill also proposes that for relevant revenue determinations for Ausgrid, Endeavour Energy, Essential Energy, Evoenergy, TasNetworks Distribution, TasNetworks Transmission and Power and Water Corporation (NT) (network service providers), for the regulatory control period of 2024–29, the amended objectives apply immediately.⁶ To assist these network service providers the AER considers it appropriate to provide guidance on how we may operationalise the amended energy objectives in assessing their revised regulatory proposals due to the AER in December 2023 and in making our final determinations by April 2024.

The following guidance is structured as a non-exhaustive list of high-level principles to which the AER is likely to have regard in making decisions. The AER may update the revenue determinations objective of this guidance from time to time.

⁵ *National Energy Laws Amendment (Emissions Reduction Objectives) Bill 2022*, proposed section 41(2) of Part 18 of Schedule 3 of the National Electricity Laws and the equivalent proposed sections for the National Gas Laws and National Electricity Retail Laws.

⁶ *National Energy Laws Amendment (Emissions Reduction Objectives) Bill 2022*, proposed section 39(3) of Part 18 of Schedule 3 of the National Electricity Laws.

2 AER's guidance on whether to apply the amended energy objectives

The AER is likely to have regard to the following matters in considering whether to apply the amended energy objectives to any processes which are underway at the time the amendments take effect (likely November 2023). This guidance is not an exhaustive list of the matters to which the AER may have regard.

2.1 Matters to which the AER is likely to have regard

When considering whether to apply the amended energy objectives, we are likely to have regard to:

- the materiality, for the possible outcomes of the AER's decision making process, of applying or not applying the amended energy objectives. This will involve consideration of whether applying the amended energy objectives is likely to make a material difference to the AER's decision - for example, by locking in (or locking out) the achievement of emission reduction benefits in the future.
- the information, capabilities and tools available or accessible to us, at this interim stage and within required or appropriate decision-making timeframes, to assess these matters.
- the likelihood that any identified long-term impacts of applying the amended energy objectives will be realised. This may include consideration of the readiness and willingness of relevant parties to take steps to meet relevant government targets or otherwise achieve emission reduction outcomes.
- the readiness of relevant parties to have the emission reduction element of the objectives applied as part of the AER's decision-making process, including the extent of any analysis those parties have undertaken about the impacts and possible trade-offs involved in doing so.
- whether relevant parties have had an adequate opportunity to consult with their stakeholders about the application of the amended energy objectives in the relevant decision-making process, including about the impacts and possible trade-offs involved in doing so
- the practicality of applying the amended energy objective to a process underway, including whether it necessitates a delay.

We will do this by:

- considering the long-term interests of consumers having regard to all objectives of the amended energy objectives
- having regard to good regulatory practice
- considering information provided by the parties, including stakeholders

- requesting further information if we do not have sufficient information to satisfy our consideration of the emissions reduction objective, or other objectives, of the energy objectives.

2.2 Quantifying emission reductions and their value

Law changes to include an emissions reduction objective in the national energy objectives will create a need for a value of emissions reduction to be used in processes such as regulatory investment tests and investment planning frameworks. The Commonwealth Government will lead work on developing a value, or method for determining one, in close consultation with market bodies, states and territories. A value, or method for determining one, is expected to be available by November 2023.

If guidance on a value of emissions, or method for determining one, is published this year, we will consider how this could be factored into our final revenue determinations for the 2024–2029 regulatory period, as these will be subject to the amended NEO. In doing this, we will work with the affected network businesses so it is clear how this would be operationalised. For example, when it comes to the cost benefit analysis, in some cases it may be reasonable to include a monetarised value of emissions in calculating net benefits within the cost benefit framework.

The Bill contains a transitional provision⁷ which states that if a government or regulatory entity, including the AER, issues administrative guidance about the value, or method of working out a value, of reducing greenhouse gas emissions then that must be complied with by the government or regulatory entity in considering or applying the amended objective. Additionally, any such administrative guidance issued by the AER about the value, or method of working out a value, of reducing greenhouse gas emissions must be complied with by regulatory investment test proponents. This transitional provision applies until such time that a further framework is in place by regulation, or under the applicable energy rules. The same provision also provides that any guidance issued by a government or regulatory entity must be consistent with any statement issued by the Ministerial Council on Energy.

We appreciate that the timing of any value or method for the value of emissions reduction in November may present challenges for network service providers taking this into account in any revised proposal required by December 2023. We will work with the network service providers and their stakeholders to provide sufficient guidance for how any value or method incorporated in their revised proposal will be assessed.

⁷ *National Energy Laws Amendment (Emissions Reduction Objectives) Bill 2022*, proposed section 42 of Part 18 of Schedule 3 of the National Electricity Laws and the equivalent proposed sections for the National Gas Laws and National Electricity Retail Laws.

3 AER's guidance on how it will operationalise the amended electricity objective

The guidance applies only to Ausgrid, Endeavour Energy, Essential Energy, Evoenergy, TasNetworks Distribution, TasNetworks Transmission and Power and Water Corporation (NT) (network service providers) for the 2024–29 regulatory determinations.

The purpose of the guidance is to provide an overview of how the AER may operationalise the amended electricity objectives in making its final determinations in April 2024 for these network service providers. We intend releasing the final version of this guidance by September 2023, so it is available to the network service providers in preparing and consulting on their revised regulatory proposals due to the AER in December 2023.

Through our ongoing engagement with these network service providers, we note that many of them have been proactive in considering the impact of emissions reduction as part of their regulatory proposals.⁸ In considering customer and stakeholder engagement provided as part of the regulatory resets, many of these network service providers noted that stakeholders were advising that climate change mitigation was a priority to them and should be incorporated or prioritised accordingly in regulatory proposals.

3.1 Expenditure Forecast Assessment

The AER's assessment approach to electricity distribution (and transmission) expenditure proposals is set out in several documents, with the AER's overarching guideline being the Expenditure Forecast Assessment Guidelines (Guidelines).⁹

Our Guidelines include a range of assessment tools and techniques the AER considers when assessing the prudence and efficiency of capital and operating expenditure proposals. We consider that our existing tools and assessment techniques are sufficiently flexible to accommodate the additional emissions reduction objective in the national electricity objective.

Alongside our assessment tools, we also consider the extent to which proposed forecast expenditure is consistent with, or takes into account, consumer preferences identified during consumer engagement. This will continue to be an important factor that we have regard to in assessing expenditure proposals that include an emissions reduction objective.

If the network service providers' revised proposals include material new expenditure items because of the amended electricity objective, we would expect them to provide evidence that explains the nature, depth and breadth of consumer engagement on the proposal, and

⁸ AER, *Submission on emissions in the NEO consultation paper: Integrating an emissions reduction objective into the national energy objectives – stakeholder feedback template*, 9 February 2023, p. 7.

⁹ AER, *Expenditure forecast assessment guideline – distribution*, August 2022 and AER, *Expenditure forecast assessment guideline – transmission*, November 2013.

demonstrate the impact of consumer preferences consistent with the principles outlined in the AER's Better Resets Handbook.¹⁰ If guidance is provided on a value, or method of working out a value of emissions reduction, then as discussed in section 2.2 we will work with the network businesses on how it will be utilised in our final determinations for the 2024–29 regulatory control period.

3.2 Cost benefit analysis

A key assessment technique is a cost benefit analysis of the proposed expenditure. The AER generally expects network service providers to submit this analysis in support of relevant components of expenditure forecasts. As part of any cost benefit analysis, network service providers will need to estimate the change in the quantity of emissions that their proposed expenditure will create, and then apply a value to those emission reductions (in accordance with any guidance by government).

A cost benefit analysis can be used to demonstrate the proposed expenditure that has the highest net economic benefit compared to other feasible options and best satisfies the national electricity objective. Maximising net benefit ensures the promotion of efficient investment in, and efficient operation and use of, electricity services in the long-term interest of consumers with respect to price, quality, safety, reliability and security of supply.

With the inclusion of emission reductions into the national electricity objective, it may be reasonable to include a monetarised value of emissions in calculating net benefits within the cost benefit analysis framework. This would allow the comparison of the overall estimated costs and benefits including those related to the emission reduction objective, just as cost benefit analyses may explicitly account for costs and benefits associated with other limbs of the electricity objective, such as safety or reliability.

Including a value of emission reductions as an input into the cost benefit analysis framework allows for the weighing up of all costs and benefits to identify and promote efficient investment, consistent with the national electricity objectives, including the new emission reduction objective. If emission reduction is a material source of costs or benefits associated with an investment, the calculation of emission reductions associated with a proposed project or program should take account of the change in energy market emissions with and without the investment.

3.3 Consumer energy resources

As consumer energy resources' penetration levels increase and consumer expectations evolve, we see distribution network service providers responding by investing in projects aimed at increasing consumer energy resources' hosting capacity and supporting a broadening range of consumer energy resource services. Justifying consumer energy resource integration expenditure requires quantifying consumer energy resource benefits, not just to the distribution network in question, but to the broader electricity system, including the impact consumer energy resources can have on the wholesale electricity market.

¹⁰ AER, *Better Resets Handbook – Towards consumer-centric network proposals*, December 2021.

Our 2022 guidance note¹¹ outlines our expectations for how distribution network service providers should develop business cases and quantify values associated with network investments for consumer energy resources integration (specifically, to increase hosting capacity). Currently, these values are partly estimated using our customer export curtailment value methodology, which we developed in consultation with stakeholders following the access, pricing and incentive arrangements for distributed energy rule change.

However the inclusion of emission reduction in the national electricity objective means that consistent with our comments about cost benefit analysis, distribution network service providers will have the opportunity to propose environmental benefits and quantify the emission reductions by applying a value (in accordance with any guidance by government).

¹¹ AER, *Distributed energy resources integration expenditure guidance note*, June 2022. Note: the AER has since changed its references to distributed energy resources to consumer energy resources.