AER guidance on amended National Energy Objectives

Guidance Note

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AUSTRALIAN
ENERGY
REGULATOR

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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 as it transitions to net zero emissions.

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 21 September 2023, the *Statutes Amendment (National Energy Laws) (Emissions Reduction Objectives) Act 2023* (the Act)[1] received Royal Assent.

The AER supports clarity around the changes to the national energy objectives to refer to government emissions 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 emissions reduction targets, alongside our existing considerations including price, quality, safety, reliability and security of energy supply.

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

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 has been 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 interest of consumers now extends 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] *Statutes Amendment (National Energy Laws) (Emissions Reductions Objectives) Act 2023.* The amended national energy objectives therefore take effect from 21 November 2023.

1.2 Governments set strategic policy for energy and emissions reduction targets

Both Commonwealth and State and Territory Governments, have responsibility for the strategic direction of the energy transition in the National Energy Market and to set emissions reduction targets and update them from time to time. The Australian Energy Market Commission is responsible for maintaining a document (the targets statement) that states the targets set by participating jurisdictions.

The AER and other market bodies will take these targets into account when applying the relevant objective in those jurisdictions.

With the implementation of these changes, emissions reduction 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. Our decisions will shift to internalising 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 Bill[2] explained, and consistent with the current approach to applying the energy objectives, we will consider and balance the emissions reduction objective alongside the other existing objectives,[3] 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 powers.[4] It does not extend to other AER roles, such as taking compliance or enforcement action.

1.4 AER guidance

The amended energy objectives come into effect two months after the commencement of the Act. The Act requires the AER, within 45 days after commencement (that is, by 5 January 2024):

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

3 The existing objectives being price, quality, safety, reliability and security of supply.

4 *Statutes Amendment (National Energy Laws) (Emissions Reductions Objectives) Act 2023*, section 40(1)(c) of Part 18 of Schedule 3 of the National Electricity Laws and the equivalent sections for the National Gas Laws and National Electricity Retail Laws.

> *'…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]

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 (21 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 Act also provides for the amended National Electricity Objective to apply immediately to the 2024−29 revenue determinations for Ausgrid, Endeavour Energy, Essential Energy, Evoenergy, TasNetworks Distribution, TasNetworks Transmission and Power and Water Corporation (NT) (network service providers).[6] To assist these network service providers the AER considers it appropriate to provide guidance on how we may operationalise the amended electricity objective in assessing their revised regulatory proposals due to the AER in late November 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 this guidance from time to time.

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5 *Statutes Amendment (National Energy Laws) (Emissions Reductions Objectives) Act 2023*, section 41(2) of Part 18 of Schedule 3 of the National Electricity Laws and the equivalent sections for the National Gas Laws and National Electricity Retail Laws.

6 *Statutes Amendment (National Energy Laws) (Emissions Reductions Objectives) Act 2023*, 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

This chapter discusses the matters we will consider in deciding whether to apply the amended energy objectives and how we might expect to see emissions reduction quantified.

2.1 Matters to which the AER is likely to have regard

The AER's default position is to apply the amended energy objectives to any processes which are underway at the time the amendments take effect (21 November 2023), unless we have reasonable concerns.

This guidance is a non-exhaustive list of the matters to which the AER may have regard to when considering whether to apply the amended energy objectives:

- 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 emissions 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, including jurisdictional targets, or otherwise achieve emissions reduction outcomes.
- the readiness of relevant parties to have the emissions 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 interest 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
- providing reasons if we decide not to apply the amended energy objectives.

2.2 Quantifying emissions reductions and their value

The recent law changes to include an emissions reduction objective in the national energy objectives creates a need for a value of emissions reduction to be used in processes such as regulatory investment tests and investment planning frameworks. Decisions to consult on determining the value of emissions reduction rest with Energy Ministers.

In the meantime, the Ministerial Council on Energy is expected to release a statement on interim arrangements in November 2023. The AER expects to use a transitional provision in the Act to release and consult on further guidance on *how the value of emissions reduction will be applied* to processes such as regulatory investment tests and revenue determinations. Any further guidance note must be consistent with the Ministerial Council on Energy statement (which will state an interim value of emissions reduction). In relation to the Regulatory Investment Tests for Transmission and Distribution (RIT-T and RIT-D), the AER and the RIT-T or RIT-D proponent must comply with the further guidance. This is binding on the AER and RIT proponents. The AER must also comply with the interim value of emissions reduction in considering or applying the amended national electricity objective.

The power to make the AER's guidance note binding comes from a transitional provision[7] in the Act. This 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 and market bodies in considering or applying the amended objective. This transitional provision applies until such time that a further regulation or rule is made (under the national framework) for the value of emissions reduction. In practice, the AER envisages that the further guidance will be in force for some time.

We are also working with the affected network service providers to understand how an interim value could be factored into our final revenue determinations for the 2024–29 regulatory period.

[7] *Statutes Amendment (National Energy Laws) (Emissions Reductions Objectives) Act 2023*, section 42 of Part 18 of Schedule 3 of the National Electricity Laws and the equivalent 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 following 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 this guidance is to provide an overview of how the AER may operationalise the amended electricity objective in making its final determinations in April 2024 for these network service providers. This guidance is available to the network service providers in preparing and consulting on their revised regulatory proposals due to the AER in late November 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. The AER has also issued guidance notes for network service providers on how to consider integrating expenditure related to such things as network resilience and consumer energy resources.[9] Consequently, we have seen these expenditures reflected in recent proposals.

For example, we have seen expenditure proposed to enhance network resilience and mitigate network impacts of increased weather-related climate risks such as windstorms, floods and bushfires. We have also seen increased expenditure to facilitate the integration of consumer energy resources such as PV, batteries, community batteries and electric vehicles into the network. We consider that the introduction of a value of emissions reduction would likely have an impact on the business cases that support various consumer energy resource proposals.

We intend to apply the interim value of emissions reduction quantitively in our regulatory decisions where, in the AER's regulatory judgment, it is appropriate to do so. In practice, this is likely to be where a network service provider has itself used an emissions reduction value in developing its regulatory proposal. As we outline in Section 3.3, we expect that a value of emissions reduction would be applied in determining the efficient levels of investment by network service providers to enable consumer energy resources.

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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, *Note on Network Resilience*, April 2022; 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

The AER intends to provide further guidance after the release of the statement from the Ministerial Council on Energy expected in November 2023.

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).[10]

Our Guidelines include a range of assessment tools and techniques the AER considers when assessing the prudency 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 by the network service providers during their 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 demonstrate the impact of consumer preferences consistent with the principles outlined in the AER's Better Resets Handbook.[11] If guidance is subsequently 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 may be utilised in our final determinations for the 2024–29 regulatory control period. In practice, this is likely to be the case where a network service provider has itself used a quantitative value in developing its initial or revised revenue proposal. For the 2024−29 regulatory determinations, only a limited number of network service providers used a quantitative value in their initial regulatory proposals, and it was related to a relatively small component of the proposed overall expenditure.

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 emissions reductions (in accordance with any guidance by government).

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

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

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 emissions reduction 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 emissions 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 emissions reduction 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 emissions reduction objective. If emissions reduction is a material source of costs or benefits associated with an investment, the calculation of emissions 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. This would support 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.

Our 2022 guidance note[12] 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.

The inclusion of emissions 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 emissions reductions by applying a value (in accordance with the Ministerial Council on Energy statement).

[12] 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.

We intend reviewing our 2022 guidance note when undertaking other AER Guideline reviews to implement the amended national energy objectives during 2024.