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Dr Kris Funston
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Dear Mr Funston

Ausgrid response to Draft Guidance on amended National Electricity Objectives (NEO)

Ausgrid is pleased to provide this submission to the Australian Energy Regulator (**AER**) in response to its *Draft Guidance on the amended National Electricity Objectives* (Draft Guidance).

Ausgrid operates a shared electricity network that powers the homes and businesses of more than 4 million Australians living and working in an area that covers over 22,000 square kilometres from the Sydney CBD to the Upper Hunter.

The amended NEO affirm that emissions reduction is an important market benefit to be assessed in AER decisions, including our 2024-29 regulatory determination. We welcome this important reform that sends a clear signal that the regulatory framework is required to facilitate a decarbonised grid that contributes to the achievement of Australia's emission reduction targets.

Our submission makes the following key points:

- Early guidance on an emissions reduction value, prior to November 2023, would help facilitate the development of our 2024-29 Revised Proposal, with the AER then able to refine this value for its final decision in April 2024;
- Transitional provisions make it clear that the amended NEO is intended to apply to Ausgrid's 2024-29 Revised Proposal without any qualification;
- How the AER interprets the total net emissions of an investment should be clarified, including the role of low emission materials like green steel and carbon offsets;
- The AER should clarify how it will consider emissions targets in the Australian Energy Market Commission's (**AEMC**) targets statement, including targets for infrastructure that is likely to reduce emissions, such as community batteries; and
- Consideration should be given to how the amended NEO supports climate resilience.

More information about these key points is set out in **Appendix A**. We would be happy to discuss our submission please contact Shannon [redacted]

Regards,

[redacted]

Fiona McAnally
Head of Regulation (Acting)

Appendix A

Tight timeframes require collaborative engagement

We incorporated emissions reduction as a market benefit in our investment cases that supported our 2024-29 Regulatory Proposal submitted to the AER in January 2023. We intend to update this analysis in our 2024-29 Revised Proposal using the value of, or method for calculating, emissions reductions that the Commonwealth government plans to release in November 2023. As our Revised Proposal is due in December 2023, the timeframe for making this update requires collaborative engagement between the AER, network businesses and other stakeholders. We recommend that AER considers running a workshop with the electricity distributors on the 2024-29 reset cycle with the aim of providing preliminary guidance on an emissions value ahead of November 2023. Any preliminary guidance on the value could be refined for the AER's final decision due April 2024.

While timeframes are constrained, transitional provisions mean that the amended NEO applies to our 2024-29 determination from the commencement date of the enabling legislation.[1] Policy makers have confirmed that 'this has been done to ensure emissions are considered immediately on commencement to reduce uncertainty and delays to critical investments that could support emission reductions'.[2] The AER should give effect to this policy intent by applying the amended NEO to the 2024-29 determination without qualification.

Delaying consideration of emissions in long lived network assets could lock in a higher carbon footprint for customers for as long as 40 years. Delays can also be problematic for shorter lived assets, such as Information Communications Technology (**ICT**) and fleet. They have technical lives which align to the length of a 5-year regulatory period, so a failure to consider emissions can materially hamper a full replacement lifecycle of these assets. ICT that enables customer energy resources (**CER**) and fleet electrification are likely feature in our 2024-29 revised proposal.

Total net emissions from an investment

The Commonwealth and state governments responsible for developing the amended NEO have made it clear that the reform is intended to drive changes in how networks and other market participants consider the total net emissions from an investment. In a case study on how the amended NEO would apply to AER decisions assessing network expenditure, the Department of Climate Change, Energy, the Environment and Water has stated that:[3]

> The calculation of emissions reduction from a proposed project or program would take account of the total net emissions from the investment. It would therefore incorporate emissions from inputs (e.g. materials used in the investment), as well as outputs (e.g. emissions reduction from coal or gas).

The AER's final guidance on the amended NEO should reflect this policy intent. It should clarify that emissions reduction benefits can include 'outputs – scope 1 and 2 emissions' like the avoided marginal generator dispatch from the integration of CER, as well as 'inputs – scope 3 emissions' like low emissions steel and concrete in the construction of network assets. Consideration of these inputs is likely to become more important in the future as advances in

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[1] *Statutes Amendment (National Energy Laws) (Emissions Reductions Objectives) Bill 2023* (NEO Bill), s. 39.
[2] South Australia, *Parliamentary Debates*, House of Assembly, 14 June 2023, (A. Koutsantonis, Minister for Energy and Mining)
[3] Department of Climate Change, Energy, the Environment and Water, *Incorporating an Emissions Reduction Objective into the national energy objectives*, 20 December 2022, p.16

technology or trade tariffs make lower emissions materials more cost competitive, and investors and stakeholders seek for organisations to reduce their scope 1, 2 and 3 carbon footprints.

Our largest source of emissions as an electricity distribution network is from line losses (3.5% of electricity carried). The International Energy Agency estimates that worldwide losses in electricity networks account for 1 gigatonne of carbon dioxide emissions.[4] Traditional options to reduce these losses include replacing transformers and power lines. Innovation and the rollout of digital platforms can also play a part with the investment in smart, climate resilient grids holding the key to diversifying Australia's generation mix to support more renewables, along with the adoption of electric vehicles and improvements in energy efficiency.

The role of carbon offsets may require consideration. Ausgrid has an ambition to achieve net zero by 2045. While this cannot be achieved primarily through the use of offsets, these financial instruments may need to be used to address residual emissions that cannot be removed. Investors increasingly expect that businesses have genuine ESG ambitions such as net zero, and this expectation has a direct influence on debt pricing. Mechanisms to support this and cost recovery of offsets are needed. Purchasing offsets will come at a cost that is currently not factored into the AER's operating expenditure assessment approach. Emerging issues like this require further engagement with a diverse range of stakeholders so the implications of the amended NEO are addressed in a way that reflects the long-term interests of customers and prudent trade-off decisions.

Guidance on how the AER will exercise its discretion when considering the Australian Energy Market Commission's (AEMC) target statements

The *Emissions Reduction Objectives Bill* (**Bill**) requires the AEMC to 'prepare and maintain' a new regulatory instrument called a target statement. Regulatory decision-makers, including the AER, will be required to consider this target statement when making determinations on complex matters that may have a significant impact on customers, influence investment decisions that drive decarbonisation, and inform the direction of Australia's pathway towards net zero. The AER should provide more guidance on how this new regulatory instrument will work in practice, given its potentially far-reaching implications.

The AER's final guidance should set out the factors the AER will have regard to when considering the AEMC's target statement. Section 32A(5) of the Bill states that 'a person or body [such as the AER] <u>must consider, as a minimum</u>, the <u>targets</u> stated in the target statement (emphasis added). The word 'must' and use of the plural 'targets' suggests that the AER may, technically speaking, have to turn its mind to every target on the AEMC's target statement, yet in practice it may be more helpful to put more weight on some targets and less on others. The word 'minimum' in section 32A(5) also implies that the AER and other market bodies are not limited to considering only those targets included in the AEMC's target statement i.e. other targets can be considered.

To promote transparency in regulatory decision making, we recommend that the AER sets out the matters it will consider when exercising its discretion about how much weight is placed on a target in the AEMC's target statement. The AER would ideally include a case study explaining how a target would be applied to an expenditure assessment process involving, for example, the enablement of small-scale renewable generation. We further recommend that the AER sets out the factors it may consider when deciding whether to give weight to an emissions reduction target that is not on the AEMC's target statement. This is likely to be a particularly important

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[4] https://www.iea.org/reports/sustainable-recovery/electricity

point to clarify if the AEMC does not finalise its target statement before the AER makes its final decision on our 2024-29 determination.

Clarification about how the AER will assess targets involving infrastructure

The Second Reading Speech of the Bill states that the items that can be included on the AEMC's target statement could be targets 'with an explicit objective of emissions reduction or those that are likely to contribute to emissions reductions, such as a renewable energy target or an electric vehicle target (emphasis added)'.[5] The example given of an electric vehicles (**EV**) target could be extended to EV charging facilities and other infrastructure targets from Australian governments that are 'likely to contribute to emissions reduction' such as targets for community batteries.

We recommend that the AER's final guidance considers the scope for infrastructure targets in the AEMC's target statements and how this may impact the AER's decision making processes. This should include whether there is scope for an item on the AEMC's target statement to include a level of specificity that it creates a regulatory obligation on a regulated network or other market participants to act or invest in a certain way.

Guidance on how the AER intends to apply the amended NEO to investments that support climate resilience

The AER's Draft Guidance recognises that 'in considering customer and stakeholder engagement provided as part of the [2024-29] regulatory resets, many of these network service providers note that stakeholders were advising that climate change mitigation was a priority to them and should be incorporated or prioritised accordingly in regulatory proposals'.[6]

We have been engaging extensively with customers on this topic. Between February and June 2023, Ausgrid sought the views of communities in climate vulnerable areas on the development of a tailored package of responses to deal with the effects of extreme weather on our network. We put forward $202 million of resilience expenditure in the hands of the community with the aim to better understand their priorities, identify the resilience solutions they value the most, and find out their willingness to pay for resilience initiatives. Customers expressed a high level of comfort with a refined proposal ($177 million) which was incorporated into an updated Climate Resilience Business Case submitted to the AER in July 2023 as part of our 2024-29 regulatory determination.

We recommend that the AER expands on its acknowledgement in the Draft Guidance that customers want electricity networks to prioritise climate action. It could do this by setting out how the AER intends to incorporate the amended NEO into the way it assesses climate resilience programs. These could include projects such as the rollout of aerial bundled cable that promotes a denser, more prominent urban tree canopy near distribution networks assets, acting as a form of green, emissions free infrastructure that provides shade and reduces ambient temperatures without the need for air-conditioning.

Putting more weight on the emissions reduction objective should be considered

Elevating emissions reductions to the NEO places emissions reduction on an equal footing with price, quality, safety, reliability and security of supply as the objectives that guide regulatory decisions. Nonetheless, to balance competing considerations in a way that achieves the long-term interests of customers, we expect that the AER is likely to put more weight on some objectives in the NEO and less weight on others, depending on the circumstances at hand. In

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[5] South Australia, *Parliamentary Debates*, House of Assembly, 14 June 2023, (A. Koutsantonis, Minister for Energy and Mining)

[6] AER, *Draft Guidance on amended National Energy Objectives*, July 2023 p. 10.

doing so, the AER should have regard to where Australia stands in relation to our emission reductions targets relative to the other, more mature objectives in the NEO.