

Amended National Energy Objectives: The AER's Expenditure Forecast Assessment Guidelines Review

Draft Decision

June 2024

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Request for Submissions

We are undertaking a consultative process for amending the Expenditure Forecast Assessment Guidelines, to take into account the Australian Energy Market Commission's (AEMC) final rule for harmonising the national energy rules with the updated national energy objectives.

We are consulting in accordance with the distribution and transmission consultation procedures set out in rules 6.16 and 6A.20 of the National Electricity Rules.

In this draft decision paper, we have outlined the changes we propose to make to the Expenditure Forecast Assessment Guidelines.

We invite interested parties to make written submissions to us on the 2 separate parts contained within this draft decision by the close of business, 9 August 2024.

We prefer stakeholders send submissions electronically to: aerinquiry@aer.gov.au.

Alternatively, stakeholders can mail submissions to:

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We prefer all submissions be publicly available to facilitate an informed and transparent consultation process. We will therefore treat submissions as public documents unless otherwise requested.

We request parties wishing to submit confidential information to:

- clearly identify the information that is subject of the confidentiality claim, and reasons for the confidentiality claim
- provide a non-confidential version of the submission, in addition to a confidential one.

We will place all non-confidential submissions on our website at www.aer.gov.au. For further information regarding our use and disclosure of information provided to us, see the ACCC/AER Information Policy, June 2014 available on our website.

Please direct enquiries about this paper to aerinquiry@aer.gov.au.

We look forward to engaging with all stakeholders on these important updates to our Guidelines to support the energy transition.

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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 (NEO), 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. A new emissions reduction objective has been added to the existing economic efficiency framework in all three energy objectives.

Following assent of the Act, the Australian Energy Market Commission (AEMC) published a targets statement that lists jurisdictional targets to be considered.² The long-term interests of consumers now extends to the achievement of Commonwealth, State and Territory targets for:

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

On 1 February 2024, the AEMC published its final determination to harmonise the national energy rules with the updated energy objectives.³ The final harmonising rule change (Amending Rule) supports the incorporation of emissions reduction in the energy regulatory framework.

As a result of the AEMC’s Amending Rule, the capital expenditure and operating expenditure objectives have been amended to include expenditure that would contribute to achieving emissions reduction targets through the supply of regulated services.⁴ The Amending Rule provides the AER with a clear role in considering expenditure proposed by network businesses in their revenue proposals which contribute to achieving emissions reduction targets.

In operationalising the Amending Rule, we have reviewed our Expenditure Forecast Assessment Guidelines (EFA Guidelines).⁵ This document constitutes our draft decision on

¹ [Statutes Amendment \(National Energy Laws\) \(Emissions Reductions Objectives\) Act 2023](#).

² AEMC, [Targets Statement for greenhouse gas emissions](#), February 2024.

³ AEMC, [Harmonising the national energy rules with the updated national energy objectives \(electricity\) - Final Determination](#), February 2024. Noting that the Final determination contains both electricity and gas rule changes.

⁴ Regulated service in this statement means standard control services for distribution and prescribed transmission services for transmission network service providers. See NER cl. 6.5.7(a)(5), 6A.6.6(a)(5) and 6A.6.7(a)(5) for further detail.

⁵ AER, *Expenditure forecast assessment guideline – distribution*, August 2022; AER, *Expenditure forecast assessment guideline – transmission*, November 2013.

changes proposed to the EFA Guidelines, and also seeks feedback on the development of a separate guidance note.

1.1 Structure of this Paper

This draft decision contains two parts:

- our proposed amendments to the EFA Guidelines
- our proposed approach to develop an emissions reduction guidance note.

Chapter 2 contains our proposed amendments and our explanatory statement for the EFA Guidelines. We consider the amendments to the EFA Guidelines are relatively minor, as our existing tools and assessment techniques, as outlined in the EFA Guidelines, can accommodate the additional emissions reduction objective. However, we note that stakeholders may benefit from further guidance on how we will consider emissions reduction in implementing our expenditure assessment.

Chapter 3 contains our proposed approach to develop an emissions reductions guidance note. In this guidance note, we intend to publish further guidance on how we will consider emissions reduction in implementing our expenditure assessment of proposals, in both electricity and gas, as well as in related areas such as tariffs.

We seek stakeholder views on both parts and we have listed consultation questions in the respective chapters.

1.2 Background

1.2.1 AEMC's Harmonisation Rule Change

An emissions reduction component has been added to the three energy objectives: National Electricity Objective, National Gas Objective and National Electricity Retail Objective (the objectives).

The objectives are to promote efficient investment in, and efficient operation and use of, energy services for the long-term interests of consumers with respect to:

- a. price, quality, safety, reliability and security of supply of electricity and natural gas; 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.

On 1 February 2024, the AEMC published final electricity, gas and retail rules (Amending Rule) that harmonise the national energy rules with the emissions reduction component.⁶

⁶ AEMC, [Harmonising the national energy rules with the updated national energy objectives \(electricity\) - Final Determination](#), February 2024. Noting that the Final determination contains both electricity and gas rule changes.

The Amending Rule supports the incorporation of emissions reduction in the energy regulatory framework by allowing network and pipeline operators to propose expenditure for activities that contribute to achieving emissions reduction targets.

The AEMC's Amending Rule:⁷

- Allows network service providers and pipeline operators to include capital and operating expenditure in their revenue proposals and access arrangement proposals that would contribute to achieving Australian greenhouse gas emissions reduction targets.
- Requires that in order to be included in a network or pipeline operator's building block proposal, any proposed expenditure targeted at reducing emissions must relate to regulated services or pipeline services.
- Allows emissions reduction resulting from expenditure on regulated services across the Australian economy to be considered. We will need to assess whether it considers a jurisdictional target proposed by a network service provider or pipeline operator as justification for expenditure meets the definition established in the rules.
- Mandates that any expenditure contributing to emissions reduction outside Australia should not be included, as the new NEO refers to targets for reducing Australia's greenhouse gas emissions.
- Includes transitional provisions for revenue determination and access arrangement processes underway when this Amending Rule came into effect. This transitional arrangement allows us to choose whether to apply the new rules in assessing expenditure proposals that are currently underway.

Gas Rule

In relation to gas, the Amending Rule:⁸

- Amends the criteria governing operating expenditure, and the criteria for conforming capital expenditure to, make clear that contributing to meeting emissions reduction targets is a relevant objective of capital and operating expenditure.
- Enables pipeline operators to include capital and operating expenditure in their access arrangement proposals where that expenditure would contribute to meeting emissions reduction targets through the supply of pipeline services.
- Amends the exemption criteria under rule 39A to provide an exemption to the prohibition on increasing charges to develop pipeline assets if the expansion is necessary to contribute to meeting emissions reduction targets.

The Amending Rule enables us to consider expenditure proposals that contemplate jurisdictional (Commonwealth and State/Territory) emissions reduction targets. All entities that apply the energy objectives must, at a minimum, consider these targets when having

⁷ AEMC, [Harmonising the national energy rules with the updated national energy objectives \(electricity\) - Final Determination](#), February 2024, section 4.

⁸ AEMC, [Harmonising the national energy rules with the updated national energy objectives \(electricity\) - Final Determination](#), February 2024, section 4.

regard to the emissions component of the energy objectives.⁹ In addition, the AEMC may update its Targets Statement from time to time.

1.2.2 Our Role

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 Amending Rule requires us:

- to consider expenditure targeted at reducing emissions that relate to regulated services in their building block proposals.
- update the guidelines and instruments, required under the Laws or Rules, incorporating amending national energy objective including the changes to the capital and operating expenditure objectives.

Therefore, in giving effect to the Amending Rule, we must review the EFA Guidelines for electricity distribution and transmission.¹⁰ This review is in addition our guidance provided in September 2023.¹¹ Our September 2023 guidance sets out the high-level principles we are likely to have regard to in making decisions.¹²

1.2.3 Related processes

We note that there are other AER processes that are in effect or currently underway, which overlap with the matters of emissions reduction. Our guidance on the amended National Energy Objectives,¹³ and valuing emissions reduction final guidance,¹⁴ are two AER documents that are in effect. Where possible, we have considered submissions received during the consultation of these documents, insofar as they relate to this review.¹⁵

The Amending Rule also requires us to review all statutory guidelines including its Cost Benefit Analysis Guidelines and Regulatory Investment Test (RIT) Application Guidelines.

Figure 1.1 below illustrates the direct interlinkages and indicative timing of our work schedule giving effect to the amendments to three national energy objectives. The details of the work streams are summarised in Appendix A.

⁹ AEMC, [Targets Statement for greenhouse gas emissions](#), February 2024.

¹⁰ The Expenditure Forecast Assessment Guidelines is established under the NER cl 6.4.5 and 6A.5.6.

¹¹ AER, [Guidance on amended National Energy Objectives](#), September 2023.

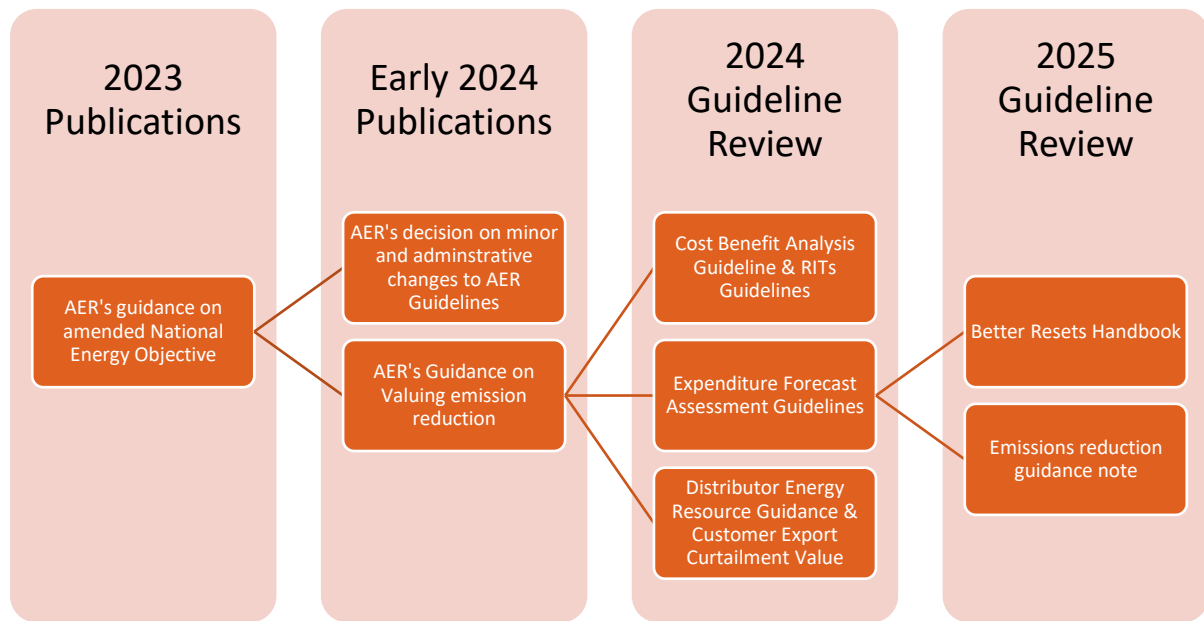
¹² AER, [Guidance on amended National Energy Objectives](#), September 2023, p. 6.

¹³ AER, [Guidance on amended National Energy Objectives](#), September 2023.

¹⁴ AER, [Valuing emissions reduction – Final guidance and explanatory statement](#), May 2024.

¹⁵ Ausgrid and AEC raised issues in relation to network investments in its submissions to the AER draft guidance on amended National Energy Objective and the AER valuing emissions reduction respectively. Please refer to our explanatory statements for [amended National Energy Objective guidance](#) and [valuing emissions reduction guidance](#).

Figure 1.1: AER Work Schedule: Amended National Energy Objective



Note: The timeline is only indicative
Source: AER

1.2.4 Scope of this review

In this process, we are considering how we should have regard to emissions reduction in assessing the capital and operating expenditure forecasts. To do this, we have separated our review into two parts:

- the first is to implement changes to the EFA Guidelines
- the second is to develop an emissions reduction guidance note that provides more detailed, principles based, information on our implementation approach.

This review of the EFA Guidelines is constrained to amendments required by the AEMC's harmonisation rule change. Therefore, we seek stakeholder views specific to the questions set out in Chapters 2 and Chapter 3.

As discussed in Chapter 3, we propose to develop principles specific to emissions reduction expenditure and to publish a guidance note on emissions reduction after the other related processes to update guidance for the amended NEO are completed. This approach will allow us to consider all the issues identified through these processes, and adequately respond to issues raised in submissions that may overlap with the proposed emissions reduction guidance note. That way, we can provide more detailed information for stakeholders on our considerations and approach to assessing emissions reduction expenditure than is provided in the EFA Guidelines. In practice, this would mean the emission reduction guidance note will likely be published in 2025.

1.2.5 Expected Timeline

Following the release of this draft decision, we will consider submissions from stakeholders before releasing our final decision, as per the distribution and transmission consultation

procedures.¹⁶ There are no statutory requirements for the proposed emission reduction guidance note. Indicative timing is shown in Table 1.1.

Table 1.1 Timeline

Description	Indicative Date
Accepting Submissions - Draft Decision	July 2024 – August 2024
Submission close	9 August 2024
Final Decision - Expenditure Forecast Assessment Guidelines	17 October 2024
<i>Timing on emissions reduction guidance note</i>	
Draft emissions reduction guidance note	<i>January 2025</i>
Accepting Submission – Draft guidance note	<i>January – February 2025</i>
Final emissions reduction guidance Note	<i>April 2025</i>

Note: The dates are indicative and subject to change.

¹⁶ Please refer to NER rules 6A.20 and 6.16 for transmission consultation procedure and distribution consultation procedure, respectively.

2 Expenditure Forecast Assessment Guidelines

2.1 Purpose of the Expenditure Forecast Assessment Guidelines

Our assessment approach to electricity distribution and transmission expenditure proposals is set out in several documents, with the overarching guideline being the Expenditure Forecast Assessment Guidelines (EFA Guidelines).¹⁷

The EFA Guidelines describe, at a high level, the process, techniques and associated data requirements for our approach to setting efficient expenditure for network businesses.

The assessment techniques we can use to test the efficiency of a network business's expenditure include:

- economic benchmarking—productivity measures used to assess a business's efficiency overall
- category level analysis—comparing how well a business delivers services for a range of individual activities and functions, including over time and with its peers
- predictive modelling—statistical analysis to predict future spending needs, currently used to assess the need for upgrades or replacement as demand changes (augmentation capex, or augex) and expenditure needed to replace aging assets (replacement capex, or repex)
- trend analysis—forecasting future expenditure based on historical information, particularly useful for opex where spending is largely recurrent and predictable
- cost benefit analysis—assessing whether the business has chosen spending options that reflect the best value for money
- project review—a detailed engineering examination of specific proposed projects or programs
- methodology review—examining processes, assumptions, inputs and models that the business used to develop its proposal
- governance and policy review—examining the business's strategic planning, risk management, asset management and prioritisation.

Over time, the AER has supplemented the EFA Guidelines with more detailed guidance on specific expenditure assessment approaches and issues, such as capex assessment outline, non-network ICT capex assessment guidance note, distributed energy resource guidance

¹⁷ AER, *Expenditure forecast assessment guideline – distribution*, August 2022; AER, *Expenditure forecast assessment guideline – transmission*, November 2013.

note, Industry practice application note for asset replacement planning, and note on network resilience.¹⁸

2.2 Amending Rule Requirements

The AEMC's Amending Rule requires that our review of the EFA Guidelines must consider:

- The amended national energy objective as stated in section 7 of the National Electricity Law
- The inclusion of emissions reduction objective in the capital and operating expenditure objectives
- The AEMC's target statement.

The review of the EFA Guidelines is required to be undertaken using the distribution and transmission consultation procedure as out in the NER.¹⁹ All consultation procedures allow the AER, under specific circumstances, to extend the time on the final decision. Further details on these procedures are set out in the NER.²⁰

2.3 Explanatory Statement

In accordance with the Amending Rule, we have reviewed the EFA Guidelines and considered what changes are necessary.

Overall, our review of the EFA Guidelines suggests that only minor changes are required. As described above, the EFA Guidelines are high-level documents that outline a range of assessment tools and techniques that the AER can use when assessing the prudence and efficiency of capital and operating expenditure proposals. We consider that the existing tools and assessment techniques, as outlined in the EFA Guidelines, are sufficiently flexible to accommodate the emissions reduction objective. Therefore, we consider our assessment methodology as outlined in the EFA Guidelines is still valid.

There are some minor updates we intend to make to reflect the updated NEO in the EFA Guidelines. Table 2.2 constitutes our draft decision, listing the sections and the proposed amendments to the EFA Guidelines.

¹⁸ AER, [Capex assessment outline for electricity distribution determinations](#), February 2020; AER, [Non-network ICT capex assessment approach for electricity distributors](#), November 2019; AER, [DER integration expenditure guidance note](#), June 2022; AER, [Note on the key issues of network resilience](#), April 2022 and AER, [Industry practice application note – Asset replacement planning](#), January 2019.

¹⁹ NER cl. 6.16 and 6A.20.

²⁰ NER cl. 6.16(g) and 6A.20(g).

Table 2.2 Proposed Amendments

Section and Page number	Proposed Amendment
Transmission – Section 2.1 Page 7 Distribution – Section 2.1 Page 7	Replace the quoted NEO with: The National Electricity Objective as stated in the National Electricity Law (NEL) 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: <ul style="list-style-type: none"> 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— <ul style="list-style-type: none"> i. for reducing Australia’s greenhouse gas emissions; or ii. that are likely to contribute to reducing Australia’s greenhouse gas emissions.”
Transmission – Section 2.1 Page 8 Distribution – Section 2.1 Page 8	Amend (3) to “a realistic expectation of the demand forecast, cost inputs and other relevant inputs required to achieve the capex and opex objectives.”
Transmission – Section 2.2.1 Page 11 Distribution – Section 2.2.1 Page 11	In section relating to “Past expenditure was at least sufficient to achieve objectives” amend the last sentence to “Accounting for such changes (including in demand, input costs, regulatory obligations, emissions reduction objectives themselves and productivity) ensures the TNSP (DNSP) receives an efficient allowance that a prudent operator would require to achieve the expenditure objectives for the forthcoming regulatory control period.”
Transmission – Section 2.2.2 Page 12 Distribution – Section 2.2.2 Page 12	Insert an additional dot point stating, “expenditure to reduce emissions, to contribute to achieving emissions reduction targets, is prudent and efficient and relates to the provision of prescribed transmission services (standard control services)”.
Transmission – Section 2.2.2 Page 14 Distribution – Section 2.2.2 Page 14	Insert sub-heading “Emissions reduction expenditure”. Insert the following paragraph “Our approach to assess emission reduction expenditure, for the

Section and Page number	Proposed Amendment
	<p>purpose of contributing to the achievement of emission reduction targets, will focus on the prudence and efficiency of the investment. We expect the TNSP (DNSP) to provide information, amongst other things, to explain the driver of the investment and how it will achieve emission reduction targets through the supply of prescribed transmission services (standard control services). In conjunction with our related assessment process described in the Guideline, we will have particular regard to factors such as the:</p> <ul style="list-style-type: none"> • efficiency of costs, including the calculation methodology, input drivers and assumptions • quality and veracity of data sources and assumptions, including basis for input values, accounting methodologies and emission factors • links with incentive schemes and relevant policies.”

While we consider there are minor changes required to the EFA Guidelines for the reasons outlined above, we acknowledge that further guidance on specific implementation issues for our expenditure assessment, for both electricity, gas and related issues such as tariffs, would be beneficial for stakeholders. For this reason, we are proposing to consult on the development of a separate guidance note on emissions reduction. This is set out in Chapter 3.

2.4 Consultation Questions

1. Do you agree with the proposed updates to the EFA Guidelines?
2. Are there any additional updates, related to the amended national energy objective, we have overlooked that need to be incorporated?

3 Emissions Reduction Guidance Note

The EFA Guidelines provide an overview of our assessment processes and techniques for assessing the prudence and efficiency of electricity distribution and transmission expenditure. The EFA Guidelines are supplemented by guidance notes that provide more granular and targeted information to stakeholders on how we will apply certain assessment approaches.

Similar to the other guidance notes that support the EFA Guidelines, we consider an emissions reduction guidance note would provide information to stakeholders on how we will assess the emissions reduction component set out in the NEO and the capital and operating expenditure objectives.²¹

The guidance note would cover issues related to both electricity and gas, as well as related matters such as tariffs. It would likely be of relevance to investments such as consumer energy resources, the replacement of assets that use Sulphur Hexafluoride gas (SF6), investment in gas connections, and expenditure to minimise leaking gas pipelines.

The proposed guidance note will be non-binding, and we may update it from time-to-time as needed.

Our current review of the Cost Benefit Analysis Guidelines and RIT Application Guidelines are likely to cover some similar matters.²² Our emissions reduction guidance note will have regard to and consider relevant stakeholder submissions provided as part of these processes, insofar as they are relevant to the proposed emissions reduction guidance note.

3.1 Key implementation considerations

We have included an initial list of implementation considerations as a starting point for consultation and will consider other issues raised by stakeholders. Following consultation, we intend to issue a guidance note that sets out the principles we will consider when assessing emissions reduction proposals, including against the capex and opex objectives.

We note that the emissions reduction objective is one of several objectives contained in the NEO.²³ We will consider and balance the emissions 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.²⁴

We invite stakeholders to provide practical examples of expenditure or tariffing issues when giving a response to the consultation questions. This will provide a tangible basis for further discussion and development of the guidance note.

²¹ NER rr. 6.5.6, 6.5.7, 6A.6.6 and 6A.6.7; NGR rr. 79 and 91.

²² AER, [Consultation Paper – Review of the cost benefit analysis guidelines and RIT application guidelines](#), April 2024.

²³ The other objectives being price, quality, safety, reliability and security of supply.

²⁴ AER, [Guidance on amended National Energy Objectives](#), September 2023, p. 5.

3.1.1 Regulated services and expenditure that contributes to meeting emissions reduction targets

The changes to the capital and operating expenditure objectives introduce expenditure that contributes to meeting emissions reduction targets. However, the rules are clear that, for such expenditure to be acceptable, it must still relate to providing regulated services.²⁵ That is, a network or pipeline operator could not earn regulated revenue for expenditure that is outside what is required to provide the regulated service.

Our initial position is that, when proposing emissions reduction expenditure, a business must establish that capex or opex is required to provide a regulated service. We consider regulated services are those reasonably required for the provision of electricity network or gas pipeline services. That is, services that provide for the efficient use of energy networks in respect of price, quality, safety, reliability, emissions reduction and security of supply of electricity and natural gas.

- 1) We are interested in any views as to whether there are further specific considerations that we should take into account in considering whether proposed expenditure which contributes to the achievement of emissions reduction targets relates to relevant regulated services.

3.1.2 What emissions reductions are included

The new emissions reduction objective considers activities that contribute to the achievement of greenhouse gas emissions reduction targets set by respective jurisdictions.²⁶

Before considering the impact of emissions reduction on proposed expenditure, we consider it will be important to establish that the expenditure contributes to meeting a jurisdictional emissions reduction target. If the proposed emissions reduction does not have a direct and commensurate reduction impact on the respective jurisdiction's total carbon account, including where the reduction is classified as immaterial, the expenditure may not be consistent with the objective. It is also important to establish the link between the proposed expenditure and the forecast reduction in emissions.

- 2) We are seeking stakeholder input on what emissions reduction should be considered in meeting the new objective, including what materiality thresholds should apply. We note that this issue is currently being consulted in our review of the Cost Benefit Analysis Guideline and Regulatory Investment Test (RIT) Application Guidelines. We will consider submissions in response to Cost Benefit Analysis Guidelines and Regulatory Investment

²⁵ Regulated service in this statement means standard control services for distribution and prescribed transmission services for transmission network service providers. See NER cl. 6.5.7(a)(5), 6A.6.6(a)(5) and 6A.6.7(a)(5) for further detail.

²⁶ This is further clarified in the new capital and operating objectives, which specify that it should "...contribute to achieving emissions reduction targets."

Test (RIT) Application Guidelines review process insofar as it relates to the EFA Guideline and the emissions reduction guidance note.

3.1.3 Emissions accounting

Accurate quantification or forecasting of emissions reduction is an important part of justifying expenditure under the capex and opex objectives. Quantifying total greenhouse gas emissions from the respective emissions source may involve the use of multiple datasets, actual or estimated quantities, quantification methodologies and projections, and other input assumptions. We acknowledge the complexities and intricacies often involved in the carbon accounting process, and therefore are unlikely to assume a prescribed approach on these matters. However, we consider transparency to be vital, and expect the service provider to provide all relevant supporting information on these matters, including a description and explanations of methodologies, inputs and assumptions used in the emissions reduction estimation process.

We will have particular regard to the compatibility of the datasets with the relevant jurisdiction's carbon account. We are seeking stakeholder views on the quantification of emissions reductions to give guidance on what supporting information should be included as part of a revenue determination or access arrangement proposal. We note that, in terms of valuing the reduction in emissions, service providers must use the value of greenhouse gas emissions reduction as specified by the Energy and Climate Ministerial Council.

- 3) We are seeking stakeholder views on appropriate emissions accounting for electricity and gas regulatory proposals. We note that this issue is currently being consulted in our review of the Cost Benefit Analysis Guideline and Regulatory Investment Test (RIT) Application Guidelines. We will consider submissions in response to these guideline review processes insofar as it relates to the EFA Guideline and the emissions reduction guidance note.

3.1.4 Emissions Scopes

Emissions reduction may occur directly in a service provider's regulated operation, but it may also occur outside of a network. Carbon accounting may comprise broadly of both direct and indirect greenhouse gas emissions. These emissions may be classified as Scope 1, Scope 2 or Scope 3 emissions, and may include for example embodied emissions, fugitive emissions, or changes in the emissions in other sectors as a direct result of the project. It is the emissions boundary which generally clarifies the relevant emission sources for consideration, and thus influences what Scopes are considered when we make our decision on a capital and operating expenditure proposal.

- 4) We are seeking stakeholder views on what the relevant scope of emissions can be considered in forming a view on a capex or opex proposal. We note that this issue is currently being consulted in our review of the Cost Benefit Analysis Guideline and Regulatory Investment Test (RIT) Application Guidelines. We will consider submissions in response to these guideline review processes insofar as it relates to the EFA Guideline and the emissions reduction guidance note.

3.1.5 Incentive schemes and policies

Any overlap and interaction with policies and regulatory schemes will be important consideration to ensure that service providers face incentives that are consistent with the NEO and NGO, and are not over or under-compensated for activities related to emissions reduction.

For instance, we are aware of the operation of the safeguard mechanism, and the intent for covered entities to pursue reductions, including associated rewards or tradeable credits, in their respective carbon footprint. We consider an inappropriate scenario may arise if the relevant business proposes emission reduction expenditure, through the reset process, which may result in achieving rewards, through the safeguard mechanism, without passing on the relevant benefit to consumers.

The incentives-based regulation framework is designed to encourage service providers to pursue efficiencies by rewarding efficient cost savings. However, we are conscious that emission reduction expenditure and investment may impact the outcome of these schemes.

The capital expenditure sharing scheme (CESS) rewards service providers for achieving savings against their capex forecast. For the CESS, an undesirable scenario may arise if a more expensive but lower carbon intensive investment is approved at our determination stage, but the service provider ultimately invests in a cheaper, higher emission asset. Therefore, in this instance, the service provider would be rewarded for not investing in the asset that achieves higher emissions reduction.

We would expect service providers to be transparent in disclosing and quantifying any overlap between the safeguard mechanism and incentive schemes as part of their revenue determination.

- 5) We are seeking stakeholder views on whether our approach to approving expenditure and incentive schemes needs to be adapted to mitigate any adverse outcomes.

3.1.6 Tariff structure

Electricity distribution network tariffs

When assessing network tariff proposals submitted to the AER by electricity distributors, we balance the efficiency and emissions reduction aspects of the updated NEO. However, it is often not a case of trading off efficiency for emissions reductions. Rather, the two considerations tend to be mutually reinforcing in tariff design.

There is currently strong alignment between efficient price signals and maximising the use of renewable energy. This is due to Australia's electricity generation mix and when different sources of electricity dominate our market.

At midday, our networks are flooded with rooftop solar. To match, network tariffs increasingly have very low prices in the midday period. These 'solar soak' tariffs incentivise use of electricity in the midday period, providing more room on the grid for additional rooftop solar.

Peak period charges, applied to residential customers in the late afternoon and early evening and intended to signal when energy use drives network costs, match the time of day when

solar electricity declines and fossil fuel generation dominates. By imposing higher prices in the peak period, network tariffs incentivise less electricity use from fossil fuel generators.

Export reward tariffs pay customers for exporting electricity from their own rooftop solar or battery onto the grid in the evening peak period. Again, more evening exports will help to substitute fossil fuel electricity with rooftop solar exports, even when the sun isn't shining.

By applying a small charge to some rooftop solar exports in the midday period, export reward tariffs incentivise self-consumption and recover network costs in a fairer way, from people using the grid for their exports.

Our consideration of network tariff proposals accounts for the above considerations, but also gives weight to the circumstances of individual distribution networks and to the views of stakeholders. It is also premised on a general position that for efficient investment and use of the network in the long-term interests of all consumers, all distribution customers should contribute to recovery of costs from the network service they use.

Gas distribution network tariffs

Gas distribution network tariffs for haulage services tend to have a declining block structure. That is, for an initial volume, or “block”, of gas transported, per unit haulage charges are set relatively high. For each subsequent block of gas transported, per unit haulage charges incrementally step down. The final block of transported gas has the lowest per unit charge. There are typically between 3 and 6 blocks within a single declining block tariff.

We reviewed gas distribution network tariff structures in 2023 during our review of gas distribution tariff variation mechanisms. We undertook the 2023 review because of stakeholder feedback in the context of previous gas distribution access arrangement determinations, the announcement by Energy Ministers that the National Gas Objective will be amended to incorporate an emissions reduction objective, and the establishment by some states and territories of policies encouraging gas customers to switch to electricity.

Having released an issues paper, held a well-attended online public forum and received a material number of thoughtful written submissions, we released a final decision in October 2023.

Our final decision noted we will consider these issues on a case-by-case basis in the context of individual access arrangement reviews. In this way we can account for the differing levels of reliance on natural gas as an energy source across different jurisdictional markets, different policy settings applicable in each of those markets, and the views of distributor-specific stakeholders.

At this time, it remains our intention to assess gas distribution network tariff structures in the context of assessing individual access arrangement proposals. However, we are also open to stakeholder views on whether we should issue further guidance on how we will consider gas distribution network tariffs going forward.

- 6) We are seeking stakeholder views on how tariff structures might contribute to meeting the emissions reduction objective, and whether additional guidance on the AER's approach would be useful (including what the areas of additional guidance being sought).

3.2 Consultation questions

In addition to the 6 questions raised in this chapter above, we seek stakeholder views on:

7. Do you consider that guidance on the above principles would be useful for formulating regulatory proposals for emissions reduction-related expenditure?
8. What other key principles should be included in the emissions reduction guidance note? (For example, are there issues relating to demand forecasting that might be relevant?)
9. What are some of the key information that should be included in the emissions reduction guidance note to support the submission of prudent and efficient emissions reduction expenditure proposals?
10. What are some examples of potential emissions reduction expenditure or investments that stakeholders envisage to be included in proposals?

Appendix A: Interlinkages with AER documents and processes

AER Documents	Status	Scope and overlap with Emissions Reduction
<p>AER Guidance Amended National Energy Objectives: <i>Statutes Amendment (National Energy Laws) (Emissions Reduction Objectives) Act 2023</i></p>	<p>Published September 2023</p>	<p>Provides high-level guidance on the matters the AER is likely to have regard to in considering whether to apply the amended energy objectives.</p> <p>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.</p> <p>This guidance continues in effect.</p>
<p>Minor amendments to AER Guidelines: Harmonisation Rule Change</p>	<p>Published May 2024</p>	<p>Using the ‘omnibus’ approach to consult on minor and administrative changes across AER’s Guidelines where appropriate, that is required under the Rules, through one consolidated process. This approach reduced administrative burden on the AER Board and stakeholders.</p>
<p>AER Guidance on Valuing Emission Reduction: <i>National Electricity Rules Schedule 3, Clause 42 (and corresponding savings and transition schedules in the National Gas Law and National Energy Retail Law)</i></p>	<p>Published May 2024</p>	<p>The Energy & Climate Ministerial Council issued an ‘MCE Statement’ that states the value, or a method of or guidance for working out the value, of greenhouse gas emissions or greenhouse gas emissions reduction, that is to be used by a government or regulatory entity in considering or applying the amended objective until a Regulation or Rule takes effect.</p> <p>We provided administrative guidance on the value of emission reduction (VER). The VER guidance must be complied with:</p> <ul style="list-style-type: none"> • by the AER in considering or applying the amended objective and • by the AER, and network service providers (including AEMO as a RIT Proponent) in relation to RITs, • but not otherwise by AEMO or the AEMC.

AER Documents	Status	Scope and overlap with Emissions Reduction
		<p>Our VER guidance will continue to apply unless it is varied or revoked by the AER. Issuing any revised guidelines required by the Rules does not itself revoke or amend the VER guidance, and the VER guidance would prevail to the extent of any inconsistency.</p>
<p>Cost Benefit Analysis Guidelines & RITs Guidelines: Harmonisation Rule Change</p>	<p><i>Consulting preliminary views</i></p>	<p>The AER is currently consulting on how the VER will be used to include emissions reduction as a class of market benefit in the integrated system plan (ISP) and regulatory investment test (RIT) by AEMO and network businesses respectively. The RIT is a cost–benefit test that network businesses must perform and consult on before making major investments in their networks.</p> <p>The review only considers the effect of an emissions reduction objective on the ISP and RITs, with any other effects being outside the scope of the review.</p> <p>In addition to consulting on the methodology, the AER is also seeking stakeholder views on:</p> <ul style="list-style-type: none"> • Which additional material factors should be considered in modelling emissions? • How should data to support these factors be sourced? • Should the AER consider including specific guidance on any of the factors? <p>We expect some of this submission responses may extend to expenditure assessment given the interrelation.</p>
<p>Customer export curtailment value and Distributed (Consumer) Energy Resources</p>	<p><i>In progress</i></p>	<p>In July 2024 we will update customer export curtailment value (CECV). During this process, we propose to publish the emission intensity profile, including the distributed network service providers model adjusted to include those emission intensities and ‘calculator’ for consumer energy resources. We will also include detailed instructions for network service providers to be able to use either the relevant ‘raw’ emission information and will be released as a package with the CECV update.</p> <p>Any further guidance or incremental updates specific to emission reduction may be required. However, we are contemplating to</p>

AER Documents	Status	Scope and overlap with Emissions Reduction
		captured in the proposed emissions reduction guidance note.
Expenditure Forecast Assessment Guidelines: Harmonisation Rule Change	<i>Current process</i>	<p>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).²⁷</p> <p>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 can accommodate the additional emissions reduction objective.</p> <p>There are some minor updates we intend to make to reflect the updated NEO.</p>
Emissions Reduction Guidance Note: AER’s own initiative	<i>Proposed next steps</i>	The guidance note is intended to provide detail, as appropriate, to both electricity and gas for all matters relevant to emissions reduction. In addition, this guidance is proposed to cover specific guidance in relation to tariffs, gas and consumer energy resources, and our assessment approach for expenditure proposals for emissions reduction.

²⁷ AER, *Expenditure forecast assessment guideline – distribution*, August 2022; AER, *Expenditure forecast assessment guideline – transmission*, November 2013.