Review of the cost benefit analysis guidelines and RIT application guidelines

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About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is leading social justice law and policy centre. Established in 1982, we are an independent, non-profit organisation that works with people and communities who are marginalised and facing disadvantage.

PIAC builds a fairer, stronger society by helping to change laws, policies and practices that cause injustice and inequality. Our work combines:

- legal advice and representation, specialising in test cases and strategic casework;
- research, analysis and policy development; and
- advocacy for systems change and public interest outcomes.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program works for better regulatory and policy outcomes so people's needs are met by clean, resilient and efficient energy and water systems. We ensure consumer protections and assistance limit disadvantage, and people can make meaningful choices in effective markets without experiencing detriment if they cannot participate. PIAC receives input from a community-based reference group whose members include:

- Affiliated Residential Park Residents Association NSW;
- Anglicare;
- Combined Pensioners and Superannuants Association of NSW;
- Energy and Water Ombudsman NSW;
- Ethnic Communities Council NSW;
- Financial Counsellors Association of NSW;
- NSW Council of Social Service;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW;
- Salvation Army;
- Tenants Union NSW; and
- The Sydney Alliance.

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1. Introduction

PIAC welcomes the opportunity to respond to the Australian Energy Regulator's (AER) Review of the cost benefit analysis guidelines and RIT application guidelines April 2024 consultation paper (the consultation paper).

In examining how to integrate the value of emissions reductions (VER, PIAC urges the AER to consider the intentions of the legislators when they amended the national electricity objective (NEO) and national gas objective (NGO) to include emissions reductions alongside the established elements.

This implies accepting that no single VER (or VER schedule) could satisfactorily suit the needs of the AER when approving regulatory tests for transmission (RIT-T) and regulatory tests for distribution (RIT-D) and the needs of the Australian Energy Market Operator (AEMO) in producing the Integrated System Plan (ISP).

Legislators intended to enable the national energy market (NEM) to become the driver of wider decarbonisation of the Australian economy, and result in the most efficient reduction of actual emissions. This requires a dynamic value of emissions reductions in relation to ISP scenarios and a need for the AER and AEMO to consider scope 1, 2, and 3 emissions when they use their respective powers and functions.

We provide feedback on this and the other issues raised by the AER in relation to the cost benefit analysis (CBA) guidelines below.

2. Value of emissions reduction

The interim VER should only be used for the cost benefit analyses (CBA) that appear in RIT-Ts and RIT-Ds. It should not be used for the CBAs that appear in the ISP. A single value is not appropriate for the latter as the needs of the revised ISP include a dynamic value of emissions reductions, one that is dependent on a complex set of variables that are given outside of the ISP.

This is the solution that is most in keeping with the intent of the legislators.

The Intent of the Act

We highlight the intent of the legislators of the *Statutes Amendment (National Energy Laws) (Emissions Reduction Objectives) Act 2023* (South Australia) (the Act). This focuses on consideration of achieving specific emissions reduction targets by market bodies exercising their decision-making functions and powers.[1] The intent gives scope to the market bodies on how to trade off the other elements of the Objectives on a case-by-case basis.

[1] 2nd Reading SA House of Assembly 14 June 2023, Hansard pp.4378-4379, 4381-4382; 2nd Reading SA Legislative Council 31 August 2023, Hansard pp.3544-3545.

The intent of the legislators is for the market bodies to consider options in relation to the impacts on economy-wide, not merely NEM-wide targets.[3]

This can be seen in lines such as:

> As currently framed, the energy objectives do not refer to emissions reduction either directly or indirectly. Changing this will send a clear signal to wider industry, market participants, investors and the public, of governments' commitments to achieve a decarbonised, modern and reliable energy system that contributes to the achievement of Australia's emissions targets.

Later, the speech includes the line:

> The Bill frames the emissions reduction objective by reference to the achievement of targets set by a participating jurisdiction, be it the Commonwealth, a state or a territory, for reducing or that are likely to reduce Australia's greenhouse gas emissions.[4]

This implies the aim of amending the Objectives is that the market bodies' task is to implement the transformation of the NEM as the driver to decarbonise the wider economy.

In our reading, this unambiguously directs the AER to consider scope 2 and 3 emissions in the Guidelines. More importantly, it fundamentally alters the purpose and structure of the ISP. There is no way the intent of the legislators could be resolved with a decision to enforce a single valuation of emissions reductions through the CBAs as they appear in the ISP and RIT-T and RIT-D.

Impact of the amendment of the Objectives on the purpose of the ISP

The amendment of the Objectives has significant implications for the ISP which are not yet widely appreciated.

Up until the 2024 ISP, the intent of the planning document has been to describe the least-cost paths for energy infrastructure (specifically transmission) development under a range of scenarios and sensitivities, chief among them the speed at which the wider Australian economy is decarbonised. The implication of this was that if the wider decarbonisation occurred more slowly than anticipated, the consumer benefit from investments in new infrastructure in the NEM would be maximised by taking a slower path, and vice versa.

The demand to make the NEM the driver decarbonisation of the wider Australian economy reverses this implication. If the wider economy decarbonises at a slower rate than is anticipated within a given central scenario, the value of the more rapid investment in and transformation of the NEM goes *up*, as it makes wider decarbonisation more rapid and more attractive.

For the purposes of the Guidelines there is an important implication. The targets that AEMO is charged with using the ISP to bring about are given. That means that the scenarios describing

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[3] See s. 7, *National Electricity Law - schedule to the National Electricity (South Australia) Law 1996* (**NEL**); s. 23, *National Gas Law – schedule to the National Gas (South Australia) Law 2008* (**NGL**)

[4] 2nd Reading SA House of Assembly 14 June 2023, Hansard pp.4378-4379, 4381-4382; 2nd Reading SA Legislative Council 31 August 2023, Hansard pp.3544-3545.

different rates of decarbonisation across the economy cannot value emissions reductions equally. There is a dynamism in terms of the value of a unit of reduced emissions built into the ISP. Emissions targets are a given and the speed of wider economic decarbonisation is dependent on choices made within the ISP.

Accordingly, there is no way that a single VER (or VER schedule, charting the value of emissions reductions over time) could be applicable to all uses within a single ISP. It certainly could not also be consistent with the VER used by the AER for the purposes of the RIT-T and RIT-D. The aim of consistency should be dropped, and the published interim VER schedule should be used for the purposes of the RIT-T and RIT-D only.

We note that the AER raised a concern about the potential for integrating a VER into the ISP to diminish the narrative value of the ISP scenarios. This is understandable, but only holding the assumption that AEMO will not update the purpose of the ISP in line with the intentions of the legislators of the Act. Given the Act requires AEMO to alter the wholesale meaning and implication of the scenarios already, any concern about the integrity of the scenarios should be disregarded.

Inclusion of scope 2 and scope 3 emissions

The quotes from the second reading of the Act in the sections above clearly indicate that the intent was to ensure market bodies consider the implications of their decisions beyond the narrow confines of the NEM itself. This implies a clear instruction to consider implications of investments on emissions that fall under scope 2 and 3.

With regard to scope 2 emissions being minimal, we see no reason to carve out them out ahead of analysis. A fully cradle to grave approach to the impact of decisions is preferable.

3. Social licence

PIAC supports a principles-based approach to the setting of minimum standards. First, transmission and distribution projects are diverse and particular and a flexible approach is appropriate. Second, network businesses should be aiming for best practice and a minimum standards approach can create the unintended impact of disincentivising pursuit of performance above the minimum standards (ie. that they are treated as a ceiling not a floor).

Social licence is a problematic metric

PIAC proposes that network businesses are not set expectations in terms of social licence, which is a point in time outcome, but social performance or community responsiveness performance, which is an input.

Network businesses should be judged in terms of prudence and efficiency in their spending not on the basis of subjective (and ephemeral) outcomes, but their own performance. Social licence is an outcome, and network businesses only ever have partial control over it. Their actions can undermine it, but it is almost impossible to assign them sole responsibility or agency for earning it.

As an outcome it is also difficult to measure objectively. What are the boundaries which are considered relevant? How much of the community need 'assign' license for a business to be successful? What proportion of the community would be regarded as representing a loss of license? It is also subject to change over time, meaning that even if it was to be measured the AER would need to make an arbitrary decision over when to judge its attainment, alongside the subjective qualifications as to when it is earned or lost.

Social performance or community responsiveness, however, is entirely within the control of the network business. It can be broken down into categories of activity and investment building on existing best practice guidelines, most obviously the *Better Resets Handbook*. Network businesses can propose activities aimed at conforming to their understanding of best practice social performance or community responsiveness and make applications for monies spent on these activities on the basis of their conformity with the AER's existing guidance.

Notably, social performance or community responsiveness activities can be judged qualitatively (according to response and contribution to set principles) as well as quantitatively, meaning in terms of money spent. Social performance plans produced by network businesses should engage with how they intend to conduct activities relating to social licence as well as what money they intend to spend.

Arrangements concerning spending plans

Network businesses have raised the reasonable concern that while they are required to make decisions about spending on activities relating to social licence ahead of the activities, the AER is often in a position to judge the prudence and effectiveness of their spending with the benefit of hindsight.

In order to address this, PIAC proposes that network businesses produce detailed plans for activities relating to social performance ahead of spending any money, and that these are given conditional approval by the AER. The spending could then be entered into capex or opex in CPA1 or CPA2 as per the current arrangement.

Social performance plans could be consulted on confidentially with expert advisors by both the AER and the network businesses as needed.

The move to gain approval for social performance or community responsiveness spending ahead of time would both allay the concerns of the network businesses above and mitigate the risk of network businesses overspending consumers' money to 'attain social licence'.

4. Concessional finance

If net benefit to consumers for an investment or a preferred investment option are contingent on the receipt of a concessional finance agreement, the AER's approval of the RIT should also be contingent on that.

More broadly, PIAC is concerned about the incidence and impact of overlapping financeability responses. Concessional finance is appearing in CPAs as one of a number of solutions aimed at resolving financeability issues, with the provider of the concessional finance determining the quantum of their support on the assumption their response is the only solution to the issue.

Any concessional finance agreements should be in place and the terms of the agreement, including the intentions of the provider, should be available to the AER at the time the AER approves any spending be it in CPA1 or CPA2. It should be considered by the AER when making any further adjustments to resolve a financeability issue.

5. Improving the workability of the feedback loop

PIAC believes that the feedback loop is not currently fit for purpose and does not protect the interests of consumers. Currently the only party that can identify the existence of a material change in circumstances is the project proponent, who is incentivised to ensure the project goes ahead, whether it is in consumers' interest or not.

The feedback loop does not currently consider whether the assessment that the project returns a net benefit to consumers remains valid. It is limited to confirming that the project remains on the most recent ISP's optimal development path and that the preferred option identified in the RIT-T remains the preferred option.

This is inadequate as it places the onus for assessment of net benefit with AEMO rather than the AER, which is more expert at the task. More fundamentally, the assessment AEMO does is taken not in light of the change of material circumstances that triggers the feedback loop, but rather is done in the context of whenever the last ISP or ISP draft was completed, whether this includes the new information or not.

Further changes are required beyond the scope of the changes being considered here.

6. Early works

PIAC agrees that there are potential benefits to consumers from network businesses moving certain activities forward to early works.

However, there are also risks arising from network businesses spending consumer money before a RIT is completed. In the case of VNI West, the net spend in NSW is expected to be close to $2billion and the early works spend that has now been approved is slightly less than $1billion.

This proportion of overall costs falling into early works risks undermining the AER's ability to amend or outright refuse to approve a RIT. In the event of the AER determining that a RIT does not successfully defend the case that the investment returns a net benefit to consumers, the AER would be in the unenviable position of writing off the entire early works spend as a loss for consumers or approving a project that does not return net benefits to consumers.

A threshold should be established setting a limit on the proportion of a project costs that can be spent before a RIT is completed.

Continued engagement

We welcome the opportunity to meet with AEMO and other stakeholders to discuss these issues in more depth. Please contact Michael Lynch at mlynch@piac.asn.au regarding any further follow up.