

9 August 2024

Mr Arek Gulbenkoglul
General Manager, Network Expenditure
Australian Energy Regulator (AER)
Submitted electronically: aerinquiry@aer.gov.au

Dear Mr Gulbenkoglul,

Draft Decision – Expenditure Forecast Assessment Guidelines NEO Review

Endeavour Energy appreciates the opportunity to provide feedback to the AER's draft amendments to the Expenditure Forecast Assessment (EFA) Guidelines and proposal to develop an emissions reduction guidance note.

Distribution Network Service Providers (DNSPs) are playing a critical role in facilitating a customer-led transition to a net-zero energy system. In particular, we consider that DNSPs can:

- directly contribute to national and jurisdictional emissions targets through investment to reduce their own emissions;¹
- enable customers to do the same through facilitating the connection and use of customer energy resources (CER); and
- be key enablers of emission reductions in other sectors through facilitating the shift towards renewable generation and electrification.

Our feedback on key areas of the EFA Guidelines review are set out below.

Is guidance required?

We note the AER considers its existing tools and assessment techniques set out in the EFA Guidelines are sufficiently flexible to accommodate the emissions reduction objective. Given this, only minor amendments are required to the EFA Guideline at this stage. Following these administrative amendments, a detailed guidance note will be developed specific to emissions reductions expenditure.

As a new expenditure driver, we consider additional guidance is warranted and should address acceptable carbon accounting methodologies, the scope of emissions reductions benefits to be regarded and the application of the AER's Value of Emissions Reduction (VER) to cost-benefit analysis. We support this guidance note being developed after the AER's review of the Regulatory Investment Test (RIT) Application Guidelines given it will likely inform the areas that warrant further clarification and guidance.

We note the AER exercises discretion in its regulatory decision-making to balance the elements of the National Electricity Objective (NEO), and appreciate that this is a complex process. We consider that, as is the case with any other objective, emissions reduction need not be dealt with preferentially or prescriptively in the EFA Guideline.

¹ Examples include asset replacements to reduce Sulphur Hexafluoride (SF6) emissions and line losses (noting the difficulty in solving for emissions through line losses, given our inability to influence generators in relation to this) and accelerating EV fleet conversions.

We consider that the EFA Guidelines should aim to provide certainty in the process and/or clarify the nature of supporting evidence (including consultation) that the AER would expect a DNSP to provide where emissions reduction is a driver (in part or in full) of a proposed investment.

More broadly, we note the EFA Guidelines are complemented by several guidance notes on specific categories of expenditure such as ICT, CER, resilience and repex. Whilst transparency is valued, to enable DNSPs to provide relevant information to the AER, we would encourage the AER to consider reviewing these various guidelines to remove any duplication or redundant information and to clarify the hierarchy and interaction of these documents.

For instance, the EFA Guideline and accompanying DNSP Expenditure Forecasting Methodology Statement (EFMS) were designed to provide the AER and stakeholders with visibility of DNSPs' forecasting approach and, in turn, certainty to DNSPs and stakeholders as to the assessment techniques that will be utilised. Where assessment techniques have been standardised or clarified further, such as within the Better Resets Handbook (BRH), the question arises as to whether the EFA Guidelines and EFMS remain necessary and/or require revision in their purpose and scope.

Are the proposed amendments reasonable?

We agree the AER's proposed amendments to the EFA Guidelines appropriately reflect the updated NEO.

In addition, further clarification may be required with respect to section 2.2.1 of the EFA Guidelines which specifies that the AER's general assessment approach assumes a DNSP's past expenditure was sufficient to achieve the expenditure objectives. This enables the AER to rely on previous expenditure as the basis for assessing proposed expenditure and setting an efficient expenditure allowance (accounting for changes in demand, input costs and other relevant factors).

However, it is unlikely that prudent and efficient investment in the future, which seeks to deliver emission reduction benefits and achieve the updated expenditure objectives, will be supported by the strict application of assessment techniques which rely on previous revealed expenditure such as trend analysis and category level benchmarking. In assessing expenditure with an emissions reduction driver, the AER may need to ascribe a lower weight to these techniques or make adjustments to account for the expansion of the expenditure objectives.

What emissions should be measured and how?

We support the AER's proposal to not prescribe an emissions accounting approach and consider it should allow DNSPs the flexibility to apply an emissions accounting approach that is reputable and aligned to global best practice. These include, but may not be limited to:

- the Greenhouse Gas Protocol (GHG Protocol);
- the National Greenhouse and Energy Reporting Scheme (NGERS); and
- the Carbon Disclosure Project (CDP) (with respect to Internal Carbon Pricing).

Regarding emissions scope, we note the NER has been amended to clarify emissions reduction benefits including those which accrue, either directly or indirectly, to parties outside of the electricity sector. We consider this sets a clear boundary that includes Scope 1, 2, and 3 emissions.

Capturing each of these emissions classes would be consistent with International Sustainability Standards Board (ISSB) requirements to disclose absolute emissions, including Scope 3 emissions, measured in accordance with the GHG Protocol.² Similarly, the *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) 2024* Bill proposes to include Scope 3 emissions within the new mandatory climate reporting requirements for large businesses.

² ISSB, [IFRS Sustainability Disclosure Standard: Climate-related Disclosures \(IFRS S2\)](#), June 2023, p.32.

Scope 3 emissions can represent a substantial proportion of an entity's total emissions (potentially ~50% for electricity utilities).³ However, difficulties in accessing the requisite emissions data from numerous third parties make it currently challenging to reliably measure these broader and indirect impacts.

While we can model the impact of investment on Scope 1 and 2 emissions, we continue to develop and refine our capabilities to estimate the impact of Scope 3 emissions. We expect DNSPs will be at different stages of understanding the influence their expenditure and procurement decisions can have on emissions across their respective value chains. It is therefore appropriate that the expenditure assessment framework be flexible to ensure the benefits of emission reductions are not unduly limited by temporary measurement challenges.

Will the regulatory framework promote efficient levels of emissions reduction?

Under the NEO, networks are regulated to minimise the welfare loss of monopoly with respect to price, outputs and quality, and to maximise customer welfare. Incentive regulation is widely accepted as the most effective way to overcome the information asymmetry between the regulator and regulated firm and to encourage efficient behaviour to obtain socially optimal price and quality levels.

In developing incentive schemes and regulatory frameworks, balancing the cost-quality relationship is key to promoting the NEO. The Efficiency Benefit Sharing Scheme (EBSS), Capital Efficiency Sharing Scheme (CESS) and various expenditure assessment tools available to the AER, particularly benchmarking, means the cost efficiency aspect of regulation is relatively well established and mature. The Demand Management Incentive Scheme (DMIS) acts to incentivise dynamic efficiency so that networks pursue continuous cost efficiency improvements in the long-term.

Service quality regulation is currently focussed on normalised reliability via the Service Target Performance Incentive Scheme (STPIS) and customer service quality through bespoke Customer Service Incentive Schemes (CSIS). However, questions arise as to whether regulation is keeping pace with the changing customer expectations. For instance, the growing impacts of climate change mean customers are becoming increasingly concerned with network resilience which extends beyond normalised reliability. Further, the growing uptake of CER means power/voltage quality and export hosting are increasingly valued services.

Our ongoing engagement with customers has highlighted that they expect and value our role in reducing emissions. Currently, the regulatory framework relies on jurisdictional targets and reputational incentives to promote an efficient, cost-quality mix with respect to emission reduction. We are concerned that the development of input-focussed regulatory tools will outpace counter-balancing, output-based measures over the longer term. This could result in a suboptimal level and/or pace of emission reductions, particularly where reputational incentives are not competitive with CESS, EBSS and/or STPIS rewards that may otherwise influence management decisions on resource allocation and productivity improvement efforts.

We would encourage the AER to consider the incentive mix in the medium term to ensure well-balanced incentives are provided with respect to emissions reductions.

To discuss this submission further, please contact Patrick Duffy, Manager Regulatory Transformation and Policy, via email at [REDACTED]. We also look forward to discussing with you at our upcoming meeting on 21 August 2024.

Yours sincerely

[REDACTED]

Emma Ringland
Head of Regulation and Investments

³ Carbon Disclosure Project, [CDP Technical Note: Relevance of Scope 3 Categories by Sector](#), June 2024, p.6.