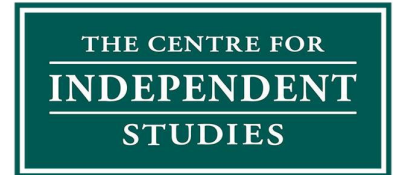


20 September 2024

Ms Stephanie Jolly
Executive General Manager
Australian Energy Regulator



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Submitted by email: RITguidelines@aer.gov.au

RE: Submission to AER's Cost Benefit Analysis and RIT Application Guidelines Draft Amendments

Dear Ms Jolly,

The Centre for Independent Studies (CIS) welcomes the opportunity to respond to the AER's draft amendments to the Cost Benefit Analysis (CBA) Guidelines, the Regulatory Investment Test (RIT) application guidelines and RIT instruments (collectively referred to as the Guidelines).

The CIS is a leading independent public policy think tank in Australia. It has been a strong advocate for free markets and limited government for more than 40 years. The CIS is independent and non-partisan in both its funding and research, does no commissioned research nor takes any government money to support its public policy work.

When considering the draft amendments to the guidelines, CIS objects to the use of a value of emissions reduction (VER) while a carbon budget is retained in the model, as well as allowing the continued exclusion of Scope 3 or embodied emissions. We also object to the assumption that the ISP ensures optimal outcomes for consumers, given AEMO's practice of placing all official government policies as binding constraints on every scenario.

Yours sincerely,

Aidan Morrison
Director of Energy Program
Centre for Independent Studies
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Valuing emissions reduction

Carbon budgets

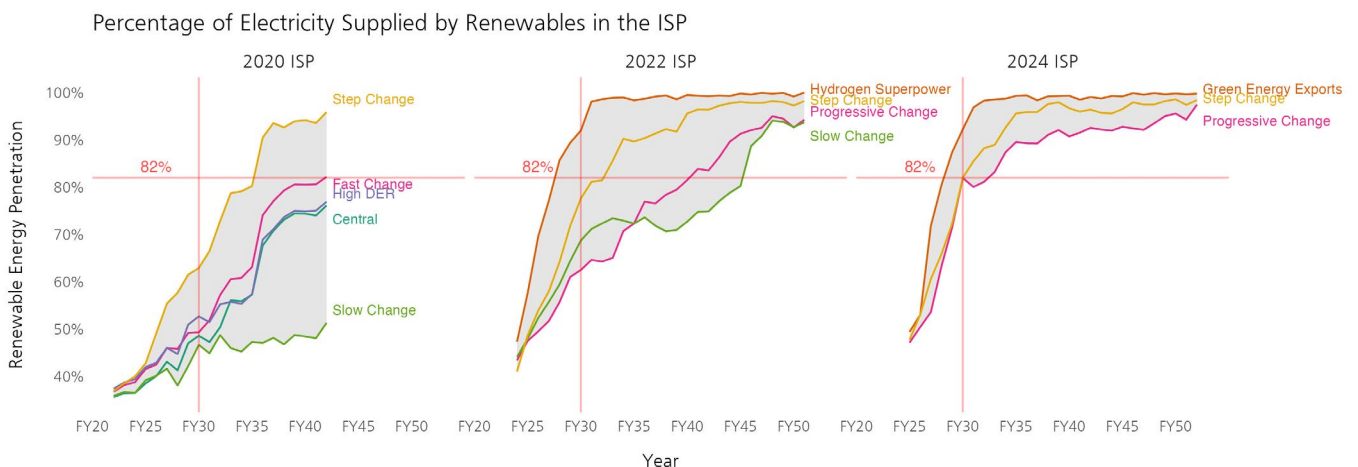
On page 13 of the explanatory statement, AER states:

The NEM-wide carbon budgets are used as a proxy for different paces of decarbonisation, and are a main source of differentiation between possible future scenarios... Without including a carbon budget there may be less of a spread of emission trajectories across the scenarios which would diminish the ability to capture uncertainty when mapping the possible different future states of the world. As such, we consider the use of carbon budgets enriches the analysis.

Combining a carbon budget and a value of emissions reduction effectively creates two 'prices on carbon' and confuses the analysis rather than enriching it.

Capturing uncertainty with ISP scenarios is certainly critical to their functioning correctly. This could be achieved just as easily, and with more simplicity, by varying the VER schedule in different scenarios.

This is also an opportune moment to highlight that the ISP scenarios now fail to capture uncertainty in spite of varying carbon budgets; because AEMO has made the federal government's 82% renewables by 2030 target binding on every scenario (see figure below). Energy experts at Grattan Institute,¹ Energetics,² and Nexa Advisory³ have confirmed this target is not only uncertain, but unlikely to be achieved.



The AER's response to the CIS's submission to the consultation paper on page 14 states:

We consider that the use of a carbon budget does not conflict with valuing emissions differences using the VER. We understand that in some cases there may be limited

additional benefits from reducing emissions beyond the benefits that are implicitly included through adoption of a carbon budget (i.e. the benefits that a project provides in meeting the carbon budget at lower system costs).

It is unclear why the “limited additional benefits” should exceed zero if the carbon budget has an implied price equal to the VER.

There are two problems with this:

1. **It compromises the model:** Where the implied price of the budget and VER differ, the combination of a budget with a VER creates an asymmetry where the most stringent of the two is satisfied.
2. **It complicates the model:** Where they do not differ, and the view above is that they will be largely similar, the combination of a VER and carbon budget makes the model harder to understand. It is not clear that industry or policymakers have a view of how the two should interact, or what the meaning of their interaction is. This is detrimental to effective policymaking.

Embodied emissions

The AER states on page 12 that only direct emissions must be considered as part of a RIT and encourages AEMO and businesses to include any other scopes that are material and relevant.

Allowing embodied emissions to be excluded from the calculation of VER will likely result in some options being overvalued in comparison with others.

This can be true even for the same technology. The embodied emissions from rooftop solar are significantly higher than utility-scale solar because of the lower efficiencies achieved without tracking, cleaning and optimised location. Including embodied emissions would ensure the model makes appropriate trade-offs to minimise whole-of-system emissions.

Improving the workability of the feedback loop

The AER stated on page 24 in response to the EUAA’s submission:

The EUAA submitted that the feedback loop process should not just confirm that a project is part of the optimal development path but should also confirm that the project provides net benefits. However, the ISP is a whole of system plan that ensures that the combination of all projects optimises outcomes for consumers. As such, a project passing implies benefits for consumers.

The ISP does not in fact ensure that the combination of all projects provides an optimum outcome for electricity consumers. As the AER states on page 13:

According to NER 5.22.3, when determining how the ISP would contribute to achieving the NEO, AEMO must consider the emissions reduction targets stated in the targets statement (published by AEMC). AEMO may also consider a current emissions reduction target which is not set out in the target statement. This includes jurisdictional policies which are sufficiently developed to enable AEMO to identify the power system impacts and where certain criteria are met (as specified under 5.22.3(b)(2)).

The Rules clearly state AEMO's obligation is to "consider" emissions reduction targets, not to apply these targets as binding constraints to every scenario. By binding the entire model to unrealistic targets such as 82% renewables by 2030, AEMO has in effect created a 'whole of system plan' that may well result in over-investment, should targets be missed, moderated or removed. This means a project passing the feedback loop does not guarantee benefits for consumers. It guarantees benefits only in a world in which all government policies are locked in and successfully delivered.

¹ Yan, Richard. 2024. "Now comes the hard part of the great energy transition." Grattan Institute. <https://grattan.edu.au/news/now-comes-the-hard-part-of-the-energy-transition/>

² Energetics. 2024. "Why Australia is not on track to achieve a 43% emissions reduction by 2030." <https://www.energetics.com.au/insights/thought-leadership/why-australia-is-not-on-track-to-achieve-a-43-emissions-reduction-by-2030>

³ Mercer, Daniel. 2023. "Australia will fall well short of 82 per cent renewable energy by 2030, analysts predict, as problems mount." ABC. <https://www.abc.net.au/news/2023-08-06/australia-likely-to-fall-short-of-82pc-renewable-energy-target/102689392>