

17 September 2024

Ms Stephanie Jolly
Executive General Manager
Australian Energy Regulator
PO Box 12241
George Street Post

Dear Ms Jolly,

Review of the cost benefit analysis guidelines and RIT application guidelines

The Justice and Equity Centre (JEC – formerly PIAC) welcomes the opportunity to respond to the Australian Energy Regulator’s (AER) explanatory statement on draft amendments to the Review of the cost benefit analysis guidelines and RIT application guideline (the explanatory statement).

Double counting

Stakeholder concerns regarding the possibility of double counting emission reductions have not been adequately addressed. While the explanatory statement considers these concerns, it only does so in relation to emission reductions occurring outside the National Energy Market (NEM).¹ The JEC raised concerns relating to any instance where another actor may be credited with an emission reduction, whether the reduction occurs within the NEM or outside of it.

Example:

A transmission line is built enabling new renewable generation to be connected. According to the criteria laid out on page 12 of the explanatory statement, all the emissions reductions resulting from the displacement of existing fossil fuel-generated energy by the energy produced by this new generation should be credited to the transmission line. The new renewable generation occurs as a ‘direct result of the project’ (ie. the transmission line); the reductions that occur are dependent upon the project (for argument’s sake the transmission line serves the sole purpose of enabling these new connections); and the emissions are estimated using a reasonable approach and data.

The generators in this scenario also receive credit for the emissions they reduce through displacing fossil fuel-generated energy, be it from large-scale generation certificates sold in the Renewable Energy Target (RET) or GreenPower, or benefits associated with Long-Term

¹ AER, 2024, Explanatory statement on draft amendments to the Review of the cost benefit analysis guidelines and RIT application guideline, p. 13, referred to as ‘emissions arising from other sectors’.

Energy Service Agreements (LTESAs). This is a precondition to renewable generation investment being viable.

Any credit the generator receives from emission reductions comes as a double counted credit from the perspective of the consumer, who is also 'paying twice' for those reductions.

In the example listed above, the assumption that new generation wholly displaces existing fossil-fuel generation further inflates the assumed emissions impact. If the line were not built, new renewable generation would still be built, but at other, potentially less desirable locations. In this sense, the new renewables are displacing other renewable generation. Importantly, the availability of new renewable generation does not directly lead to equivalent removal of existing fossil fuel generation. It can only be said to increase the scope for that fossil-fuel generation to be displaced.

The significance of this is to highlight the need to ensure assessment of emissions reduction impact does not inaccurately inflate the benefit to consumers of network options.

To address this we propose that, as a principle, transmission projects should not count as benefits any emissions reductions that accrue via a channel that includes another actor who will also accrue benefits from investments that are enabled by the transmission line.

The VER schedule produces perverse incentives

The interim Value of Emissions Reductions (VER) schedule does not appropriately reflect the relative impact of emissions over time and the higher value of emissions reduction in early years, relative to those in later years. The actual value schedule of reduced emissions goes in the opposite direction to the proposed VER schedule.

The VER which is in place until 30 June 2026 increases the value of emissions reductions in real terms over time out to 2050. There are good economic reasons for this, relating to the need to allow investors across the sector to smooth their transition to fully incorporating the externality of emissions, and so avoid shocks or coordination failures that would not be in the interests of consumers.

However, the decision reflects economic considerations over emissions impact reality. Most obviously, as carbon (or methane) emitted into the atmosphere accumulates (and reduces the future allowable emissions budget, while also impacting atmospheric temperature), a tonne of carbon (or methane) emitted today has a substantially larger relative impact than a tonne of carbon emitted in any later year. There are potentially significant consequences for retaining the proposed VER schedule.

The AER should avoid the perverse outcomes by providing RIT proponents and AEMO with a formula to reverse the direction of the schedule, allowing earlier emission reductions to be valued more for the purposes of cost-benefit analyses. This would be simple to write and apply. It requires only that RIT proponents and AEMO have the capacity to reasonably estimate when emission reductions are likely to occur, and presumably this is already a working assumption for how these actors are expected to use of the VER schedule in its current form.

Emissions reductions that occur outside the NEM

A point of contention arose in the stakeholder webinar held on 26 August 2024 concerning whether or not emission reductions occurring 'outside of the NEM' needed to be considered by proponents in their RITs. Advice from the AER in the webinar was that all emissions reductions occurring inside the NEM *must* be included in the cost benefit analysis, but emissions reductions occurring outside of the NEM *may* be included. The decision on whether to include reductions occurring outside of the NEM will fall to proponents, and they are expected to make it based on whether or not those reductions are material.

When questioned on the possibility of proponents making the decision to include these on the basis of anything other than materiality, the AER explained the structure as resting on the assumptions that:

- a. As we are in a transition towards a clean energy system, all investments can be assumed to be emissions-reducing, not increasing; and
- b. As proponents want their projects to be approved, there is no incentive for them to exclude emissions reductions that are material.

We contend a third assumption is necessary, which is that RIT proponents view all options considered in a RIT as equally attractive. This is not currently the case, where network (capital expenditure) options are often preferred over 'non-network' options, due to a preference for investment which contributes to the regulated asset base.

Given this, there may be incentive for RIT proponents to construct the analysis of various options in order to preference capital expenditure-heavy options.

To resolve this we recommend guidance on including emissions occurring outside of the NEM is adjusted as follows:

- proponents can decide whether or not to include emission reductions occurring outside of the NEM, but they must include them for all options. If they opt to include reductions occurring outside of the NEM, they must include such reductions whether they are positive or negative.
- to reduce ambiguity, the guidance should also specify what is meant by 'material' in this context.

We welcome the opportunity to meet with the AER and other stakeholders to discuss these issues in more depth. Please contact me at mlynch@jec.org.au regarding any further follow up.

Yours sincerely,

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