

Incorporating an emissions reduction objective into the national energy objectives – stakeholder feedback template

This template has been developed to assist stakeholders in providing feedback on the *National Energy Laws Amendment (Emissions Reduction Objectives) Bill 2022* (Draft Bill).

Chapter 3: Approach to incorporating an emissions reduction objective

Question 1: Do you consider incorporating the emissions reduction objective into the existing 'economic-efficiency' framework is an effective way of integrating the concept into the decision making of energy market bodies?

Feedback 1:

The AER supports including an emissions reduction objective into the national energy objectives as an element of economic efficiency and considers this will enable the energy objectives to reflect all the dimensions of economic efficiency more completely. We observe that the relevance of the national energy objectives to a particular AER decision is a matter of law, which will depend on the drafting of the relevant provisions that govern that specific decision, interpreted in the context of the surrounding regulatory framework. Given the economic nature of the framework, and the national energy objectives themselves, we consider incorporating the emissions reduction objective into the existing 'economic efficiency' framework is an effective way of integrating the concept into the decision making of energy market bodies.

We also note that the introduction of the emissions reduction objective aligns well with the direction that the AER has been taking on considering the impacts of climate change through our functions, including for example, through our work on network resilience¹. The proposed approach would enable the AER to consider emissions reduction in performing and exercising its various functions and powers under the National Energy Laws. For example, it would allow the AER to form views about the efficiency of a service provider's costs (of providing services to meet the relevant level of demand) in a manner that favours solutions to network needs that have better emissions reduction outcomes over solutions that have worse emissions reduction outcomes. The AER would consider emissions reduction alongside the existing factors in the national energy objectives, including price, in the overall aim of promoting the long-term interests of consumers. The AER considers that incorporating the emissions reduction objective into the existing economic efficiency framework will provide it with an appropriate level of discretion within the framework which will facilitate consideration of emissions reduction with other aspects of economic efficiency under the energy objectives.

Conversely, the AER considers that having an emissions reduction objective sit as a separate but equal objective would be problematic, as it would depart from the existing economic efficiency framework on which the energy laws are based. The AER considers that alternative ways of framing emissions reduction, such as by reference to cost-effectiveness, are not well defined and are not currently used in the national energy legislation and rules. This could lead to uncertainty in how to interpret and apply these terms. Additionally, we consider that introducing such concepts could create uncertainty as to how to address the trade-off between the two objectives (being economic efficiency and emissions reduction) in undertaking our economic efficiency functions, such as revenue determinations.

¹ AER, Network resilience – A note on key issues, April 2022

Question 2: Is the current level of discretion afforded through an ‘economic efficiency’ framework appropriate for balancing an emissions reduction component against existing components of the energy objectives?

Feedback 2: On the assumption that emissions reduction will be incorporated into the existing ‘economic efficiency’ framework in the national energy objectives, the AER considers this framework will provide the flexibility to consider emissions reduction alongside the existing components of the energy objectives. For example, in making revenue determinations, the AER has previously discussed the approach taken in considering the various components outlined in the current energy objectives.² In making such decisions, the AER has noted that the overall Final Decision must be made in a manner that contributes, or is likely to contribute, to achieving the National Electricity Objective, which we consider is achieved by considering each of the factors together, rather than each in isolation. Examining constituent components in isolation ignores the importance of the interrelationships between components of the overall decision and would not contribute to the achievement of the relevant energy objective.

Question 3: Do you consider that, for certain instances/processes, market bodies should develop/update guidance material to assist market participants in understanding how market bodies will interpret the proposed revised national energy objectives?

- a) What are these instances/processes and what sort of content would you want to be included in this guidance?

Feedback 3: The AER considers that including an emissions reduction objective in the national energy objectives will have an impact on a number of different regulatory processes, such as the AER’s economic regulation of electricity and gas networks. It will also have an impact on the application of the Regulatory Investment Tests for Transmission and Distribution (RIT-T, and RIT-D, respectively) by project proponents. As such, we recognise that we will need to update a number of relevant Guidelines such that any guidance is coherent with the added objectives and with any subsequent changes to the National Electricity Rules (NER). Examples of guidelines which are most likely to require material changes are the (Integrated System Plan / RIT-T) cost benefit analysis guidelines, RIT-T and RIT-D application guidelines, and the expenditure forecast assessment guideline. However, as noted in our response to Question 15, updates to these guidelines will take time.

There are some guidelines, including those that are applicable to our revenue determinations and to the RIT-T and RIT-D processes, that are made in accordance with the consultation procedures set out in the NER. In other cases, we publish guidance notes that are of assistance to businesses in formulating their revenue proposals and otherwise engaging with AER decision making processes. The AER is considering whether an “omnibus” guidance note that supplements the existing guidelines and guidance notes would be appropriate. This would also streamline stakeholder consultation on subsequent updates to specific guidelines and guidance notes, in turn mitigating the resource impact for stakeholders engaging in this process.

As such, we expect to publish a guidance note (or similar guidance) soon after any legislation is passed. This should support the swift introduction of emissions reduction in the energy objectives while at the same time providing transparency to interested stakeholders as to how the AER will operationalise an emissions reduction objective in our various functions, where impacted, including in making our network revenue determinations. We remain interested to gauge stakeholder views through this consultation to inform the nature of this guidance and whether any other guidance would also be useful.

² AER, FINAL DECISION TransGrid transmission determination 2018-2023, Overview, May 2018, p. 36-37.

Section 3.3 Reference to Australia’s greenhouse gas emissions reduction targets

Question 4: Does this approach give an appropriate level of clarity as well as discretion to market bodies to consider relevant targets in their decision making? If not, detail your reasons and suggested solutions.

Feedback 4: The proposed amendments to the objectives in proposed section 7(c) (and corresponding amendments to the retail and gas laws) in the Draft Bill³ extend to ‘the achievement of targets for reducing Australia’s greenhouse gas emissions to which the Commonwealth, a State or a Territory has made a public commitment,’ including Commonwealth legislated targets, state or territory legislated targets, targets stated in an international agreement or targets stated as a matter of policy. The AER considers there are a wide range of policies and processes, whether explicitly called out as emissions reduction targets or not, that may contribute towards emissions reduction and therefore fall within this last category⁴. The AER considers this scope lends itself to allowing more flexibility for decision-makers to accommodate relevant policies, as appropriate for a particular decision, in a rapidly evolving policy landscape. As such, we are comfortable with discretion provided in the Draft Bill.

We observe that targets publicly stated by Government as a matter of policy can be a useful input for decision makers. For example, the AER has considered the Victorian Gas Substitution Roadmap in its recent access arrangement draft decisions for AusNet Services, Australian Gas Networks and Multinet Gas Networks.⁵

The AER notes that it is important that policies of this nature can be considered in the context of applying the proposed emissions reduction component of the energy objectives, but also notes that policies—in contrast to legislated targets—can vary in their context and applicability.

To further promote flexibility in how the objective is to be interpreted and applied, we recommend the emissions reduction element of the objective be drafted at a higher level. That is, in a manner similar to the other existing limbs of the objectives by referencing “emissions reduction”.

Question 5: Does the inclusion of ‘public commitments’ including ‘publicly as a matter of policy,’ as well as legislated targets, provide sufficient certainty for effective consideration of an emissions objective by market bodies?

Feedback 5: As covered in our response to Question 4, the AER considers that a wide scope for flexibility and discretion is preferable to accommodate the rapidly evolving policy landscape, but we acknowledge the uncertainty that necessarily accompanies this. Similar uncertainty prompted us to publish an information paper in 2021, *Regulating gas pipelines under uncertainty*,⁶ which explored how we can manage such risks in our regulation of gas distribution networks. This paper outlines that while we may not be able to resolve this uncertainty, approaches can be tailored to mitigate the potential impact of any related risks. As suggested in our response to Question 4, the AER considers there is a place for including government policy statements in the consideration of emissions reduction targets. Accordingly, we consider decision makers should be given greater discretion about how to consider such policies.

³ National Energy Laws Amendment (Emissions Reduction Objectives) Bill 2023 – Consultation Draft.

⁴ Proposed section 7(c)(ii)(C) of the Draft Bill.

⁵ For example, AER, Draft Decision AusNet Gas Services Access Arrangement 2023 to 2028, Overview, December 2022, p. 14

⁶ AER, *Regulating gas pipelines under uncertainty* – Information paper, November 2021.

Section 3.4 Amendments to acknowledge interactions between electricity and gas markets and enable management of transition impact

Questions on 'consumers of energy'

Question 6: Do you agree that the proposed change to 'consumers of energy' is necessary and appropriate to recognise the interconnections between the two energy markets and to enable future decisions to consider the implications for the energy system as a whole?

Feedback 6: As the economy transitions to net zero by 2050 and moves towards greater levels of electrification, it will become increasingly important for regulatory determinations to recognise the interconnections between the electricity and gas sectors. For example, understanding and taking into account these interactions is also relevant to our regulatory determinations for gas pipeline networks, and gas network expenditure, which will be impacted by changes in gas demand and potentially the growth of hydrogen as the economy electrifies. Whilst the AER considers it already has some flexibility to consider cross sector issues, we also support the proposed change in making explicit the need to consider interconnections across the sectors.

Question 7: What impacts (positive and/or negative) would the proposed change have on your organisation or your stakeholders/customers?

- a) What are these instances/processes and what sort of content would you want to be included in this guidance?
- b) Do you foresee any unintended adverse consequences coming from such a change, especially for market participants or consumers?

Feedback 7: The AER considers the proposed change should provide clarity around the need to consider the increasing interconnections between the two sectors.

Questions on 'supply of energy'

Question 8: Do you consider the additional change to 'supply of energy' is necessary given the reasons above?

Feedback 8: Consistent with the proposal to move towards the concept of "consumers of energy" the AER is also, in principle, supportive of the additional change to the "supply of energy". We consider that there are benefits in making explicit the need to consider interactions across electricity and gas sectors. As discussed in our response to Question 10, the AER considers it important to take into account any potential unintended outcomes, should this amendment be deemed advantageous. The AER is willing to work with the Department to determine the impact of such a change, including further consideration of potential unintended consequences.

Question 9: Do you agree that the market bodies, when making a decision under the NEL/NER should be empowered to consider the implications for price, reliability, security etc. in the gas market and vice versa? If not, what are other ways of managing the potential implications of the transition on all energy consumers?

Feedback 9: As noted above, the AER notes that the proposed change would provide increased clarity of the need to take into account the interactions across the electricity and gas sectors.

Question 10: Do you foresee any unintended adverse consequences coming from such a change, especially for market participants or consumers?

Feedback 10: A potential unintended consequence coming from this change could be uncertainty around the scope of matters that are potentially relevant to network businesses' revenue proposals, including how decisions regarding one commodity includes potential impacts on the other commodity. In these cases, businesses based around the first commodity may not be in a position to assess these impacts. For example, a gas pipeline operator may face challenges in identifying the impacts of their gas access arrangements, including the operation of their gas networks on the price and security of electricity supply. In such instances, market participants may not have access to information to enable them to properly consider these matters. While we consider that these issues are manageable in the context of our overall regulatory decision making processes, we observe that they may nevertheless be challenging for industry participants.

The AER will support the Department in its further consideration of whether, and what, changes are needed to ensure this flexibility whilst avoiding unintended consequences for decision makers and affected stakeholders.

Section 3.5 Consequential changes

Question 11: Do you have views on other consequential changes that might be required for the NEL, NGL or NERL as part of implementing the emissions reduction component?

Feedback 11: The AER does not have any views on this matter.

Question 12: Are there existing rules or regulations under the national energy laws that may require consideration of consequential changes? If so, please provide details including why consequential changes are envisaged as necessary or appropriate.

Feedback 12: The AER is aware that the Australian Energy Market Commission has considered the rules to identify areas that may need to be harmonised with the updated energy objectives. We have regular discussions with AEMC and AEMO staff on these potential changes.

Question 13: Do you have views on any rules that would benefit from a concurrent change within the current Bill process? If so, please provide details of the changes and the reasons why they would benefit from a concurrent change.

Feedback 13: The AER does not have any views on this matter.

Question 14: Do you have views on/are you aware of any rules that might benefit from more explicit reference to the objectives as a whole, or specifically the emissions reduction component?

Feedback 14: As per our feedback to Question 12, we are having regular discussions with AEMC and AEMO staff on any potential changes.

Section 3.6 Commencement and transitional arrangements

Question 15: Do you agree with the proposed Proclamation date being six months after passage through the South Australian Parliament?

Feedback 15: The AER supports updates to the national energy objectives to include emissions reduction, and its efficient implementation. The AER acknowledges that the energy market bodies have an important role in the operationalisation of these changes, as they impact on the performance and exercise of functions and powers under the National Energy Laws and Rules.

These amendments are likely to prompt the need to update a number of guidelines, which the AER publishes as a statutory function under the Rules. We note that the National Energy Rules require the AER to follow regulatory procedures—such as, in the National Electricity Rules, the Rules Consultation Procedures, the Transmission Consultation Procedures, and the Distribution Consultation Procedures—to update such guidelines. Due to the number of potentially impacted guidelines, and the minimum timeframes for consultation, it is important to note that the time required for reviewing and updating those guidelines will certainly extend beyond the proposed Proclamation date.

To support the efficient implementation and operationalisation of the updated national energy objectives, particularly with regard to core economic regulatory functions, the AER is considering publishing informal ‘guidance notes’. As noted above, the AER is considering publishing an informal guidance note to indicate how the AER is likely to apply the updated national energy objectives in the context of its 5-yearly network revenue determinations, given there are several network determination processes scheduled to commence over the coming year, and other network determination processes underway to which the updated national energy objectives may be applied. The AER notes, however, that it may not be possible to publish informal guidance with respect to all of its regulatory functions. For example, the NER include specific requirements about the extent to which particular market benefits can be considered when undertaking a RIT-T or RIT-D, which all relate to the existing limbs of the National Electricity Objective. As such, it is likely that a rule change will be required to ensure that the benefits of emission reductions can be fully considered as market benefits. In appropriate cases, the AER anticipates that we may provide *ad hoc* guidance to stakeholders to foreshadow how we intend to apply the updated national energy objectives in our decision-making, which may allow our stakeholders to anticipate our approach, and provide them with an opportunity to accommodate our approach in their processes in a timely manner.

Ultimately, the AER considers that there is no definitive reason as to why the Proclamation date could not be sooner than six months after passage through the South Australian Parliament. In fact, an earlier implementation could tend to avoid some issues arising from accommodating transitional arrangements. As noted above, this would need to be tempered with the understanding that it could take several months to identify, consult on and complete formal processes to update Guidelines and other subordinate instruments in order to operationalise an emissions reduction objective across all of the AER’s powers and functions. The AER will work with the other market bodies to progress these processes in a timely and efficient manner.

Question 16: What are your views on the proposed transitional arrangements in the Draft Bill?

- a) Are there particular processes that should be subject to different transitional arrangements?
- b) How or where should arrangements for these specific processes be prescribed – in the primary legislation or through a subordinate instrument?

Feedback 16: The AER’s views on the transitional arrangements applicable to particular regulatory processes are set out in our response to Question 17 below. The AER considers that these matters need to be addressed at or before the time at which the primary legislation becomes law, in order to provide certainty for all relevant stakeholders. That said, the AER considers that it may be optimal for transitional arrangements to be set in a subordinate instrument, rather than in the primary legislation, as this is likely to provide flexibility for transitional arrangements to be adjusted in response to new issues that might emerge after the Bill has become law.

Question 17: What already-commenced regulatory processes under the energy laws or rules might benefit from transitional arrangements that provide for the emissions reduction component to apply (i.e. automatically and not be subject to market body discretion)?

- a) Should business-initiated processes such as RIT-Ts and RIT-Ds be captured, rather than just market body processes?

Feedback 17: The AER considers that transitional arrangements should apply to the process of making network revenue determinations for electricity and gas transmission and distribution businesses, and to the process of applying the RIT-T and RIT-D investment tests to proposed new network investments. This would provide upfront certainty for all relevant stakeholders. Our response to Question 19 details how this may be applied in practice.

Question 18: Should market bodies be afforded a broad discretion to decide when to apply the amended objective to a process that is ‘underway’?

Feedback 18: Given that the AER will be responsible for making decisions on the various economic regulatory processes, we consider that it would be appropriate for the legislative package to provide clear guidance about when to apply the amended objective. We consider that jurisdictions having this discretion or having the transition defined through a subordinate instrument may strike the optimal balance between operational certainty and flexibility. We consider that such guidance from the jurisdictions would provide clarity for network businesses about whether the amended objective can be taken into account in revenue proposal processes that are underway. As discussed below, the practical extent to which network businesses can incorporate the amended objectives in their proposal will depend on the stage at which their proposals are up to and on whether there are opportunities for the business to sufficiently engage with stakeholders on the relevant updates to their proposal.

Question 19: Are there logical points in multi-stage and/or multi-year processes (e.g. RIT-T and RIT-D assessment processes and revenue determination processes/resets) after which the emissions reduction component should or should not be able to be applied?

- a) Should a RIT-T process be considered ‘underway’ when a project specification consultation report has been made available (clause 5.16.4(c)), or at a different stage?
- b) Should a RIT-D process be considered ‘underway’ when an options screening report or determination has been published (clause 5.17.4(b)) and (c), or at a different stage?
- c) Electricity – should a revenue determination/reset be considered ‘underway’ when the network service provider has submitted its initial revenue proposal (clause 6A.10.1 for transmission and clause 6.8.2 for distribution), or at a different stage?
- d) Gas – should a gas access arrangement process be considered ‘underway’ when an access arrangement proposal is lodged with the AER under rule 46(1A) in the NGR, or at a different stage?

Feedback 19: The AER considers that for electricity and gas transmission and distribution businesses, the submission of their initial regulatory proposal represents the preferable cut-off date for when the proposed updated national energy objectives ought to apply. Network businesses need the opportunity to consult on their proposals and factor in stakeholder feedback in order to determine the efficient and prudent expenditure it should seek approval for, which therefore preferably needs to be done prior to submission of their regulatory proposal to the AER. It may be possible to accommodate the updated energy objectives at later stages of the reset process where these issues can be appropriately consulted on. Through our ongoing engagement with network businesses, we note that many of these businesses have been proactive in considering the impact of emissions reduction and climate change resilience as part of their proposals. However, it is vital that sufficient time is required for the network businesses to consult on and incorporate the new energy objectives into their submission, and for the AER to consult on, and assess their proposal.

We also note that DirectLink, Energex, Ergon Energy, and SA Power Networks are due to submit their regulatory proposals on 31 January 2024, with Jemena submitting one in June 2024. Passage of legislation

in the first half of 2023 may provide enough time for these businesses to accommodate the emissions reduction component into their proposals ahead of the required submission date.

We would welcome further discussions, and any guidance from jurisdictions as to how these transitional arrangements may apply to their relevant regulatory processes.

For the RITs, the AER considers that a likely cut-off date for application would be the publication of the Project Assessment Draft Report (PADR) for a RIT-T or the Draft Project Assessment Report (DPAR) for a RIT-D. This is the step that triggers the final round of public consultation in the RIT-T and RIT-D processes. If a proponent seeks to incorporate emissions reduction into its assessment after this draft report has been released, it is likely to be very difficult for interested stakeholders to meaningfully participate in the process, by making submissions on a properly informed basis, unless the proponent first publishes a revised version of the draft report. That said, it would be appropriate that the transitional provisions only require the release of a revised draft report where the introduction of an emissions reduction component into the assessment is expected to result in a change in the preferred option identified in the report.

The AER will work with the Department to clarify the processes that will be underway at the time of the anticipated passing of the Legislation.

Chapter 4: Application by market bodies of the proposed changes

Question 20: Do you agree with the characterisation of how market bodies' decision processes might be impacted or changed as a result of inclusion of an emissions reduction component in the energy objectives?

Feedback 20: The AER agrees with the characterisation of how an emission reduction component would impact on our decision processes.

Question 21: Do you have any concerns with regards to the impact an emissions reduction component in the energy objectives may have in broadening the scope of the AEMC's rule making power or the decision-making powers of the other market bodies under the laws and rules?

Feedback 21: The AER does not have a view on this matter.