AUSTRALIAN ENERGY COUNCIL

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Valuing Emissions Reduction – AER Draft Guidance

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Australian Energy Regulator's ('AER') consultation on the *Valuing Emissions Reduction – AER Draft Guidance* ('Draft Guidance').

The Australian Energy Council is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 per cent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

With the electricity sector expected to drive decarbonisation efforts across the economy up until 2030, it is important that businesses, investors, and regulators have a tool to value the efficiency of emissions reduction options. In the absence of an economy-wide carbon price, the inclusion of a value on emissions reduction ('VER') ensures that market bodies now have explicit consideration of the end goal of the energy transition, to be net-zero. A transparent carbon value is preferrable to the current practice of shadow pricing and will provide some benchmark to the internal carbon prices energy businesses are using to determine their investment in the market.

At the same time, the practical implementation of a carbon value into decision-making relating to monopoly infrastructure is not simple and requires detailed AER guidance to avoid speculative network proposals. Adding VER as a "new class of market benefit" means that the benefits associated with already committed transmission and distribution projects are likely to be higher than previously assessed. In an environment of rising infrastructure deployment costs, the AER must be careful to ensure regulated networks do not use these higher benefits to argue for ever higher costs. Adding VER might also result in marginal network projects, which previously failed to stack up, now being assessed as having a positive net marginal benefit. This policy intent is not opposed so long as projects are assessed equally against all NEO objectives.

To ensure all projects meet the existing expectation of prudent and efficient expenses, the AER should prescribe a materiality threshold and boundary scope for proponents to follow when assessing the emissions impact of their project. These constraints are a necessary precaution against the difficulties associated with accurately predicting VER (i.e. it is predicting future emissions benefits in an electricity grid with almost endless scenario forecasts), and the reality that transmission build does not directly abate emissions. In that sense, incremental emissions benefits (e.g. reduced transport emissions that might result from a relocated depot) that are peripheral to the key market benefit of new transmission (i.e. allowing for more renewable projects to come online) might not be cost-efficient relative to using an alternative policy mechanism.

The AER should also consider issuing detailed guidance to project proponents to ensure proposals are realistic and use commonly available and transparent data. This guidance might also prescribe

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categories of VER benefits, and either exclude speculative categories upfront or in discussions with networks ahead of lodgment, depending on the propose/respond model of network regulation. Implementing such boundaries will make it simpler for the AER to administer and enforce.

While the VER associated with transmission build is likely to reflect the renewables that can now connect to the transmission network, the project proponent will not be in a position to accurately estimate the amount and type of energy that is displaced. This is despite the fact the amount and type of energy displaced from new renewables (which could previously not connect) is what gives rise to the VER.

In this context, it may be the case that some projects already committed to through the Integrated System Plan ('ISP') are not impacted by the introduction of the VER measure. AEMO, in modelling the ISP, estimates the optimal development path that supports the various emissions reductions policies of both Commonwealth and State Governments through using an implicit shadow price for emissions reductions. Where this implicit shadow price is higher than the VER price, there would not be any additional benefit associated with the introduction of VER. Where the implicit shadow price is lower than the VER price, there would be additional benefits, meaning additional network investment may be warranted. The issue here is it is not transparent to market participants what the shadow price is compared to the VER, which will need to be addressed.

Industry consultation will help navigate transitional issues

The current VER is interim and was set through a target-consistent approach (i.e. achieving 43 percent by 2030), with the intent being to publish a permanent emissions reduction value prior to 30 June 2025. By the time this value is determined, Australia's 2035 emissions reduction target should be known.

The magnitude of difference between the interim and final value will depend on the ambition of the 2035 target and methodological approach that is taken. There is also the current unknown of how different the interim value is to the shadow price AEMO has applied in the 2024 Draft ISP. In these circumstances, some transitional issues might arise if there are markedly different investment scenarios between the Draft and Final ISP, and then later, the 2024 ISP and 2026 ISP, which would increase investment risk in an already volatile market.

There should be an opportunity, preferably through public consultation, for industry and other stakeholders to provide input into these matters so any unintended outcomes or disruptions are managed.

Any questions about this submission should be addressed to Rhys Thomas, by email Rhys.Thomas@energycouncil.com.au or mobile on 0450 150 794.

Yours sincerely,

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