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Consultation on AEMC guide to applying the emissions component of the national energy objectives

AGL Energy (AGL) welcomes the opportunity to contribute to the AEMC's consultation on the guide to applying the emissions component of the national energy objectives.

This submission also comprises AGL's feedback in response to other ongoing related consultations¹.

About AGL

AGL is a leading integrated essential service provider, delivering 4.3 million gas, electricity, and telecommunications services to our residential, small, and large business, and wholesale customers across Australia. We operate Australia's largest electricity generation portfolio and have the largest renewables and storage portfolio of any ASX-listed company, having invested \$4.8 billion in renewable and firming generation over the past 20 years and added more than 2,350 MW of new generation capacity to the grid since 2003.

The emissions reduction imperative

By 2050, AGL considers that Australia has the opportunity to be carbon neutral and an energy superpower. Over the next three decades, substantial amounts of new large-scale renewable generation and distributed solar generation are forecast to be connected to the NEM. Ageing thermal generation will be replaced by a range of variable and flexible generation technologies with lower emissions intensity to decarbonise Australia's energy sector. Gas networks will be decarbonised through switching to renewable electricity and zero-emissions fuels.

Although the transition to a low-emissions economy is not without challenge, with well-designed policies and working together across industry, government and market bodies, there is potential to promote a more productive, inclusive economy with healthy, connected communities, underpinned by affordable energy.

AGL is therefore supportive of the commitment taken by energy ministers to align emissions reduction and energy policy objectives. Over several years AGL has consistently advocated for more comprehensive action to integrate energy and climate policies. Steps to align Australia's climate ambition with policy action in the energy sector are welcome.

Current state of Australian climate and energy policy

While the electricity sector is currently leading on Australia's emissions reduction efforts, it also has an enduring role in the decarbonisation of Australia's broader economy, both as a sector that contributes to significant emissions itself and as an enabler for other organisations and sectors to meet their climate ambitions.

¹ AEMC, Harmonising the network and pipeline expenditure rules with the updated energy objectives (electricity); AEMC, Harmonising the electricity network planning and investment rules and AER guidelines with the updated energy objectives (electricity); AEMC, Reliability Panel guide to applying the emissions component of the NEO; AER, Draft guidance on amended National Energy Objectives



There is always scope for greater alignment on the pace of the energy transition. This is because deeper decarbonisation efforts will require challenging infrastructure replacement programs on an accelerated timeframe and actions taken to reduce emissions may have material impacts on grid reliability and price outcomes for customers. Efforts to reduce emissions across electricity and gas sectors need to be well coordinated across regions or focused by a carbon budget or pricing constraint to operate over a long-term basis.

In recent times, governments have ratcheted up their climate action, reflecting more ambitious, but varying pathways to net zero. Further action is required. In addition to amending the energy objectives and requiring energy market bodies to consider a value of emissions reduction, alignment of energy and climate policy through national collaboration under a consistent vision is critical. This will enable clear, coordinated, and nationally consistent policy approaches to reducing emissions both across the economy, with a long-term objective of reaching Australia's net-zero ambition.

Over the long term, nationally consistent emissions reduction targets and frameworks are likely to produce significant benefits including de-risking operational challenges within energy markets undergoing structural change, strengthening Australia as a destination for major investment in low-emissions energy resources, realising efficiencies and opportunities through the development of scaled national supply chains and trade, and avoiding carbon leakage.

The consideration of emissions within the energy objectives is a useful step that could assist these broader objectives, especially under a framework that considers the value of emissions. However, care must be taken that the proposed treatment of jurisdictional targets does not embed structural differences into national frameworks, which may have the impact of reducing overall efficiency of energy markets and unintentionally creating impediments to meeting long-term climate targets.

Consideration of a value of emissions reductions

Key to the approach put forward by the AEMC is the proposal to consider emissions as a class of market benefit, to be used as a tool for use in processes such as regulatory investment tests and investment planning frameworks. In its consultation paper, the AEMC notes the Commonwealth Government will lead work on developing a value, or method for determining one, in close consultation with market bodies, states and territories, which is expected to be available by November 2023.

In our view, the development of this value is a significant step forward which will have implications for the broader direction of public policy across Australia, not just for the energy sector.

We are supportive of a determination of a value of emissions reduction (VER), or social cost of carbon (SCC), which can then be utilised to support the development of efficient policy outcomes to meet Australia's national climate targets. Although some governments across Australia already consider a cost of carbon in setting policies, this could benefit from a consistent approach led by federal government, both in quantification and then application in the development of public policy.

Policy challenges associated with determined a value of emissions reductions are global. Many countries around the world have also already adopted a SCC, most prominently in the US, but also in other nations including the United Kingdom, Canada, and Germany. There is also a vast field of literature surrounding the various approaches in which SCCs could be determined, and how they can be applied in the formulation of government policy to account for the impact of various policies on reducing emissions and meeting climate objectives. Although the way that value is determined is strongly contested, it is nevertheless a valuable tool for government to set appropriate policies to support climate ambitions.



Challenges with applying the value of emissions reductions

Although globally there is increasing acknowledgment that governments should consider a value of emissions in setting public policy, the way that government bodies should make administrative decisions with respect to this value is less clear.

While the discussion in the consultation paper on the different approaches that could be taken to apply a value of emissions acknowledges this challenge, it would be preferable that trade-offs on outcomes are not made by administrative bodies under decision-making frameworks, but rather by elected governments who are representative and whose decisions are subject to the adjudication by the electorate.

Accordingly, and because the range of decisions made by market bodies is extremely broad and often very impactful, it will be important to have clear advice from government as to how bodies like the AEMC should consider the value of emissions in the exercise of their functions. This will allow market bodies to make more consistent decisions, which will in turn support the long-term efficient operation of energy markets for the benefit of energy consumers.

Despite these challenges, in the consultation document the AEMC has put forward a commendable and useful initial proposal as to how it will consider these issues in the exercise of its functions, which recognises many of these concerns.

Although we consider that the complexity of the issue demands further consideration and government guidance, we raise here some initial perspectives for the AEMC to consider:

1. **In some cases, there appears to be a clear case to apply a value of emissions.** Where a determination relates to an area not directly covered by government policy, or a determination relates to an area completely within the responsibility of the market bodies, it seems logical for the market bodies to apply a value of emissions reductions as class of market benefit. For example, this would appear to be the case in the example of the assessment of network expenditure applications.
2. **A risk of double counting modelled benefits.** Market bodies may need to consider what value is placed on the hard carbon constraints imposed in ISP scenarios. Given that the ISP already considers the impacts of carbon reductions to identify the optimal transmission pathway, there is potential for double counting of some emissions reductions if benefits are assessed in the RIT process as well as the ISP.
3. **Governments may have already made appropriate trade-offs.** Where a decision is being made that supports or aligns with the delivery of a government policy, the value of emissions may not need to be reassessed as it may already be integrated into the government policy-making process. In this instance, there may emerge complexities in determining if emissions benefits have already been fully or partially priced into policies, which will very much depend on each case. We would recommend that the AEMC should take a cautious approach to assessing additional benefits in its assessment of action required to deliver government policies that have already likely to have considered trade-offs between price, reliability, and climate objectives.
4. **Consider the complexity of quantifying emissions.** Some decisions are likely to have very uncertain impacts on emissions, potentially over unclear time horizons and over multiple sectors, including areas that are not under the authority of the market bodies. For example, decisions relating to the electricity sector may impact on emissions in the gas, transport, and industrial sectors. Decisions that directly produce short-term emissions may have the effect of reducing more significant emissions over time. This level of multi-sectoral and intertemporal modelling of emissions is extremely complex, and while such complexity may occasionally be insightful, it may also lead to extremely technical and complicated determination processes and some perverse or unexpected



outcomes. We would recommend that the market bodies therefore err on the side of making qualitative assessments regarding alignment with the NEO.

5. **Considering multiple and changing values of emissions.** There may be competing values of emissions reductions that emerge. Globally, it is common for both national and sub-national governments to determine their own SCC for the purposes of setting policy. In this instance, it may not be clear which value, if any, should apply. Additionally, the value of emissions is likely to change over time, depending on methodologies employed by governments. We would recommend that the government provides further guidance on this point.

The AEMC has already stated that some proposals and decisions will not require quantitative assessment of the value of emissions. This is a sensible and pragmatic approach, and we encourage the market bodies where possible to take qualitative approaches to their assessment of how decisions and determinations will contribute to the emissions objectives where possible. Incorporating complex emissions modelling into smaller decisions may create additional delays, uncertainty, and reduce market efficiency and the delivery of investment to support emissions reductions.

Working towards jurisdictional targets

Although Australian governments have made net-zero commitments, set interim climate policies, and announced several policies that are aimed at reducing greenhouse gases, it is not always readily evident how the value of emissions or social cost of carbon has been considered in the formulation of these policies. The market bodies will therefore need to be careful to not be making trade-offs that are unlikely to have been considered by government through the legislative process.

This could present a significant challenge for the market bodies under their proposed approach to support jurisdictional targets and may result in unintended consequences. For example, taking a strict approach to meeting jurisdictional policies may result in market bodies making decisions within their remit that lead to the uptake of specific technologies or the delivery of projects that are in conflict with other jurisdictional ambitions. This could create a complex feedback loop, resulting in additional government interventions and policy shifts to deliver specific outcomes – resulting in greater uncertainty and delaying the transition.

To counter this, we would recommend that the market bodies only consider policies that are legislated or provide a clear and specific policy direction, and where a decision may have a material impact, to highlight this to the respective government for further policy direction.

Effective institutions are critical to deliver the transition

Establishing clear guideposts for the market bodies to exercise their functions is critical, as it will assist market participants and capital providers to make investment decisions and contribute to the long-term interests of energy customers by ensuring that efficient decisions are made with clear targets in mind and on a long-term trajectory.

This is particularly important given the nature of the energy transition, which will occur over several decades and will need to accelerate in years to come, requiring major investment across all sectors of the economy from both the public and private sector. This scale of investment will require effective institutions working under clear directions to deliver a supportive operating environment to transition Australia to a renewable superpower.



If you would like to discuss this submission further, please contact Aleks Smits (Senior Manager Policy) at asmits@agl.com.au.

Yours sincerely,

Chris Streets

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