AUSTRALIAN ENERGY REGULATOR

October 2024

AER Submission to the Select Committee on Energy Planning and Regulation in Australia

The Australian Energy Regulator (AER) welcomes the opportunity to provide a submission to the Select Committee on Energy Planning and Regulation in Australia.

The AER is an independent decision-making body responsible for regulating wholesale and retail energy markets, and energy networks, under national energy legislation and rules. We regulate gas and electricity markets and/or networks in all states and territories of Australia, except Western Australia. We focus on ensuring a secure, reliable and affordable energy future for Australia as it transitions to net zero emissions.

However, the core focus for the AER can be found in our purpose – to ensure energy consumers are better off, now and in the future.

Our submission outlines the key elements of the AER's role and functions in response to item (b) in the Terms of Reference, but with a particular focus on energy system planning and its regulation.

1 Energy market governance

The Energy and Climate Change Ministerial Council's (ECMC) role is to develop and co-ordinate priority policy issues of national significance and key energy and climate change policy reforms. The ECMC is chaired by the Commonwealth Minister for Climate Change and Energy with Ministers from the Commonwealth and each state and territory as members. Energy Ministers are collectively responsible for the legislative architecture that establishes and governs the energy system.

The AER is one of three energy market bodies spanning multiple jurisdictions under the national energy laws. Each market body is an independent decision-maker with clear roles and responsibilities.

The Australian Energy Market Commission (AEMC) develops the rules by which the market participants – and the AER – must operate. The AEMC can be directed by Energy Ministers to do market reviews and they can also self-initiate reviews. These reviews can recommend rule changes, but the AEMC cannot initiate rule changes itself. Once it receives a rule change proposal, which can be made by any other party, it must assess the proposal in accordance with statutory requirements for rule changes. An example of this process at work is the Transmission planning and investment review, which recommended rule changes to amend the regulatory processes for transmission projects.

The Australian Energy Market Operator (AEMO) manages the day-to-day operations of the electricity and gas systems and markets, and is the national transmission planner through its development of the Integrated System Plan (ISP).

The AER undertakes a broad range of functions in accordance with the National Electricity Law (NEL), National Gas Law (NGL), National Energy Retail Law (NERL), and the National Electricity Rules (NER), National Gas Rules (NGR) and National Energy Retail Rules (NERR). The AER performs these functions in line with the National Electricity Objective, National Energy Retail Objective and National Gas Objective. The AER does not have any functions in Western Australia. The AER has slightly different functions in Victoria and the

Northern Territory (as these jurisdictions have not adopted all elements of the national energy legislation) and has additional state-based functions in New South Wales and Queensland.

In 2023, Energy Ministers established the Energy Advisory Panel (EAP) to provide whole of system oversight throughout the transition to net zero emissions and enables the three market bodies to provide co-ordinated advice to governments on issues relating to the security, reliability, and affordability of Australia's east coast energy system. The AER Chair is currently chair of the EAP.

1.1 AER governance framework and institutional arrangements

The AER is an independent Commonwealth statutory entity, comprising five full-time members appointed under Part IIIAA of the *Competition and Consumer Act 2010* (CCA). As part of the appointment process, an Independent Energy Appointments Selection Panel, managed by the Commonwealth Department of Climate Change, Energy, Environment and Water, makes recommendations to the Energy Ministers (collectively). The CCA specifies that two members are to be Commonwealth members and three members are to be State/Territory members. Appointments are made by the Governor-General in Council. The current AER members are Clare Savage (Chair) (State/Territory), Justin Oliver (Deputy Chair) (Commonwealth), Jarrod Ball (State/Territory), Lynne Gallagher (Commonwealth) and Kate Symons (State/Territory).

Under the Administrative Arrangements Orders, Part IIIAA of the CCA (and by implication, the AER) is part of the Climate Change, Energy, the Environment and Water portfolio.

However, for the purposes of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), the AER and the Australian Competition and Consumer Commission (ACCC) are a combined entity, with the Chair of the ACCC as the accountable authority. The ACCC is part of the Treasury portfolio. The Chair of the ACCC is also the head of agency for the purposes of the *Public Service Act 1999* (PS Act). The Chair of the ACCC must make staff and consultants available to assist the AER Board to perform its statutory functions. In practice, this means that while the AER has its own budget program and resource allocation, the ACCC Chair is ultimately responsible for the financial performance of the AER under the PGPA Act and for its staff under the PS Act.

Following agreement by the Australian Government and Energy Ministers in mid-2023, the AER is preparing for full legal separation from the ACCC to become a separate non-corporate Commonwealth entity in 2025, with the AER Board as the accountable authority under the PGPA Act and the AER Chair as the head of agency for the purposes of the PS Act. Amendments to the CCA will be necessary to give effect to these changes. The proposed changes will have the effect of ensuring that the AER has governance, resourcing and staffing arrangements that reflect its mature and well established role, and will enhance its operations. The proposed changes will bring the AER into line with the arrangements for other stand-alone, independent statutory Commonwealth entities.

Standards of conduct applicable to AER members are drawn from several sources including the CCA and the PS Act. The AER members also undertake their duties in line with the general PGPA Act duties to:

(a) act with care and diligence,

(b) act honestly, in good faith and for a proper purpose,

(c) not improperly use their position or information to gain a benefit, advantage or to cause detriment, and

(d) disclose material public interests.

Expectations of behaviour and accountability measures are set out in the AER Board Charter.[1]

Energy Ministers issue the AER with a Statement of expectations outlining Ministers' expectations of the AER in two key areas – our regulatory role and functions, and our stakeholder engagement and communication.[2] Our Statement of intent summarises how we intend to meet these expectations.[3] This includes outlining at a high level our key roles, strategic objectives, regulatory practice, performance, and engagement and communication.

Our annual Corporate plan details how we will meet these expectations at a more granular level.[4] Our 2020-25 Strategic plan (Strategic plan) outlines our purpose, vision, outcomes, objectives and key priorities over a five-year period.[5]

We have identified four key objectives within our Strategic plan:

- Protect vulnerable consumers, while enabling all consumers to participate in electricity and gas markets.
- Effectively regulate competitive electricity markets primarily through monitoring and reporting, and enforcement and compliance.
- Deliver efficient regulation of monopoly electricity infrastructure and gas infrastructure while incentivising networks to become platforms for energy services.
- Evolve our regulatory frameworks and approaches to support the transition to net zero emissions.

The breadth of our key functions and objectives reflects the rapidly changing nature of the energy system, and the importance of the AER's role in delivering outcomes for consumers and energy market participants.

The AER recognises that our decisions and actions taken in performing our regulatory roles affect a wide range of stakeholders. The AER has regular dialogue with a range of stakeholders, including other market bodies, consumer groups, industry participants/industry bodies and governments. We take our consultation obligations very seriously and aim to be

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[1] AER, *AER Board Charter*, March 2024, https://www.aer.gov.au/system/files/2024-05/AER%20Board%20Charter%20March%202024.pdf.

[2] Energy Ministers, *Statement of Expectations for the Australian Energy Regulator*, 2022, https://www.aer.gov.au/system/files/2024-08/AER%20Statement%20of%20Expectations-2024-25.pdf.

[3] AER, Statement of Intent of the Australian Energy Regulator for 2024-25, July 2024, https://www.aer.gov.au/system/files/2024-08/AER%20Statement%20of%20Intent%202024-25.pdf.

[4] AER and ACCC, *ACCC and AER Corporate Plan 2024-25*, August 2024, https://www.accc.gov.au/system/files/accc-and-aer-corporate-plan-2024-25.pdf.

[5] AER, *AER Strategic Plan 2020-25 summary*, 2023 update, https://www.aer.gov.au/system/files/2023-10/AER%20-%20Strategic%20Plan%202020-25%20summary.pdf.

transparent, give sound reasons for our decisions and signal well in advance any changes to our approach while maintaining our independence.

To our many and varied stakeholders, we are committed to:

- Proactively engaging and listening to understand their diverse perspectives
- Working in partnership with other energy market bodies and the government on matters of common interest
- Clearly communicating our decisions and making it easy to engage with us
- Embracing creative ways of engaging that work for stakeholders, not just us.

We ensure our approach is consistent with our statutory obligations to ensure stakeholders have adequate time to thoughtfully consider the impacts of our work and meaningfully engage.

2 AER role and key activities

2.1 Compliance and enforcement

The AER has jurisdiction to regulate and enforce compliance over:

- The relationships energy retailers, distributors and exempt suppliers have with their customers in retail markets.
- Network planning and the provision of monopoly transmission and distribution network services to customers and other market participants.
- Participation in wholesale markets for electricity and gas and the day-to-day operations of those markets.

The AER's Compliance and enforcement policy sets out how we approach our roles and functions in monitoring, investigating and enforcing compliance with the national energy laws and rules.[6] The goal of our compliance and enforcement work is to ensure that important protections are delivered and rights are respected. It gives consumers and energy market participants confidence that energy markets are working effectively and in their long-term interests, so they can participate in market opportunities as fully as possible and are protected when they cannot do so.

We also maintain compliance and enforcement priorities. These priorities, which are reviewed annually, help signal the areas we will be paying the closest attention over a 12-month period.

Having received feedback from stakeholders that our 2023–24 Compliance and enforcement priorities remain relevant, we have extended and updated these priorities for 2024–25.[7] In addition to acting where there are serious issues affecting vulnerable consumers (such as life

[6] AER, *AER Compliance and Enforcement Policy*, July 2021, https://www.aer.gov.au/system/files/AER%20Compliance%20and%20Enforcement%20Policy%20July%2021.pdf

[7] AER, *AER Compliance & Enforcement Priorities 2024-25*, June 2024,https://www.aer.gov.au/system/files/2024-06/AER%20Compliance%20and%20Enforcement%20Priorities%202024-25.pdf.

support consumers or consumers affected by family violence), we have identified five priority areas:

- Improve outcomes for customers experiencing vulnerability, including by improving retailer hardship policies and access to hardship and payment plan protections.
- Make it easier for consumers to understand their plan and engage in the market by focusing on compliance with billing and pricing information obligations, including the Better bills guideline and tariff change notification requirements.
- Support power system security and an efficient wholesale electricity market by focusing on generators' compliance with offers, dispatch instructions, bidding behaviour obligations and providing accurate and timely information to AEMO.
- Improve market participants' compliance with performance standards and standards for critical infrastructure.
- Monitor and enforce compliance with reporting requirements under the new Gas market transparency measures.

Our approach to compliance and enforcement aims to both foster compliance and address non-compliance, with a focus on the prevention of harm. We have discretion in how we approach compliance and enforcement, using a combination of tools that we consider will deliver the best outcome for consumers and the market. These include using education and guidance materials, administrative actions (e.g. letters and retailer compliance workshops), regulatory waivers where available (i.e. ringfencing waivers), infringement notices, court enforceable undertakings and civil proceedings. Our jurisdiction covers several sectors of the national energy market, including retailers, network businesses, generators, and market participants who engage in wholesale electricity and gas. A narrower range of tools are available in the case of AEMO, as there is no scope for pecuniary penalties to be imposed on AEMO, either through an infringement notice or court proceedings.

We take a risk-based approach which is informed by the environment in which we operate (e.g. public interest and community expectations), concerns emerging from our monitoring and investigative activities, the nature and severity of the harm and the compliance culture and history of the party in question. This ensures that our work is focused on issues of greatest significance.

In recent years we have expanded our compliance and enforcement activity, while maximum penalties have also increased. In the 2005–06 to 2018–19 period, we issued 118 infringement notices totalling $2.36 million and obtained court-imposed penalties totalling $900,000. In comparison, since 2019–20 we have issued 121 infringement notices totalling $3.95 million, and obtained court-imposed penalties totalling $48.5 million.

We will continue to focus on enforcing compliance with the energy laws and rules in the wholesale, networks and retail sectors and take appropriate action when required. Our compliance and enforcement activities are a key regulatory tool to protect energy consumers, build trust with the community and keep the energy system stable and secure during the transition.

2.2 Performance monitoring and reporting

We monitor and report on the performance of energy wholesale and retail markets, as well as network businesses.

In wholesale electricity and gas markets, we monitor participant bidding and rebidding, market dispatch and prices, network constraints and outages, demand forecasts and forecasts of production and capacity. This independent scrutiny of participant behaviour is critical to ensuring confidence in the operation of these wholesale markets. Our market monitoring expertise also means we are well placed to support policymakers with key reforms in both the electricity and gas sectors. This expertise has been acknowledged with Energy Ministers recently extending the AER market monitoring and reporting functions to include electricity and gas contract markets (through the *Statutes Amendment (National Energy Laws) (Wholesale Market Monitoring) Act 2024* (SA)).

We report on wholesale market activity including reports into high wholesale price events in electricity and gas spot markets; quarterly reports on the performance of the wholesale electricity and gas markets; a biennial assessment of competition and efficiency in the wholesale electricity market (known as the Wholesale electricity market performance report); our annual State of the energy market report; and gas reporting on the Short Term Trading Market, gas supply hubs, day ahead auctions and the gas bulletin board. We are also starting work on our first report into the competition and efficiency of wholesale gas markets, with our inaugural biennial Wholesale gas market performance report due for publication in 2026.

We are also responsible for reporting on the performance of retail energy markets and energy businesses, including information on energy affordability, difficulties consumers face in paying their energy bills and movements in market share across retailers.

Retailers are required to report to us quarterly on data related to their performance, including customer numbers, contract types, complaints, energy debt, payment plans, hardship programs, disconnections and reconnections. We also receive pricing data from Energy Made Easy and Victorian Energy Compare, where we have back-end access to all available electricity and gas offers in the market to understand price trends and affordability outcomes. We publish retail performance data on a quarterly and annual basis and provide commentary and analysis that contributes to understanding and decision-making in the retail markets.

We also monitor network performance through a suite of reports such as our network performance and benchmarking reports. Our network performance reports measure the operational and financial performance of regulated electricity and gas network businesses and enhances transparency and accountability around how these network businesses are performing within regulatory frameworks, thereby encouraging improved performance. This includes newly established reporting into the growing role that customer exports, i.e. energy exported into the grid from consumer energy resources like rooftop solar, are playing within distribution networks. Our annual benchmarking reports are used by us, and industry, to measure network performance on operating expenditure and productivity over time against other businesses and the economy.

2.3 Energy network regulation

We are responsible for the economic regulation of over $115 billion worth of electricity transmission and distribution networks and gas transmission and distribution pipelines in all Australian jurisdictions except Western Australia. We do this by setting the maximum amount of revenue that price regulated energy networks can earn and, annually, the price they can charge consumers for regulated services.

Price regulated network businesses submit revenue proposals to us, usually every five years (reset process). We review these proposals and make decisions after considering factors including: the services proposed to be regulated; quality of engagement with customers; the prudency and efficiency of the proposed capital and operating expenditure; the projected demand for electricity and natural gas; age of infrastructure; the financial costs; and network reliability and safety standards.

We are also seeing a greater number of contingent project applications assessed outside of the reset process by electricity network businesses. Contingent project applications are applications made by network businesses to amend their regulatory revenue determination to include the revenue required for a major network infrastructure project which has previously been flagged, but not yet committed to, in long-term investment plans. These include actionable projects in the ISP, such as Victoria to New South Wales Interconnector West (VNI West) and HumeLink. The Rules and our guidelines (Cost benefit analysis guidelines[8], and Guidance note on the regulation of actionable ISP projects[9]) set out the requirements that network businesses must meet in submitting contingent project applications and how we will assess them. Contingent project applications are discussed further in section 2.4.4 below.

A further key component of our role in network regulation is the publication of the Rate of return instrument, which sets the amount of revenue electricity and gas network businesses can earn on the capital value of their network investments. We are required to publish a new instrument every four years, following a review and consultation process. The instrument must include the method for calculating a weighted average of an allowed return on equity and an allowed return on debt.

We implement the current regulatory framework in line with the NEL/NGL and the NER/NGR, which specifies an incentive-based approach must be taken, as well as the schemes we must apply in regulating monopoly electricity and gas networks. The three core incentive schemes are:

- Efficiency benefit sharing scheme (EBSS) which provides networks with additional financial incentives to undertake efficient operating expenditure over time.

[8] AER, *Cost Benefit Analysis guidelines,* August 2020, https://www.aer.gov.au/system/files/AER%20-%20Cost%20benefit%20analysis%20guidelines%20-%2025%20August%202020.pdf.

[9] AER, *Guidance note on the regulation of actionable ISP projects*, March 2021, https://www.aer.gov.au/system/files/AER%20-%20Final%20Guidance%20note%20-%20Regulation%20of%20actionable%20ISP%20projects%20-%20March%202021%20-%20FINAL%20FOR%20PUBLICATION%2812129318.1%29.pdf.

- Capital expenditure sharing scheme (CESS) which provides networks with additional financial incentives to undertake efficient capital expenditure over time, to ensure that only efficient capital expenditure is added to the regulated asset bases.
- Service target performance incentive scheme (STPIS) which provides electricity network service providers with additional financial incentives for maintaining and improving network performance, to the extent that consumers are willing to pay for such improvements.

Incentive schemes reward networks for improving productivity and service performance beyond benchmarks, which ultimately benefit consumers in the form of lower prices and better service levels through time.

Analysis from our 2024 Electricity and gas network performance report shows based on data up until 2022–23, under incentive-based regulation, networks have outperformed benchmarks, resulting in consumers paying lower network costs and experiencing improved reliability:[10]

- In 2023, after adjusting for inflation, electricity consumers on average paid the lowest cost for electricity network services since the beginning of our dataset in 2006.
- In 2023, both before and after adjusting for inflation, gas consumers paid the lowest cost for gas distribution services since the beginning of our dataset series began in 2011.
- In 2023, measured outages in both electricity and gas have been less frequent since 2011, and reliability is at a near all-time high.
- In the period 2014–2023, while electricity networks and gas distribution networks experienced a decreasing average return on assets, the networks still outperformed the allowed rate of return. This indicates that networks have remained profitable, despite declining average returns.

We are constantly looking to find ways to improve the way we regulate, including making any adjustments to improve outcomes for consumers. In 2023, we conducted a Review of incentive schemes for regulated networks.[11] The review found incentive schemes have improved network efficiency and reduced costs – however also acknowledged some parts of the framework required greater examination. As a result, we made changes to the Capital expenditure sharing scheme.[12] We are currently undertaking a review of the transmission service target performance incentive scheme[13] and are looking at ways to improve network asset utilisation (discussed in more detail below).

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[10] AER, *2024 Electricity and gas network performance report,* September 2024, *https://www.aer.gov.au/system/files/2024-09/2024%20Electricity%20and%20gas%20networks%20performance%20report.pdf.*

[11] AER, *Review of incentive schemes for regulated networks: final decision*, April 2023, https://www.aer.gov.au/industry/registers/resources/reviews/review-incentive-schemes-regulated-networks/final-decision.

[12] The scheme provides an incentive for network businesses to only undertake efficient capital expenditure and provides a mechanism to share efficiency gains between these businesses and customers.

[13] The scheme acts as a mechanism to incentivise electricity network businesses to enhance their service reliability by providing financial rewards when network businesses improve service standards and financial penalties when service standards deteriorate.

We have also undertaken other initiatives to incentivise better reset proposals overall. This includes the publication of the Better resets handbook in 2021, which outlines what we expect would be in a high-quality, consumer-centric regulatory proposal and are more likely to be largely or wholly accepted at the draft decision stage.[14] This includes our expectations for forecast expenditure, depreciation and tariff structure statements. The Better resets handbook also notes our expectations that these regulatory proposals are developed through genuine engagement with consumers to ensure consumer preferences are considered and reflects their long-term interests. This creates a more efficient regulatory process for all stakeholders.

Electricity network costs are now increasing, as illustrated in our 2024-25 DMO decision. A significant driver of this has been the economy-wide factors of higher inflation and rising interest rates, causing a higher rate of return compared with levels in previous 5-year regulatory periods. Further, while the incentive framework drives businesses to be more efficient, we are now seeing significant increases in proposed capital expenditure in electricity network businesses' revenue proposals. The increase in proposed capital expenditure has been driven by several factors including:

- increasing unit costs arising from supply chain pressures
- new requirements for networks to address cyber and climate resilience
- concerns about safety and reliability of ageing network infrastructure
- new sources of demand for electricity, such as data centres and electric vehicles
- the integration of new investments in renewable energy for transmission networks and integration of Consumer Energy Resources (CER) for distribution networks, which includes rooftop solar, behind the meter batteries, electric vehicles and community batteries.

These types of investment are critical in aiding the energy transition. However, given network charges make up over 40% of customer bills, it is important that such investments are prudent and efficient so that they involve least cost for consumers.

We are continuously looking at ways to facilitate the energy transition at least cost to consumers. While there are drivers for new investments by networks, there is also increased utilisation of the networks anticipated arising from the new sources of demand. This creates opportunities for scale economies to be realised across networks and lower network unit costs for consumers over time. We want to ensure consumers benefit from greater asset utilisation of the network and have signalled that networks should look to make greater use of the existing network infrastructure prior to building more. An important component for improved utilisation of networks is through the efficient integration of consumer energy resources in the national energy market.

Our Consumer energy resources strategy[15], released in 2023, details our objectives, outcomes and activities to enable greater utilisation of the network, while enabling

[14] AER, *Better resets handbook*, December 2021, https://www.aer.gov.au/documents/better-resets-handbook-december-2021.

[15] AER, *Consumer energy resources strategy*, April 2023, https://www.aer.gov.au/system/files/AER%20-%20Consumer%20Energy%20Resources%20Strategy-2023.pdf.

consumers to engage in the energy market through owning, consuming, storing and trading energy as they choose. Some of the initiatives within the strategy include:

- Releasing guidance on flexible export limits, which can help consumers get more out of their solar panels and batteries while making efficient use of network capacity.
- Supporting ring fencing waivers and granting an exemption for network businesses to engage in trials through the Energy Innovation Toolkit.
- Informing and engaging in policy debate on market reforms such as the AEMC's metering review and subsequent rule change, flexible trading arrangements, integrating price responsive resources rule change, and the electric vehicle smart charging review.
- Releasing our Review of consumer protections for future energy services which argues for reform of the National Energy Customer Framework to continue to protect consumers in an evolving energy market while supporting uptake of new services and driving innovation.
- Publishing our Consumer energy resources integration expenditure note and regularly updating our Customer export curtailment value methodology (including associated emission reduction profiles).
- Developing our tariff reform program which includes export tariff reforms and tariffs to manage load from electric vehicles.

We, along with the other two market bodies (AEMC and AEMO) are also working to support implementation of the National CER roadmap agreed by Energy Ministers. The roadmap aims to provide a national approach to reforms, ensuring energy consumers can harness the full potential of CER. If consumer resources are orchestrated effectively, they can help lower costs for all consumers by offsetting the need for billions of dollars in grid-scale investment.

We are also increasing our scrutiny on the energy sector through gas pipeline regulation reform, which was finalised in 2023. Under the reforms, we are required to publish a Regulatory determinations and elections guide which sets out our powers and functions in determining the level of regulation of gas pipelines, regulation of new pipelines and classification and reclassification of pipelines. This, alongside our enhanced monitoring powers, aims to streamline the regulatory framework to support the safe, reliable and efficient use of, and investment in, gas pipelines.

We also have regulatory roles in relation to newly established renewable energy zone frameworks in New South Wales and Queensland, conferred on us pursuant to legislation in those states. These roles demonstrate our ability to work flexibly under different regulatory regimes.

In the New South Wales framework, in addition to the standard approach we use to regulate networks involving a detailed assessment of cost elements, we may establish the efficient costs of network infrastructure projects on the basis of a competitive tender process that we

find to be genuine and appropriate. We have developed a guideline setting out how we undertake determinations based on competitive tender processes.[16]

In Queensland, the AER's role is to provide advice to the Queensland ministers responsible for procuring priority transmission investments and for setting up renewable energy zones. This includes advising on the method for the cost benefit analysis Powerlink will undertake to identify project options and advising on whether Powerlink's proposed expenditure in relation to its preferred option is prudent and efficient.

2.4 AER's role in energy system planning

Our role in transmission and energy system planning is now complementary to the role of AEMO, which has been established as the national transmission planner. The NER sets out requirements for AEMO, the AER and transmission network businesses for the identification, analysis and planning of projects to invest in the national electricity market (NEM) in the long-term interests of consumers.

AEMO must publish an ISP every two years in accordance with the NER. The ISP establishes a whole of system plan for the efficient development of the power system over the next 20 years and beyond. Its primary objective is to optimise value to end consumers by designing the lowest cost, secure and reliable energy system capable of meeting any emissions trajectory determined by policy makers at an acceptable level of risk. It utilises the opportunities provided from existing technologies and anticipated innovations in Consumer Energy Resources, large-scale generation, networks and coupled sectors such as gas and transport.

The inaugural ISP was introduced in 2018. Prior to this, large transmission projects were generally identified in a transmission network business' Transmission Annual Planning Report or as part of AEMO's National Transmission Network Development Plan. Either way, if such a project was not included in the expenditure allowed in the revenue determination for a transmission network business, it needed to be identified in the determination as a contingent project and certain triggers, stipulated by the AER, would need to be satisfied before it could be submitted to the AER for approval.[17] One of these triggers was the successful completion of a cost benefit analysis called the regulated investment test for transmission (RIT-T) – which included three stages at that point. Another trigger was to receive a NER clause 5.16.6 determination, on request from a transmission network business, from the AER that the preferred option maximised the net economic benefits and satisfied the RIT-T. Clause 5.16.6 was removed from the NER in April 2020.

The introduction of the ISP was intended to streamline transmission planning and approvals, replacing the first stage of the RIT-T (Project Specification Consultation Report) for actionable projects. The ISP now identifies these projects, which are defined under the NER as those which are required to meet an identified need as part of the optimal development path for the national electricity market. In preparing an ISP, AEMO undertakes a cost-benefit analysis to identify an optimal development path for the power system, chosen from a range

[16] AER, *Revenue determination guideline for NSW contestable network projects*, August 2022, https://www.aer.gov.au/documents/aer-revenue-determination-guideline-nsw-contestable-network-projects-final-19-august-2022.

[17] Contingent projects are explained in more detail in section **Error! Reference source not found.** below.

of development path options. The optimal development path contains a set of actionable projects that together address power system needs.

Options for delivering these actionable projects are considered through a new two-stage RIT-T. This includes completing a Project Assessment Draft Report within two years of the publication of the final ISP. The proponent must consult on this draft report before completing a Project Assessment Conclusions Report which responds to the consultation feedback and, amongst other things, identifies the preferred option for the project. An actionable ISP project that has completed both stages of the RIT-T and the ISP feedback loop is eligible to commence a contingent project process for that preferred option, provided it meets the trigger criteria detailed in section 2.4.4 below. This contingent project process does not include any review by the AER of the merits of the project itself.

We do not plan network investment nor determine the optimal development path. We also do not validate or review the cost benefit analysis conducted by either AEMO or a transmission network business. However, we do establish and maintain guidelines related to network planning processes and are responsible for developing and publishing the Cost benefit analysis guidelines[18], the Forecasting best practice guidelines[19] and the Regulatory investment test for transmission application guidelines[20]. We also undertake transparency views at two points throughout the development of the ISP to examine whether AEMO has adequately explained how it has derived key inputs and assumptions, how these have changed, that they are based on verifiable sources, whether stakeholders have had adequate opportunities to propose alternatives where verifiable sources are not readily available and how key inputs and assumptions have contributed to the ISP outcomes. If we identify issues through these reviews, AEMO is required to provide a further explanation and consult stakeholders on it. We also consider the extent to which the Project Assessment Conclusions Report meets the requirements in the Rules as part of our consideration of the trigger event prior to assessing a Contingent Project Application (discussed further in sections 2.4.1 and 2.4.4).

The Cost benefit analysis guidelines, produced by the AER in accordance with NER clause 5.22.5, are used by AEMO in preparing the ISP, as well as by proponents conducting RIT-Ts for actionable projects, and provide guidance on how the quantitative assessment of the costs and benefits of various options is conducted. As set out in the Energy Security Board's 2019 report to Energy Ministers, AEMO "require[s] flexibility to address reasonably anticipated risks in the context of uncertainty regarding which future scenario will arise". NER clause 5.22.5(e)(2) requires the AER to "provide flexibility to AEMO in its approach to scenario development, modelling and selection of the optimal development path" and this is achieved through our Cost benefit analysis guideline.

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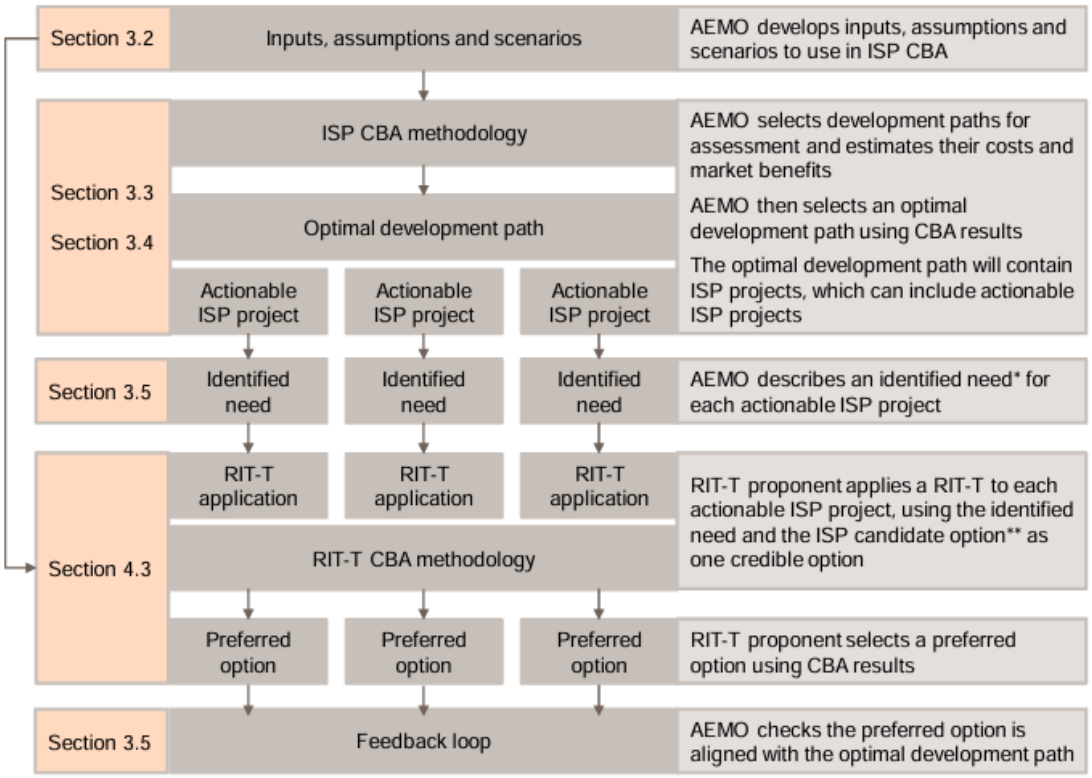
[18] AER, *Cost Benefit Analysis guidelines*, August 2020, https://www.aer.gov.au/system/files/AER%20-%20Cost%20benefit%20analysis%20guidelines%20-%2025%20August%202020.pdf.

[19] AER, *Forecasting best practice guidelines,* August 2020*, https://www.aer.gov.au/system/files/AER%20-%20Forecasting%20best%20practice%20guidelines%20-%2025%20August%202020.pdf.*

[20] AER, *Application guidelines: Regulatory investment test for transmission,* August 2020, https://www.aer.gov.au/system/files/AER%20-%20Regulatory%20investment%20test%20for%20transmission%20application%20guidelines%20-%2025%20August%202020.pdf.

Figure 1 outlines the process that large transmission projects identified in an ISP must go through, with reference to the Cost benefit analysis guidelines sections. This includes the RIT-T process that follows when a project is identified on the optimal development path.

Figure 1: Cost Benefit Analysis (CBA) guidelines alongside the ISP and RIT-T CBA processes



Source: AER, *Cost benefit analysis guidelines*, August 2020

The AER also publishes the Forecasting best practice guidelines which, in accordance with NER clause 4A.B.5, sets out how AEMO must develop its forecasts for use in developing the ISP. The purpose of the Forecasting best practice guidelines is to ensure AEMO's forecasting practices and processes as they relate to a reliability forecast, the ISP, and an ISP update are robust. These guidelines further aim to promote transparency in AEMO's forecasting practices and processes.

As required, the Cost benefit analysis guidelines provide flexibility to AEMO in its approach to scenario development, modelling and selection of the optimal development path. This includes the inputs, assumptions and scenarios they use. However, the Cost benefit analysis guidelines and Forecasting best practice guidelines also set out binding requirements to ensure that AEMO will select the optimal development path following a best practice approach and in the long-term interest of consumers.

Within the Cost benefit analysis guidelines, we also set out discretionary and binding guidance on how the set of development paths chosen for assessment should reflect a representative sample of the full range of possible transmission investment combinations. This also includes how to quantify classes of costs and market benefits in preparing each development path in each scenario.

After valuing the costs and market benefits, the Cost benefit analysis guidelines set out the framework AEMO is required to follow to select an optimal development path. This includes conducting a scenario analysis which presents the net economic benefit of each development path in each scenario, ranking the development paths, and the use of professional judgement in balancing the outcomes of the ranking. In doing this, AEMO is required to explain its choices, including how the level of risk aversion or neutrality reasonably reflects customer preferences, and what sensitivity analysis indicates about the selection of optimal development pathway.

Under rule 5.23, parties can raise disputes with the AER on the grounds that AEMO has not followed procedures required by the NER in making the ISP. The AER must determine whether to reject the dispute or uphold it. If we uphold the dispute, we have discretion as to whether to direct AEMO to take any remedial action. To date, we have not received any dispute notices in relation to an ISP.

2.4.1 ISP compliance functions

We conduct two important compliance functions under the NER associated with the ISP.

First, we are required to review the transparency of inputs and assumptions determined by AEMO in developing the ISP to provide greater stakeholder confidence in the ISP. This transparency review process is not intended to assess the merits of AEMO's decision making. The transparency review assesses the adequacy of AEMO's explanations of how it derived key inputs and assumptions. We are required to publish a report of our transparency review of AEMO's Inputs, Assumptions and Scenarios Report in accordance with NER clause 5.22.9 and a report of our transparency review of AEMO's draft ISP in accordance with NER clause 5.22.13. Each review to date has required AEMO to address a number of issues in an addendum to the Inputs, Assumptions and Scenarios Report or draft ISP. This in turn has strengthened each of the following reports, and the issues that have been identified have then been sufficiently addressed by AEMO in subsequent ISPs.

Second, AEMO is required to submit a compliance report outlining how it has complied with the guidelines in preparing the ISP. We also maintain an online register of compliance issues identified by stakeholders concerning the binding requirements of guidelines and rules governing the ISP and RIT-T. Any stakeholder is able to raise issues with us in this manner.

2.4.2 Regulatory Investment Test for transmission (RIT-T)

We also develop and publish the Regulatory investment test for transmission application guidelines, which for projects identified in an ISP, are contained in the Cost benefit analysis guidelines.

The purpose of the RIT-T for ISP projects is to conduct detailed cost benefit analysis on the range of credible options which can meet the identified electricity system need, thereby identifying the option that maximises net economic benefit (the preferred option). In other words, it is to ensure transmission investments are made in the long-term interests of electricity consumers.

In an ISP or RIT-T assessment, the net economic benefit is the balance of costs and benefits to those who produce, consume or transport electricity in the NEM (with the exception of emissions reduction benefits which are not limited to the NEM). The NER prescribe classes of costs and benefits that must be considered in the cost benefit analysis in the ISP or RIT-T, but the AER may also include additional classes of costs and benefits in the guidelines. We

have not specified additional classes of costs and benefits in the guidelines for transmission projects. The Cost benefit analysis guidelines also provide RIT-T specific guidance to valuing the costs and market benefits classes. This includes a requirement for RIT-T proponents for actionable ISP projects to use the 'take one out at a time' approach to calculate the market benefits of a project. This involves deriving the state of the world with and without each credible option to estimate the incremental market benefit.

Our Regulatory investment test for transmission application guidelines also inform network businesses on the process for conducting the RIT-T. It is important that transmission businesses consult with stakeholders and consumers. The guidelines set out public consultation requirements and identifies it as best practice for proponents to report on how they have sought to address concerns raised through stakeholder engagement. This approach is intended to ensure transparency and allow stakeholders and interested parties to contribute to and challenge the RIT-T.

This process is different for non-ISP projects. For these projects, three main documents are still produced as part of the RIT-T process: the Project Specification Consultation Report, the Project Assessment Draft Report and the Project Assessment Conclusion Report. As previously noted, for actionable ISP projects, the ISP provides the analysis that specifies the identified need and one or more credible options to be considered in the RIT-T, replacing the Project Specification Consultation Report for actionable ISP projects.

2.4.3 RIT-T compliance functions

We monitor compliance with the RIT-T to ensure it has been applied correctly. However, we do not conduct the test nor provide merit reviews of RIT-Ts nor do we identify needs, preferred options, routes or locations for projects. The onus for applying the test and identifying credible options falls on the RIT-T proponent.

As noted above, the AER formerly had an assessment role in the RIT-T under clause 5.16.6 of the NER, which allowed RIT-T proponents to request the AER make a determination as to whether the preferred option satisfies the RIT-T. However, with the creation of the ISP, clause 5.16.6 was removed from the NER. We hold a dispute resolution role on the application of the RIT-T and can receive disputes on the RIT-T process within 30 days of the RIT-T proponent publishing the conclusions report.

The AER also has a role in approving or specifying the actions (including any additional analysis) a RIT-T proponent will take if there is a material change in circumstances following publication of a conclusions report for a project.

2.4.4 Contingent project applications

The contingent project application process enables timely investment in transmission infrastructure outside of the revenue determination process. A contingent project is one assessed by the AER as reasonably required to be undertaken, but which is excluded from the forecast capital expenditure allowance in a revenue determination because of uncertainty about its requirement, timing or costs.

We include a trigger event for the contingent project in the revenue determination which is capable of objective verification. Once the trigger event occurs, the transmission network business can make a contingent project application to the AER. The AER is required by the NER to assess these applications to amend network businesses regulatory determinations to include the revenue required for a contingent project. We undertake a detailed assessment

process to ensure that consumers pay no more than is needed to build the new infrastructure.

In addition to contingent projects which are identified in our revenue determination, the transmission network business may make a contingent project application in relation to an actionable ISP project where the trigger event at clause 5.16A.5 of the NER has occurred.

Following NER amendments in 2024, there are now two categories of contingent project applications in relation to actionable ISP projects. Category 1 applies to contingent project applications for actionable ISP projects. Category 2 applies to early works contingent project applications.

In order to be eligible to submit a contingent project application for actionable ISP projects, certain criteria must be satisfied. Satisfaction of all of the relevant criteria is defined as the *trigger event*.

The trigger event for contingent project applications for actionable ISP projects (Category 1) is outlined in NER paragraphs 5.16A.5(a)–(d), and consists of all of the following criteria:

a) the RIT-T proponent must issue a Project Assessment Conclusions Report that meets the requirements of clause 5.16A.4 and which identifies a project as the preferred option (which may be a stage of an actionable ISP project if the actionable ISP project is a staged project);

b) the RIT-T proponent must obtain written confirmation from AEMO that:

    1) the preferred option addresses the relevant identified need specified in the most recent ISP and aligns with the optimal development path referred to in the most recent draft or final ISP; and

    2) the cost of the preferred option does not change the status of the actionable ISP project as part of the optimal development path in the most recent draft or final ISP;

c) no dispute notice has been given to the AER under rule 5.16B(c) or, if a dispute notice has been given, then in accordance with rule 5.16B(d), the dispute has been rejected or the project assessment conclusions report has been amended and identifies that project as the preferred option; and

d) the cost of the preferred option set out in the contingent project application must be no greater than the cost considered in AEMO's assessment in subparagraph (b).

The trigger event for early works contingent project applications (Category 2) is set out in clause 5.16A.5(e), and consists of a single criterion:

e) the contingent project application is an early works contingent project application.

The RIT-T proponent may lodge a contingent project application as soon as practical after the trigger event has occurred. This application must contain the information set out in the NER. Following receipt, we must publish the application, consult with stakeholders and make a determination on the application. We must make the determination within 40 business days of receiving the application or after any further information requested by us. This time limit may be extended for a further 60 days for complex or difficult issues.

Timeliness of decisions is important, but so is ensuring the least-cost pathway for consumers in this energy transition.

2.4.5 Addressing current issues in transmission planning

The AEMC's Transmission planning and investment review, recently made several recommendations to further amend the regulatory frameworks for transmission investment and planning to better support efficient investment and timely delivery of major transmission projects.[21]

We are updating our guidelines and processes following rule changes that arose from the AEMC's review, including rule changes on:

- Improving the workability of the feedback loop. This includes enabling the feedback loop to be assessed against the most recent optimal development path in a draft or final ISP, and requiring the AER's Cost benefit analysis guidelines to provide guidance on the timing of feedback loop requests.
- Sharing concessional finance benefits with consumers. This creates a mechanism for sharing benefits of concessional finance with consumers and assigns a role to the AER in providing guidance to businesses and assessing concessional finance agreements as part of revenue determinations.
- Bringing early works forward to improve transmission planning. The rule change referred to above introduces the concept of a new type of contingent project application (an early works contingent project application). This enables a transmission network business to seek cost recovery for early works before completing the RIT-T and AEMO's feedback loop assessment. It also clarifies how early works costs should be treated in a RIT-T.
- Enhancing community engagement in transmission building. This change clarifies that stakeholders who are reasonably expected to be affected by the development are consulted during both preparatory works and the RIT-T for actionable ISP projects, and outlines community engagement expectations for transmission network businesses when engaging with these stakeholders. This includes local landowners, local council, local community members, local environmental groups and traditional owners.

The NER requires system planning and investment decisions to be made using a cost benefit test to ensure that investments serve the National Electricity Objective. In 2023, Energy Ministers reformed the National Energy Laws to introduce an emissions reduction element into the national energy objectives.[22]

To consider changes in greenhouse gas emissions in the cost-benefit test, it is necessary to quantify the economic benefit of emissions reduction. Following Energy Ministers' agreement to a method to derive the interim value of greenhouse gas emissions reduction in considering or applying the national energy objectives, we issued guidance on valuing emissions

[21] AEMC, *Transmission planning and investment review*, 2023, https://www.aemc.gov.au/market-reviews-advice/transmission-planning-and-investment-review.

[22] Energy and Climate Change Ministerial Council, Energy Ministers Sub-Group meeting communique, May 2023, https://www.energy.gov.au/energy-and-climate-change-ministerial-council/meetings-and-communiques.

reduction.[23] We are also currently updating our network planning guidelines to provide further guidance on how this value should be applied in cost benefit analysis for the ISP and network investments.

The ISP forecasts a significant increase in transmission infrastructure required to connect renewable energy to the grid. We are mindful of the impact our work, including our regulatory approval process, has on project timelines and delivery. We strive to work with businesses and affected stakeholders as efficiently as possible, while ensuring only prudent and efficient costs are passed on to consumers.

We recognise there are growing community concerns related to social licence issues. To address this, we have published a Social licence directions paper setting out how transmission businesses can best address social licence under the existing regulatory framework.[24] This guidance is complementary to other government initiatives that address social licence challenges such as the National guidelines for community engagement and benefits for electricity transmission projects[25] and the AEMC rule change on Enhancing community engagement in transmission building.[26]

The NER does not allow the ISP or a RIT-T to consider costs and benefits other than to those who produce, consume or transport electricity in the NEM (with the exception of the benefit of emissions reduction). Therefore, impacts outside of this framing (which may include impacts on regional communities or some environmental impacts) cannot be directly taken into account as costs or benefits. The exception is where there are quantifiable costs to transmission development imposed by legislation e.g. where there are statutory requirements for landholder compensation. However, where the costs associated with achieving social licence are a direct cost to the project, we can consider it within the existing cost categories. For example, community sentiment about the project may be a factor in whether an option can be considered credible if it affects the timing with which an option can be delivered, whether it can be delivered at all or whether additional costs need to be incurred to address community concerns. Our Social licence directions paper sets out our current approach to social licence issues and how network businesses may best address social licence under our regulatory framework, including:

- our expectations of transmission networks in undertaking community engagement
- when and how social licence issues can be factored into the regulatory tests for the approval of and recovery of costs for new transmission development

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[23] AER, *Valuing emissions reduction: Final guidance and explanatory statement*, 22 May 2024, https://www.aer.gov.au/industry/registers/resources/guidelines/valuing-emissions-reduction-final-guidance-may-2024.

[24] AER, *Directions paper: Social licence for electricity transmission projects*, October 2023, https://www.aer.gov.au/documents/aer-directions-paper-social-licence-electricity-transmission-projects-october-2023.

[25] Energy and Climate Change Ministerial Council, *National guidelines: Community engagement and benefits for electricity transmission projects*, 2024, https://www.energy.gov.au/sites/default/files/2024-07/national-guidelines-community-engagement-benefits-electricity-transmission-projects.pdf.

[26] AEMC, *Enhancing community engagement in transmission building*, 2023, https://www.aemc.gov.au/rule-changes/enhancing-community-engagement-transmission-building.

- the evidence that we want to see in support of proposed transmission network expansion and associated expenditure.

The NER permits the AER to approve only forecast expenditure that is prudent and efficient. In assessing whether proposed social licence expenditure by network businesses is prudent and efficient, our role is not to determine whether or not certain activities should be undertaken. Rather, we consider whether proposed expenditure to address social licence concerns is necessary to enable a project to proceed (i.e., whether the project's objectives would be efficiently and prudently met *but for* the proposed action or incurred cost).

We are also currently reviewing the Cost benefit analysis guidelines, as well as its instruments and application guidelines for the regulatory investment tests (RIT-T and RIT-D).[27] We are considering ways to provide further guidance on social licence as part of this review. We have conducted two rounds of consultation on these changes. As part of these consultations we reached out to a broad range of stakeholders including community groups, landholders and market participants, to discuss social licence directly with affected parties.

2.5 Consumer protection and regulation of retail energy markets

We regulate the retail energy markets in Queensland, New South Wales, the Australian Capital Territory, Tasmania and South Australia (the states and territories that have adopted the National Energy Customer Framework). We also regulate the Retailer of Last Resort (RoLR) framework in Victoria since it adopted the relevant part of the National Energy Customer Framework in 2024. Our role in retail energy markets includes:

- Developing and maintaining a price comparator website – energymadeeasy.gov.au – to help consumers find the best energy offer for their circumstances.
- Setting the Default Market Offer to protect consumers from unjustifiably high prices (in New South Wales, South East Queensland and South Australia).
- Approving retailer authorisations to participate in retail energy markets or provide exemptions from the requirement to be authorised.
- Approving customer hardship policies required by energy retailers.
- Administering a retailer of last resort scheme if an energy retailer fails.
- Monitoring and enforcing compliance with energy retail law and rules.
- Administering the retailer reliability obligation (a contracting obligation on retailers when the supply outlook is tight).

In line with the first objective in our 2020–25 Strategic plan, we protect consumers experiencing vulnerability while enabling consumers to participate in energy markets.[28] In October 2022, we released the Towards energy equity strategy.[29] This strategy is focused on

[27] AER, *2024 Review of the cost benefit analysis and regulatory investment test guidelines*, https://www.aer.gov.au/industry/registers/resources/reviews/2024-review-cost-benefit-analysis-and-regulatory-investment-test-guidelines.

[28] AER, *Strategic plan 2020-25*, https://www.aer.gov.au/publications/reports/corporate/aer-strategic-plan-2020-25.

[29] AER, *Towards energy equity: A strategy for an inclusive energy market,* October 2022, https://www.aer.gov.au/system/files/AER%20-%20Towards%20energy%20equity%20strategy%20-%20October%202022.pdf.

reducing barriers to participation, supporting consumers experiencing payment difficulty, ensuring the consumer voice is heard in sector reforms and improving affordability by reducing the cost to serve energy consumers through 15 specific actions.

We are continuing to progress several of these actions including:

- Action 15: advocating for sector wide 'game changer' reforms. This is one of our largest consumer focused initiatives to date which recognises the enormous potential in the energy sector to innovate and better allocate resources to not only provide a safer, healthier experience for consumers, but also potentially save money and resources throughout the system. This package of reforms was presented to Energy Ministers for consideration at the ECMC meeting on 24 November 2023, where Ministers endorsed further consideration of the reforms.
- Action 4: implementing the Better bills guideline[30] to provide guidance to retailers on preparing and issuing bills that make it easier for customers to understand billing information. Our guideline sets out design principles and a tiered approach to billing information to ensure consumers can easily access information. It also requires retailers to let their customers know if they could be on a better plan and to provide information about Energy Made Easy.
- Action 8: progressing our Payment difficulty review to consider whether improvements can be made to the framework to ensure that consumers experiencing payment difficulty receive effective, tailored assistance. We have conducted early consultation, preliminary analysis and consumer research. We are currently considering our findings and potential next steps to improve customer protections.

We also assess and approve customer hardship policies in line with our Customer hardship policy guideline.[31] All energy retailers must have a customer hardship policy that supports residential customers experiencing payment difficulties and must also assist those customers to better manage their energy bills on an ongoing basis.

We are also undertaking a review of the exemptions framework for embedded networks. Due to considerable growth in embedded networks, we consider it is important for us to examine whether the current arrangements are working in the long-term interest of consumers, and if not, what regulatory change is warranted.

We also encourage consumers to contact us through our contact centre to share information with us about energy market issues or problems with energy businesses. This information helps us understand what issues cause the most harm to Australian consumers and businesses and where to best use our resources.

2.6 Policy and advocacy

As per our fourth strategic objective, we work to evolve our regulatory frameworks and approaches to support the transition to net zero emissions. We bring extensive expertise on energy markets and regulation, which we use to inform and influence debate about

[30] AER, *Better bills guideline* (version 2), January 2023, https://www.aer.gov.au/system/files/AER%20-%20Better%20Bills%20Guideline%20%28Version%202%29%20-%20January%202023_0.pdf.

[31] AER, *Customer hardship policy guideline* (version 1), March 2019, https://www.aer.gov.au/system/files/AER%20Compliance%20update%20-%20Customer%20hardship%20policies%20-%20November%202019_0.pdf.

Australia's energy future. We provide strong, evidence-based analysis to inform policy proposals and help ensure those proposals are effective, holistic and fit for purpose while protecting the long-term interests of consumers. This includes contributing to policy processes and reviews that impact on competition, consumers and the role of the AER, such as AEMC rule changes, as well as responding to key policy issues put forward by Energy Ministers.