



DRAFT DECISION

CitiPower Distribution Determination 2021 to 2026

Attachment 11 Demand management incentive scheme and Demand management innovation allowance mechanism

September 2020

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to CitiPower for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme and demand management innovation allowance mechanism

Attachment 12 – Not applicable to this distributor

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A – Victorian f-factor incentive scheme

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11 Demand management incentive scheme (DMIS) and Demand Management Innovation Allowance (DMIAM)

Under clauses 6.6.3 and 6.6.3 A of the National Electricity Rules (NER), our regulatory determination must specify how any applicable demand management incentive scheme (DMIS) and demand management innovation allowance mechanism (DMIAM) are to apply in the next regulatory control period.

In December 2017, we published a new DMIS and DMIAM.¹ These new scheme and mechanism will be applied in the 2021–26 regulatory control period for all Victorian electricity distributors.

This attachment sets out how we will apply the DMIS and DMIAM to CitiPower for the 2021–26 regulatory control period.

11.1 Draft decision

11.1.1 DMIS

In accordance with our framework and approach (F&A),² our draft decision is to apply the new DMIS³ to CitiPower for the 2021–26 regulatory control period, without any modification.

The DMIS contains three elements:⁴

- a cost uplift of up to 50 per cent of expected costs of efficient demand management projects;
- a net benefit constraint, to ensure the incentive payment for any project cannot be higher than that project's expected net benefit; and
- an overall incentive constraint, which limits the total incentive in any year to one per cent of the distributor's annual revenue requirement for that year.

The DMIS is also subject to an annual review and approval process through our prescribed compliance reporting requirements on the distributors. In accordance with the DMIS, our distribution determination will provide that the cost multiplier (uplift) applicable to any eligible project will be the cost multiplier specified in the current

¹ AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

² AER, *Final framework and approach, AusNet Services, CitiPower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019, pp. 86-88.

³ AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

⁴ AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

version of the DMIS that is in effect at the time the eligible project becomes a committed project.⁵

11.1.2 DMIAM

In accordance with our F&A⁶ our draft decision is to apply the new DMIAM⁷ to CitiPower for the 2021–26 regulatory control period, without any modification.

The DMIAM comprises:⁸

- a fixed allowance of \$0.2 million (\$2017), plus 0.075 per cent of the annual revenue requirement for each regulatory year, as set out in our Post-Tax Revenue Model (PTRM) for CitiPower;
- project eligibility requirements; and
- compliance reporting requirements.

In our final distribution determination, we will determine the amount of the DMIAM allowance for CitiPower for the 2021–26 regulatory control period, based on the final PTRM for CitiPower.

11.2 CitiPower's proposal

11.2.1 DMIS

CitiPower proposed to apply the DMIS in the 2021–26 regulatory control period⁹ as stated in our F&A.

11.2.2 DMIAM

CitiPower proposed to continue applying the DMIA (DMIAM) in the 2021–26 regulatory control period¹⁰ as outlined in our F&A. CitiPower included a DMIAM allowance of \$2.0 million (\$2020–21) in its proposed revenue allowance for 2021–26.¹¹

CitiPower stated that in the 2016–20 period it undertook DM initiatives to manage voltage levels on its network peak demand days and assessed the potential of partnering with commercial customers to alleviate network constraints.¹²

⁵ AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017, clause 2.1(2).

⁶ AER, *Final framework and approach, AusNet Services, CitiPower, Jemena, Powercor and United Energy, Regulatory control period commencing 1 January 2021*, January 2019, pp. 86-88.

⁷ AER, *Demand management innovation allowance mechanism, Electricity distribution network service providers*, December 2017.

⁸ AER, *Demand management innovation allowance mechanism, Electricity distribution network service providers*, December 2017.

⁹ CitiPower, *Regulatory proposal 2021–2026*, 31 January 2020, p. 130.

¹⁰ CitiPower, *Regulatory proposal 2021–2026*, 31 January 2020, p. 130.

¹¹ CitiPower, *Regulatory proposal 2021–2026*, 31 January 2020, p. 130.

11.3 Assessment approach

We are required to make a decision on how the DMIS and DMIAM are to apply to CitiPower.¹³ We outlined our proposed approach to, and reasons for, the application of the DMIS and DMIAM in our F&A.

Our draft decision has adopted the position in the F&A. We have considered materials submitted to us by CitiPower and by stakeholders.

11.3.1 Interrelationships

The new DMIS will encourage demand management (DM) initiatives that are likely to provide long-term efficiency gains to energy consumers that will outweigh any short-term price increases. For instance, these initiatives might reduce the costs of investment in new infrastructure. This might occur through deferring or removing the need for augmentation expenditure (augex) or replacement expenditure (replex) due to more efficient use of existing infrastructure.

In applying the DMIS, we will have regard to the effect it could have on the incentives created by our other incentive schemes – the efficiency benefit sharing scheme (EBSS), the capital expenditure sharing scheme (CESS), and the service target performance incentive scheme (STPIS) – and vice versa.

We currently operate the CESS and the EBSS as incentive schemes designed to encourage efficient decision making by distributors. These schemes operate symmetrically to better balance incentives between capital expenditure (capex) and operating expenditure (opex), by sharing the savings and risks of each kind of expenditure between distributors and consumers.

As explained in our final decision for the new DMIS,¹⁴ we consider that the symmetrical operation of incentives under the CESS and EBSS should balance out any negative impacts that distributors may experience under any of these schemes. For instance, as distributors spend more on opex, they may exceed their targets under the EBSS and receive a smaller incentive or higher penalty as a result. However, since the DMIS only incentivises efficient DM projects, we would expect that reductions in capex gained from project deferral or avoidance would exceed any increase in opex under the DM project. In this scenario, benefits under the CESS would outweigh any detriment under the EBSS.¹⁵ Hence, we expect the DMIS will encourage distributors to undertake more DM activities where it is efficient to do so.

¹² However, CitiPower stated that it did not seek a DMIA allowance for these initiatives: CitiPower, *Regulatory proposal 2021–2026*, 31 January 2020, p. 150.

¹³ NER, cll. 6.3.2(a)(3) and 6.12.1(9).

¹⁴ AER, *Explanatory statement, demand management incentive scheme, Electricity distribution network service providers*, December 2017.

¹⁵ AER, *Explanatory statement, demand management incentive scheme, Electricity distribution network service providers*, December 2017, p. 60.

We will not exempt DMIS projects from the STPIS as we consider this would negatively affect consumers in two ways. First, exempting DM solutions from the STPIS would transfer the risk of failure onto consumers, who have little opportunity to mitigate that risk. Second, exempting DM from performance targets may increase the perception that DM is less reliable than network solutions, furthering any potential cultural bias against DM. This would not serve to support the objective of the DMIS, which is to promote efficient investment in non-network DM options.¹⁶

11.3.2 Submissions

DMIS and DMIAM

We received submissions from the Victorian Government,¹⁷ Energy Consumers of Australia (ECA),¹⁸ and the Eastern Alliance for Greenhouse Action (EAGA)¹⁹ with comments on the Victorian distributors' use of demand management measures.

ECA commented that some incentive schemes are not being used as they might to deliver benefits for distributors and consumers, although it notes the positive outcomes reported by United Energy. ECA acknowledges that AusNet Services is the only distributor which is proposing an allowance for innovation (apart from DMIS and DMIAM)²⁰ and does not oppose this proposal as this has been supported by the Customer Forum.²¹ ECA's consultant submitted that the DM incentive schemes need more support than ever at a time when growth in capex is low and capital is cheap²² and acknowledged that AusNet Services is one of two Victorian networks which has successfully applied innovative demand management.

The EAGA²³ submitted that:

- Demand management activities should be afforded the same level of transparency as other forms of expenditure in all proposals in future.

¹⁶ NER, cl. 6.6.3(b).

¹⁷ Department of Environment, Land, Water and Planning, *Victorian Government submission on the electricity distribution price review 2021–26*, June 2020.

¹⁸ Energy Consumers Australia, *Victorian Electricity Distributors Regulatory Proposals 2021–26 Submission*, June 2020, pp. 16-17 and 33.

¹⁹ Victorian Greenhouse Alliances, *Submission to the AER, Local Government response to the Victorian electricity distribution price review 2021–26*, May 2020, pp. 5-6 and 24-29.

²⁰ AusNet Services is proposing to spend up to \$7.5 million (\$2021) in 2021–26 for innovation funding. It will focus its innovation projects on addressing DER integration and the energy sector transition. AusNet Services states that this expenditure will be outside of its proposed capex, opex and DMIAM and is in agreement with the Customer Forum. AusNet Electricity Services Pty Ltd, *Electricity Distribution Price Review 2022–26 Part III*, 31 January 2020, chapter 11.

²¹ Energy Consumers Australia, *Victorian Electricity Distributors Regulatory Proposals 2021–26 Submission*, June 2020, p. 17.

²² Spencer&Co, *Report to Energy Consumers Australia - A review of Victorian distribution networks - Regulatory proposals 2021–2026*, p. 33.

²³ Victorian Greenhouse Alliance, *Submission to the AER - Local Government Response to the Victorian Electricity Distribution Price Review (EDPR) 2021–26*, May 2020, pp. 24-25.

- Forecasted opex, capex and augex on broad-based demand management initiatives and a description of each activity should be included in the revised proposals for Jemena, CitiPower and Powercor.
- It supports United Energy and AusNet Services being granted their full requested allowance under the DMIS scheme.

The Victorian Department of the Environment, Land, Water and Planning²⁴ submitted that:

- Research and development efforts vary considerably among distribution businesses and expect to see greater investment made by CitiPower and Powercor in particular.
- It supports the distributors' proposals to use the new DMIS and access the maximum possible DMIAM to produce the greatest innovation and benefits to customers.

11.4 Reasons for draft decision

11.4.1 DMIS

The new DMIS is designed to provide more incentives for electricity distributors and consumers to adopt DM measures by engaging non-network solutions, which should put greater downward pressure on prices, benefitting the whole community.

Regarding the control of and to ensure the effective implementation of the scheme, we require that CitiPower provide compliance reports and supporting documents each year as required under the DMIS—in order to prove that its eligible and committed projects and expenditures meet the requirements of the scheme. We will determine the eligibility and specific incentive payments for each project according to the requirements of the DMIS.

11.4.2 DMIAM

Along with the new DMIS, the AER revised the DMIA. The revised scheme (DMIAM) provides more funding to networks to undertake further research on DM initiatives and to share these learnings across industry and consumers.

CitiPower will be required each year to provide DMIAM compliance reports and supporting documents as required under the DMIAM to prove that its research and development projects and expenditures meet the requirements of the mechanism. We will determine the eligibility and DMIAM payments for each project according to the criteria specified in the DMIAM.

²⁴ Department of Environment, Land, Water and Planning, *Victorian Government submission on the electricity distribution price review 2021–26*, June 2020.

We note that stakeholders, in their submissions, supported incentives for distributors to undertake demand management measures and non-network expenditure to provide benefits to consumers. These incentives would be provided to Victorian electricity distributors under the new DMIS and DMIAM for the 2021–26 regulatory control period.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CESS	capital expenditure sharing scheme
DM	demand management
DMIA	demand management innovation allowance
DMIAM	demand management innovation allowance mechanism
DMIS	demand management incentive scheme
distributor	distribution network service provider
EBSS	efficiency benefit sharing scheme
ECA	Energy Consumers Australia
F&A	framework and approach
NER	National Electricity Rules
NSP	network service provider
opex	operating expenditure
repex	replacement expenditure
RIN	regulatory information notice
STPIS	service target performance incentive scheme