DRAFT DECISION
TasNetworks distribution determination
2017−18 to 2018−19

Attachment 12 – Demand management incentive scheme

September 2016

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Note

This attachment forms part of the AER's draft decision on TasNetworks' distribution determination for 2017–19. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

Attachment 12 – Demand management incentive scheme

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

Contents

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	Expenditure Forecast Assessment Guideline for Electricity Distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure

Shortened form	Extended form
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

12 Demand management incentive scheme

The National Electricity Rules (NER) require us to develop and implement mechanisms to incentivise distributors to consider efficient alternatives to building more network.[1] To meet this requirement, and motivated by the need to improve distributors' capability in the demand management area, we implemented a demand management incentive scheme (DMIS)[2] for TasNetworks (formerly Aurora Energy) distribution determination for the 2012–17 regulatory control period.

The current DMIS for TasNetworks includes the demand management innovation allowance (DMIA).[3]

The DMIA is a capped allowance for distributors to investigate and conduct broad-based and/or peak demand management projects.

The DMIS contains two parts:

- Part A provides for an innovation allowance to be incorporated into each distributor's revenue allowance for opex each year of the regulatory control period. Distributors prepare annual reports on their expenditure under the DMIA[4] in the previous year, which we then assess against specific criteria.[5]
- Part B compensates distributors for any foregone revenue demonstrated to have resulted from demand management initiatives approved under Part A. Currently only Part A applies to TasNetworks because its regulatory control period is subject to a revenue cap form of control. As the revenue cap form of control will continue to apply to TasNetworks during the 2017–19 regulatory control period, Part B will not apply.

Under the scheme, we return any underspend against the allowance to customers.

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1 NER, cl. 6.6.3(a).

2 The rules have since changed the name to 'Demand Management and Embedded Generation Connection Incentive Scheme' (DMEGCIS) to explicitly cover innovation with respect to the connection of embedded generation. Our current and proposed DMIS includes embedded generation. We consider embedded generation to be one means of demand management, as it typically reduces demand for power drawn from a distribution network.

3 AER, Demand management incentive scheme, Aurora Energy, Regulatory control period commencing 1 July 2012, 15 October 2010.

4 The DMIA excludes the costs of demand management initiatives approved in our determination for the 2012–17 regulatory control period.

5 AER, Demand management incentive scheme, Aurora Energy, Regulatory control period commencing 1 July 2012, 15 October 2010, pp. 4–5.

12.1 Draft decision

We have determined to continue Part A of the DMIS for TasNetworks in the 2017–19 regulatory control period (that is, the DMIA component). We will not apply Part B of the DMIS to TasNetworks for the 2017–19 regulatory control period because the revenue cap form of control will continue. This is consistent with our proposed approach in our framework and approach for TasNetworks (F&A).[6]

An innovation allowance amount of $0.4 million ($June 2017) per annum will be applied in the 2017–19 regulatory control period.

12.2 TasNetworks' proposal

TasNetworks proposed that Part A of the DMIS (the DMIA) continue to apply and that the incentive allowance be increased from $0.38 million ($2009-10) per annum, ($1.9 million over the current regulatory period) to $0.4 million ($June 2017) per annum (or $0.8 million over the shorter 2 year regulatory period in this case).[7]

12.3 Assessment approach

The NER require us to have regard to several factors in developing and implementing a DMIS for TasNetworks.[8] These are:

- Benefits to consumers
    - the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme
    - the willingness of customers or end users to pay for increases in costs resulting from implementing DMIS.
- Balanced incentives
    - the effect of a particular control mechanism (i.e. price as distinct from revenue regulation) on a distributor's incentives to adopt or implement efficient non-network alternatives
    - the effect of classification of services on a distributor's incentive to adopt or implement efficient embedded generator connections
    - the extent the distributor is able to offer efficient pricing structures
    - the possible interactions between DMIS and other incentive schemes.

6 AER, *Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017*, July 2015, p. 73.

7 TasNetworks, *Tasmanian Distribution Regulatory Proposal*, 29 January 2016, p. 127.

8 NER, cl. 6.6.3(b).

We had regard to these factors in considering the proposed approach to the DMIS for TasNetworks as set out in our F&A[9] and we have again taken these factors into account in making our draft decision.

12.4 Reasons for draft decision

We have determined that an innovation allowance amount of $0.4 million ($June 2017) per annum (or $0.8 million over this period) will continue in the 2017–19 regulatory control period.

Our F&A stated that our intention to develop and implement a new DMIS for the 2017–19 regulatory control period was dependent on the progress of the rule change process arising from the AEMC's Power of Choice review.[10] On 20 August 2015, the AEMC released the final rule change determination.[11]

We received submissions from the Tasmanian Small Business Council (Council) and Consumer Challenge Panel (CCP) member David Headberry.

CCP member David Headberry stated that the amounts allowed for the DMIA are significant when assessed in aggregate across all of the DNSP's in the NEM and that the amount claimed has to be justified in more detail.[12]

The Council noted that the proposed DMIA of $400,000 per annum compared to $380,000 per annum at present is a modest increase.[13]

In the recent distribution determinations for Victoria[14], we considered that any change to the current allowance (which was originally set by scaling the allowance to the relative size of each DNSP's average annual revenue) should be considered at a whole of industry level, rather than each individual business. We further considered

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9 AER, Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017, July 2015, pp. 73–75.

10 AER, Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017, July 2015, p. 73. For information regarding the AEMC's Power of Choice Review, see http://www.aemc.gov.au/Major-Pages/Power-of-choice. The AEMC received a proposed rule change from COAG Energy Ministers and the Total Environment Centre.

11 AEMC, *Rule Determination, National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, 20 August 2015.

12 CCP (David Headberry), *Submission to the AER, Response to the proposal from Tasmania's electricity distribution network service provider (TasNetworks - TND) for a revenue reset for the 2017–19 regulatory period,* May 2016, p. 42.

13 Tasmanian Small Business Council - Submission on TasNetworks' regulatory proposal - May 2016, p. 38.

14 AER - Final decision AusNet Services distribution determination - Attachment 12 - Demand management incentive scheme - May 2016, AER - Final decision Jemena distribution determination - Attachment 12 - Demand management incentive scheme - May 2016, AER - Final decision United Energy distribution determination - Attachment 12 - Demand management incentive scheme - May 2016, AER - Final decision CitiPower distribution determination - Attachment 12 - Demand management incentive scheme - May 2016, AER - Final decision Powercor distribution determination - Attachment 12 - Demand management incentive scheme - May 2016.

that this will be done during the development of the new scheme[15]. We are still of this view.

However, we consider TasNetworks proposed innovation allowance of $0.4 million ($June 2017) per annum to be a relatively small increase on the current allowance of $0.38 million ($2009–10). It represents a 5% increase on the current allowance per annum. We consider this increase of $40 000 for the next regulatory control period is immaterial in comparison to the $1.9 million approved in the 2012–17 regulatory control period.

For this reason, we have approved the innovation allowance amount of $0.4 million ($June 2017) per annum (or $0.8 million over the period), proposed by TasNetworks.

TasNetworks recognised that the DMIA is not designed to be the sole or even primary source of funding for demand management expenditure.[16] TasNetworks' has proposed a number of demand management costs as part of its total forecast capital and operating expenditure building block. Our decision on TasNetwork's demand management related capital and operating expenditure building block can be found in attachments 6 and 7, respectively.

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15 In Victorian, a number of businesses proposed significant increases in the innovation allowance –. See for example Jemena (460%), United Energy (230%) and AusNet Services (233%).

16 TasNetworks, *Tasmanian Distribution Regulatory Proposal*, 29 January 2016, p. 127.