

Draft

Demand Management Innovation Allowance Mechanism

Electricity distribution network service providers

August 2017

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# ****Nature and authority****

## ****Introduction****

1. In accordance with the requirements of clause 6.6.3A of the **NER**, this publication sets out the **AER's** **demand management innovation allowance** **mechanism** for **distribution network service providers**.

## Authority

1. Clause 6.6.3A of the NER requires the **AER** to develop the **mechanism** in accordance with the **distribution consultation procedures**.

## NER requirements

1. Clause 6.6.3A of the NER requires the **AER** develop a **mechanism** consistent with the **demand management innovation allowance objective**.
2. The **demand management innovation allowance** **objective** is to provide **distributors** with funding for research and development in **demand management** projects that have the potential to reduce long term network costs (the **allowance objective**).
3. In developing, and applying, any **mechanism**, the **AER** must take into account the following:
4. the **mechanism** should be applied in a manner that contributes to the achievement of the **allowance objective**;
5. **demand management** projects should have the potential to deliver ongoing reductions in demand or peak demand, and be innovative and not otherwise efficient and prudent **non-network options** that a **distributor** should have provided in its **regulatory proposal**;
6. the level of allowance;
	* 1. should be reasonable, considering the long term benefits to **retail customers**;
		2. should provide funding that is not available from another source, including under a relevant **distribution determination**; and
		3. may vary by **distributor** and over time;
7. the allowance may fund **demand management** projects which occur over a period longer than a **regulatory control period**;
8. Any **mechanism** developed and applied by the **AER** must require **distributors** to publish and report on the nature and results of **demand management** projects that are the subject of this allowance.
9. The **AER**:
10. must develop and publish the **mechanism**; and
11. may, from time to time, amend or replace the **mechanism** developed and published under clause 6.6.3A of the **NER**;

in accordance with the distribution consultation procedures.

## AER Objectives

1. The **AER's** objectives for this **mechanism** are that it:
2. contributes to the achievement of the **NEO**.
3. is consistent with the principles in clause 6.3.3A of the **NER**.

## Confidentiality

1. The **AER's** obligations regarding confidentiality and the disclosure of information provided to it by a **distributor** are governed by theCompetition and Consumer Act 2010,the National Electricity Law and the **NER** including the **confidentiality guidelines**. The **confidentiality guidelines** are binding on the **AER** and each **distributor**.

## Definitions and interpretation

1. In this mechanism, the words and phrases presented in bold have the meaning given to them in:
2. the glossary, or
3. if not defined in the glossary, the NER.
4. Any example, figure or explanatory box in this mechanism is for guidance only.

## Processes for revision

1. The AER may amend or replace this mechanism from time to time in accordance with clause 6.6.3A (e) of the NER and the distribution consultation procedures.

## Version history and effective date

1. A version number and an effective date of issue will identify every version of this **mechanism**.

# The demand management innovation allowance mechanism

1. This **mechanism** provides a **distributor** with an annual, ex-ante allowance in the form of a fixed amount of additional revenue at the commencement of each **regulatory year** of the **regulatory control period**.
2. In the second **regulatory year** of the subsequent **regulatory control period**, when the **distributor's** expenditure under this **mechanism** for the **regulatory years** of the preceding **regulatory control period** are known, a single adjustment will be made to recover the amount of any underspend, and of any unapproved expenditure, from the distributor.
3. When a **distributor** receives funding under this **mechanism**, it must submit annual reports on its activities, expenditures, projects and programs undertaken in a **regulatory year** to the **AER** for **publication** in accordance with the compliance requirements set out in clause 2.3.
4. The **AER** will consider the **mechanism's** outcomes through an annual review process.
5. By the end of the first month of each **regulatory year**, a **distributor** may apply for an up-front, indicative approval for planned expenditure under this **mechanism** as set out in clause 2.2.2.
6. The steps involved in the operation of this **mechanism** are as follows:
7. The **AER** will determine how this **mechanism** will apply to a **distributor**, including the cap on the allowance available under this **mechanism,** in accordance with clause 2.1.
8. The **distributor** must identify **eligible projects** against the **AER's** **project criteria** in accordance with clause 2.2, and must implement these projects.
9. The **distributor** must submit annual **compliance reports** in accordance with clause 2.3.
10. The **AER** will calculate, determine, and apply any carryover amount in accordance with clauses 2.4 and 2.5.

Figure 1: Outline of mechanism operation

## Application of the mechanism

1. The **AER** will determine how this **mechanism** will apply to a **distributor** for a **regulatory control period** through the following process:
2. The **AER’s framework and approach paper** for a **distributor** will set out whether the **AER** intends to apply this **mechanism** to that **distributor's** forthcoming distribution determination under clause 6.8.1(b)(2)(vi) of the **NER**.
3. A **distributor's regulatory proposal** must:
	* 1. Include a description, including relevant explanatory material, of how it proposes this **mechanism** should apply for the relevant **regulatory control period**; and
		2. Detail how its proposed approach would satisfy the requirements of the National Electricity Law and **NER**.
4. The **AER’s** distribution determination for the **distributor** will set out how this **mechanism** is to apply to the **distributor** in the relevant **regulatory control period** under clause 6.12.1(9) of the **NER**.
5. Without otherwise limiting clause 2.1(1)(c), the **AER** must apply this **mechanism** to the **distributor** in a distribution determination in the following manner:
6. The **AER** must calculate and determine the maximum amount of the allowance under this mechanism for the regulatory control period. This amount must be calculated and determined as the sum of:
	* 1. $200,000 (in 2017 dollars, where the **AER** accounts for inflation using **CPI**) for each **regulatory year** in the **regulatory control period**; and
		2. 0.075% of the **distributor's MAR** as determined in that **distribution determination** at the time the **distribution determination** is first made.
7. The **AER** must set out, in the distribution determination, how the carryover of any underspend of the allowance under this **mechanism** will be applied in accordance with clause 2.5.

|  |
| --- |
| Example 1:0.075% of a **distributor's** MAR was $4.8 million (real dollars at time t), in its distribution determination made at time t, under subclause 2.1(2)(a) of this **mechanism**,. Given this, the **AER** would grant a **distributo**r a total allowance of $5 million (being the sum of $4.8 million and $200 000) over the **regulatory control period**.Under subclause 2.1(2)(a) of this **mechanism**, the **AER** might determine to provide this allowance in five instalments of $1 million (real dollars at time t) — one in each **regulatory year** of the **regulatory control period**. The amount spent under this **mechanism** in any one **regulatory year** is at the **distributor's** discretion. However, the total amount recoverable over the five **regulatory years** cannot exceed $5 million (real dollars at time t). The **distributor** would have the flexibility to select an expenditure profile that suits its circumstances, subject to remaining within the approved cap.  |

## Identifying eligible projects

1. An eligible project is a project that is eligible to receive funding under this mechanism. To be an eligible project, a project must satisfy the **project criteria**.

### Project criteria

1. An **eligible project** must:
2. be a project or program for researching, developing or implementing **demand management** capability or capacity;
3. be innovative, in that the project or program:
	* 1. is based on new or original concepts;
		2. involves technology or techniques that differ from those previously implemented or used in the **NEM**; or
		3. is focused on customers in a market segment that significantly differs, from those previously targeted by implementations of the relevant technology, in relevant geographic or demographic characteristics that are likely to affect demand; and
4. have the potential, if proved viable, to reduce long term network costs.
5. A project or program is not an **eligible project** if any part of the costs of the project or program are:
	* 1. recoverable under any other jurisdictional incentive scheme;
		2. recoverable under any state or Australian Government scheme; or
		3. otherwise included in forecast capital expenditure or operating expenditure approved in the **distributor's** distribution determination.

### Option for indicative up-front consideration by the AER

1. A **distributor** may apply for the indicative up-front consideration of a project or program under this **mechanism** by the **AER**.
2. To apply for indicative up-front consideration, a **distributor** must provide details of the proposed project or program under this **mechanism**, including details of the **distributor's** proposed expenditure on the project or program,to the **AER** before the end of the first month of the **regulatory year** in which the **distributor** proposes to first incur expenditure on the project or program.
3. The **AER** will provide an in-principle indication of whether the proposed project or program (including the proposed expenditure on the project or program) is likely to satisfy the **project criteria**.

## Compliance reporting

1. For each **regulatory year**, a **distributor** must submit a **compliance report** to the **AER** no later than 4 months after the end of the **regulatory year** to which the **compliance report** relates.
2. The **distributor** must submit each **compliance report** in a form suitable for publication.
3. Each **compliance report** must include, for the **regulatory year** to which the **compliance report** relates:
4. the amount of the allowance spent by the **distributor**;
5. a list and description of each **eligible project** on which the allowance was spent; and
6. a summary of how and why each **eligible project** complies with the **project criteria**.
7. For each **eligible project** on which the allowance was spent, and in a form that is capable of being published separately for each individual **eligible project**, a project specific report that identifies and describes:
	* 1. The nature and scope of the **eligible project**;
		2. The aims and expectations of the **eligible project**;
		3. How and why the **eligible project** complies with the **project criteria**;
		4. The **distributor's** implementation approach for the **eligible project**;
		5. The **distributor's** outcome measurement and evaluation approach for the **eligible project**;
		6. The costs of the **eligible project**:
8. incurred by the **distributor** to date as at the end of that **regulatory year**;
9. incurred by the **distributor** in that **regulatory year**; and
10. expected to be incurred by the **distributor** in total over the duration of the **eligible project**.
	* 1. For ongoing **eligible projects**:
11. a summary of project activity to date;
12. an update of any material changes to the project in that **regulatory year**; and
13. reporting of collected results (where available).
	* 1. for **eligible projects** completed in that **regulatory year**:
14. reporting of the quantitative results of the project;
15. an analysis of the results; and
16. a description of how the results of the **eligible project** will inform future **demand managemen**t projects.
	* 1. any other information required to enable an informed reader to understand, evaluate, and potentially reproduce the **demand management** approach of the **eligible project**.
17. Where an **eligible project** has extended across more than one **regulatory year** of the **regulatory control period**, details of the actual expenditure on each such project or program in each **regulatory year** of the **regulatory control period** to date.
18. A statement signed by a director of the **distributor** certifying that the costs of each **demand management** project:
	* 1. are not recoverable under any other jurisdictional incentive scheme;
		2. are not be recoverable under any state or Australian Government scheme; and
		3. are not otherwise included in forecast capital expenditure or operating expenditure approved in the **AER's** distribution determination for the **regulatory control period** under which the **mechanism** applies, or under any other incentive scheme in that distribution determination.
19. The **confidentiality guidelines** apply to the information contained in **compliance reports**. If the **distributor's** compliance report contains confidential information, the distributor must also provide a non-confidential version of the report in a form suitable for **publication**. The **AER** may publish the **compliance report** (or the non-confidential version of the **compliance report**, if applicable) on its website, including by publishing a separate report for each **eligible project** as contemplated by clause 2.3.3(d) above.

## AER review and determination

1. The **AER** will review the expenditure a **distributor** has incurred in each **regulatory year** in relation to this **mechanism** to ensure compliance with the **project criteria**.
2. For each **regulatory year**, the **AER** will determine, and inform the **distributor** of, the amount of the allowance recoverable by the **distributor** in accordance with this **mechanism** as at the end of that **regulatory year**.
3. The total amount of expenditure determined by the **AER** as recoverable by the **distributor** for a **regulatory control period** will not exceed the cap of the allowance recoverable determined under clause 2.1.

## Application of carryover

1. Once all relevant information (including the content of each **compliance report**) for a **regulatory control period** becomes available after the end of the **regulatory control period**, the **AER** will calculate any carryover amount, C to account for:
2. any amount of allowance unspent or not approved over the **regulatory control period**; and
3. the time value of money accrued or lost as a result of the expenditure profile that the **distributor** selected.
4. At the end of the **regulatory control period** with N regulatory years, the **AER** will calculate a carryover amount, C to be deducted from the **distributor's MAR** in **regulatory year** 2 of the subsequent **regulatory control period**, in accordance with equation 1.

Equation 1: Carryover amount, C for subsequent regulatory control period

$$C=-\left[\sum\_{t=1}^{N}\frac{R\_{t}-A\_{t}}{\left(1+r\_{t}\right)^{t}}\right]×\prod\_{t=1}^{N+2}(1+r\_{t})^{t}$$

Where:

* t is a **regulatory year**. It takes the value of an integer between 1 and N+2, where N is the number of regulatory years in the distributor's regulatory control period for which the carryover is being calculated.
* $R\_{t}$ is the ex-ante revenue allowance under this **mechanism** for **regulatory year**, t.
* $A\_{t}$ is the expenditure approved ex-post under this **mechanism** for **regulatory year**, t.
* $r\_{t}$ is the **allowed rate of return** in **regulatory year**, t. In equation 1, t can take the value of 1 to N+2, with 1 referring to the first regulatory year of the **regulatory control period** in which the expenditure was incurred, and N+2 referring to the second regulatory year of the subsequent **regulatory control period**.
1. For clarity, equation 1 calculates the carryover amount, C, so the distributor is revenue neutral (that is, net present value = 0) to the profile of expenditure approved by the AER over the regulatory control period.[[1]](#footnote-1) That is, equation 1 can be rearranged as follows:

$$C+\left[\sum\_{t=1}^{N}\frac{R\_{t}-A\_{t}}{\left(1+r\_{t}\right)^{t}}\right]×\prod\_{t=1}^{N+2}(1+r\_{t})^{t}=0$$

# Glossary

| Shortened form | Extended form |
| --- | --- |
| AER | Australian Energy Regulator |
| allowance objective | the demand management innovation allowance objective, as defined in the NER |
| confidentiality guidelines  | the document published by the AER entitled "Confidentiality Guideline, November 2013", as amended or replaced by the AER from time to time. |
| compliance report | the compliance report required under clause 2.3(1) of this mechanism |
| CPI | the headline Consumer Price Index, calculated as the weighted average of eight capital cities |
| demand management  | network demand management - that is the act of modifying the drivers of network usage. |
| distributor | distribution network service provider |
| eligible project | has the meaning given in clause 2.2(1)  |
| MAR | Maximum Allowed Revenue, as defined in the NER |
| mechanism | Demand Management Innovation Allowance Mechanism |
| NEM | National Electricity Market, as defined in the NER |
| NEO | National Electricity Objective as defined in the National Electricity Law |
| NER | National Electricity Rules |
| non-network option | as defined in chapter 10 of the NER |
| project criteria | the criteria set out in clause 2.2(1) of this mechanism |

1. This includes an adjustment to account for the time value of money in the first two years of the subsequent regulatory control period. [↑](#footnote-ref-1)