Draft
Demand Management Incentive Scheme

Electricity distribution network service providers

August 2017
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1 Nature and authority

1.1 Introduction

(1) In accordance with the requirements of clause 6.6.3 of the NER, this publication sets out the AER’s demand management incentive scheme for distribution network service providers.

1.2 Authority

(1) Clause 6.6.3 of the NER requires the AER to develop a scheme in accordance with the distribution consultation procedures.

1.3 NER requirements

(1) Clause 6.6.3 of the NER requires the AER develop a scheme consistent with the demand management incentive scheme objective.

(2) The demand management incentive scheme objective is to provide distributors with an incentive to undertake efficient expenditure on relevant non-network options relating to demand management (the scheme objective).

(3) In developing, and applying, any scheme, the AER must take into account the following:

(a) the scheme should be applied in a manner that contributes to the achievement of the scheme objective;

(b) the scheme should reward distributors for implementing relevant non-network options that deliver net cost savings to retail customers;

(c) the scheme should balance the incentives between expenditure on network options and non-network options relating to demand management. In doing so, the AER may take into account the net economic benefits delivered to all those who produce, consume and transport electricity in the market associated with implementing relevant non-network options;

(d) the level of the incentive:

   i. should be reasonable, considering the long term benefit to retail customers;

   ii. should not include costs that are otherwise recoverable from any another source, including under a relevant distribution determination; and

   iii. may vary by distributor and over time;

(e) penalties should not be imposed on distributors under any scheme;

(f) the incentives should not be limited by the length of a regulatory control period, if such limitations would not contribute to the achievement of the scheme objective; and

(g) the possible interaction between the scheme and:
i. any other incentives available to the distributor in relation to undertaking efficient expenditure on, or implementation of, relevant non-network options;

ii. particular control mechanisms and their effect on a distributor's available incentives referred to in sub-paragraph (i); and

iii. meeting any regulatory obligation or requirement.

(h) The AER:

i. must develop and publish the scheme; and

ii. may, from time to time, amend or replace the scheme developed and published under clause 6.6.3 of the NER, in accordance with the distribution consultation procedures.

1.4 AER objectives

(1) The AER's objectives for this scheme are that it:

(a) contributes to the achievement of the National Electricity Objective.

(b) is consistent with the principles in clause 6.6.3 of the NER.

1.5 Confidentiality

(1) The AER's obligations regarding confidentiality and the disclosure of information provided to it by a distributor are governed by the Competition 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.

1.6 Definitions and interpretation

(1) In this scheme, the words and phrases presented in bold have the meaning given to them in:

(a) the glossary, or

(b) if not defined in the glossary, the NER.

(2) Any example, figure, or explanatory box in this scheme is for guidance only.

1.7 Processes for revision

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

1.8 Version history and effective date

(1) A version number and an effective date of issue will identify every version of this scheme.
2 The demand management incentive scheme

(1) The steps involved in the operation of this scheme are the following:

(a) The AER will determine how this scheme will apply to a distributor in accordance with section 2.1.

(b) The distributor must identify eligible projects and must commit to those projects as committed projects in accordance with section 2.2.

(c) The distributor must determine the project incentive for eligible projects in accordance within section 2.3.

(d) The distributor must prepare and submit a compliance report in accordance with section 2.4

(e) The AER will determine the total financial incentive available to the distributor under this scheme for each regulatory year of a regulatory control period in accordance with sections 2.5 and 2.6.

(f) The total financial incentive determined by the AER for the regulatory year $t-2$ will be included in the distributor’s annual revenue requirement for regulatory year $t$. 
2.1 Application of the scheme

(1) The AER will determine how, if at all, this scheme will apply to a distributor for a regulatory control period through the following process:

(a) The AER’s framework and approach paper for a distributor will set out whether the AER intends to apply this scheme to that distributor’s forthcoming distribution determination under clause 6.8.1(b)(2)(vi) of the NER.

(b) The distributor’s regulatory proposal must include a description, including relevant explanatory material, of how it proposes this scheme should apply for the relevant regulatory control period. The distributor’s regulatory proposal must also detail how its proposed approach would satisfy the requirements of the National Electricity Law and NER.
(c) The AER’s distribution determination for the distributor will set out how, if at all, this scheme is to apply to the distributor in the relevant regulatory control period under NER cl. 6.12.1(9).

(2) Without otherwise limiting clause 2.1(1)(c), when the AER applies the scheme to a distributor, it must do so in that distributor’s distribution determination. The distribution determination must provide that the cost multiplier applicable to any eligible project will be the cost multiplier specified in the version of this scheme that is in effect under clause 6.6.3 of the NER at the time at which an eligible project becomes a committed project (that is, \( d_v \) — the cost multiplier \( d \), in version \( v \) of this scheme).

2.2 Identifying and committing eligible projects

(1) An eligible project is a project that a distributor has identified, in accordance with clause 2.2(4), as being an efficient non-network option relating to demand management, but that has not had expenditure committed to it by the distributor before the first application of this scheme to the distributor in a distribution determination.

(2) An ‘efficient non-network option’ is a non-network option that is a credible option to meet an identified need on the distribution network, where that credible option is the preferred option.

(3) To be an eligible project, the NPV of the project’s net economic benefit to all those who produce, consume and transport electricity in the relevant market must be positive when assessed against a base case of:

(a) The network option with the highest net economic benefit to all those who produce, consume and transport electricity in the relevant market, where the project is for reliability corrective action.

(b) Doing nothing, where the project is not for reliability corrective action.

(4) A distributor must identify whether a project is an efficient non-network option by completing at least one of the following processes.

(a) the AER’s regulatory investment test for distribution (RIT–D); or

(b) the minimum project evaluation requirements.

(5) In determining by means of the minimum project evaluation requirements whether a project is an efficient non-network option, including when estimating the NPV of the net economic benefit of a project as part of that process, the distributor must include:

(a) Costs and benefits of a kind that accrue to consumers via the distribution network.

(b) To the extent they exist and may affect the distributor’s identification of the preferred option:

i. Costs and benefits of a kind that accrue to consumers via parts of the relevant market other than the distribution network; and
ii. Benefits that consist of option value.

### 2.2.1 Minimum project evaluation requirements

1. This clause 2.2.1 sets out the **minimum project evaluation requirements** for the purposes of clause 2.2(4)(b) of this **scheme**.

2. Where an **identified need** on its **distribution network** could be fully or partly addressed by a **demand management** solution, a **distributor** must issue a **request for demand management solutions** to the following parties:

   (a) Persons registered on its **demand side engagement register**.

   (b) Any other parties the **distributor** may identify as having or potentially having the capabilities to provide a **demand management** product, service or solution to either fully or partly form a **credible option** to address the **identified need** on the **distribution network**.

3. A **request for demand management solutions** may include, but need not include, a request for a quote.

4. As part of the **request for demand management solutions**, the **distributor** must provide the following information:

   (a) A description of the **identified need** that the **distributor** is seeking to address.

   (b) Technical information about the **identified need**, including the load at risk, energy at risk, duration and load curves, and the annual probability and frequency of relevant events.

   (c) The location of the **identified need** and a description of the affected classes of customers and network area.

   (d) A description of the project it has identified as its **preferred option** to meet the **identified need** on the **distribution network**.

   (e) Other information that is sufficient to enable the parties receiving the **request for demand management solutions** to provide an informed response in presenting an alternative potential **credible option**, including, to the extent relevant, the information that a distributor is required under the **NER** to provide in a **non-network options report**.

5. A **request for demand management solutions** must require the provision of the following information:

   (a) A description of the proposed **demand management** product, service or solution that is put forward as a **credible option**, or as part of a **credible option**, to address the **identified need** on the **distribution network**.

   (b) Where the proposed **demand management** product, service or solution is put forward as part of a **credible option** (but not as the whole of a **credible option**), a description of the other elements of the **credible option**.

   (c) A reasonable estimate of:
i. The proposed product, service or solution's expected outputs, including the amount of network demand (based on a specified kVA per year) that the party responding to the request for demand management solutions expects to be able to manage (either at its request or at its control).

ii. The expected payments that the distributor would be required to make to the responding party if the distributor were to enter into a contract with the responding party for the responding party to provide that product, service or solution to the distributor.

(d) Any other information relevant to determining where the proposed product, service or solution would be a credible option, or part of a credible option, to address the identified need on the distribution network

2.2.2 Committed projects

(1) Project incentives under this scheme are only available for committed projects. An eligible project becomes a committed project where the requirements of this clause 2.2.2 are satisfied and if:

(a) the distributor enters into a demand management contract with another legal entity to procure the demand management required to deliver that preferred option; or

(b) An officer or employee of the distributor delegated by the chief executive officer of the distributor, and who has responsibility for network planning by the distributor, approves a demand management proposal for the distributor to provide to itself the demand management required to deliver that preferred option. This approval must include a declaration by the delegate of the chief executive officer that he or she has a reasonable basis for being of the view that the estimated costs of providing that demand management set out in the demand management proposal are reasonable and were estimated in accordance with an approach commonly used by the distributor, as at the date of the approval, for estimating costs of that kind.

(2) A demand management contract is a contract under which the distributor agrees to make payments to another legal entity in return for the other legal entity agreeing to ensure that, by means of the relevant eligible project, network demand can be managed, at the distributor's or other legal entity's request or control by an amount that is based on a specified kVA per year.

(3) A demand management proposal is a proposal that, when implemented, will ensure that, by means of the relevant eligible project, network demand can be managed, at the distributor's request or control, by an amount that is based on a specified kVA per year, and that sets out the costs that the distributor expects to incur in managing, or having the capacity to manage, the distributor's network demand in this manner.

2.3 Determining project incentives
(1) For each committed project, the distributor must calculate the project incentive that the committed project (referred to in this clause 2.3 as 'project i') can receive.

(2) The distributor must calculate project i’s project incentive in accordance with equation 1, which sets this cap to the lower of the following two values:

(a) The expected present value at time \( t \) of project i’s demand management costs, multiplied by the cost multiplier.

(b) The expected present value at time \( t \) of the net benefit to all those who produce, consume and transport electricity in the relevant market under project i.

(3) In this scheme (version, \( v = 1 \)), the cost multiplier \( d_v = d_1 = 50\% \).

**Equation 1: Project incentive calculation**

\[
PV \text{ incentive}_i = d_v \times E[PV \text{ DMcost}_i]
\]

Subject to the constraint:

\[d_v \times E[PV \text{ DMcost}_i] \leq E[NPV_i]\]

Where:

- Subscript \( i \) means the parameter concerns eligible project \( i \).
- PV is the present value at time \( t \). A parameter following PV is in real dollars at time \( t \).
- \( incentive_i \) is the project incentive for each project \( i \).
- \( E[.] \) denotes an expected value.
- \( DMcost_i \) is project i’s demand management costs.
- \( NPV_i \) is the net present value of option \( i \) to all those who produce, consume and transport electricity in the relevant market.

(4) The expected value of project i’s demand management costs used for the purposes of clause 2.3(2)(a) and equation 1 must be consistent with:

(a) The payments, or potential payments for the demand management solution under the demand management contract or in the demand management proposal (as relevant); and

(b) The distributor’s reasonable expectation of the frequency and duration on which it will call on or utilise the capability to control network demand under the demand management proposal or the demand management contract (as relevant). In order to determine this expectation, the distributor must probabilistically determine the amount of network demand that it expects to control.

(5) A distributor must calculate the expected present value of project i’s net benefit to all those who produce, consume and transport electricity in the relevant market referred to in clause 2.3(2)(b) and equation 1 in accordance with the requirements for carrying out cost–benefit analysis that are set out in the RIT–D. This includes the requirement that the distributor estimate project i’s net benefit relative to ‘the base case’, being:
(a) where distributor does not implement a credible option to address the identified need; or

(b) if the identified need is for reliability corrective action, where the distributor implements its preferred network option.

2.4 Compliance reporting

(1) For each regulatory year, a distributor must submit a demand management compliance report to the AER no later than 4 months after the end of that regulatory year to which the reported data pertains.

(2) The compliance report must be reviewed in accordance with the assurance requirements set out in the annual reporting regulatory information notice applicable to the distributor, at the distributor’s expense and by a person permitted to conduct such a review under that regulatory information notice.

(3) Each compliance report must include two parts—Part A and Part B. Part A includes information on committed projects and Part B contains information on projects that the distributor has identified as eligible projects.

(4) Each compliance report must include the following information in Part A:

(a) A description of the eligible projects that became committed projects in that regulatory year, for which the distributor is claiming a project incentive for in that regulatory year.

(b) The volume of demand management delivered by committed projects in that regulatory year (that is, the kVA per year of demand that a distributor controlled (either directly or indirectly) by means of committed projects in that regulatory year).

(c) The distributor’s estimate of the benefits realised from the demand management delivered by committed projects in that regulatory year.

(d) The total financial incentive that the distributor has assessed that it able to claim in accordance with clauses 2.2, 2.3 and 2.5 of this scheme, for that regulatory year.

(5) For each eligible project that a distributor identifies as a preferred option in a regulatory year, Part B of the compliance report relating to that regulatory year must include the following information about that eligible project:

(a) In present value terms, the expected costs and benefits that the distributor determined, in accordance with clause 2.2, that the eligible project would deliver to electricity consumers.

(b) A description of the responses that the distributor received to either its RIT–D or its request for demand management solutions under the minimum project evaluation requirements (as relevant) including, for each response:

i. a short description of the proposed project;

ii. the proposed costs and deliverables put forward in the response to the request for demand management solutions; and
iii. for any response that proposed a potential credible option, the distributor’s estimate of that project’s net economic benefit to all those who produce, consume and transport electricity in the relevant market.

(c) Identify whether, if the distributor decides (or has decided) to proceed with the project as a committed project, it is likely that this will occur via a demand management contract, or whether this is likely to occur via a demand management proposal. If the former, the compliance report must also identify the proposed party or parties to the demand management contract.

(d) The expected costs of delivering demand management, by means of the eligible project, that the distributor used as an input into its assessment, under clause 2.2, that the project is an efficient non-network option in relation to demand management.

(e) the kVA per year of network demand that the distributor:
   i. would be able to call upon, dispatch or control if the project is implemented (that is, the kVA per year of demand management capacity); and
   ii. expects to call upon, dispatch or control, based on its probabilistic assessment of future demand, if the project is implemented.

(6) Where a distributor decides, in a regulatory year, to defer or not proceed with an eligible project that it has previously decided (either in that regulatory year or in a previous regulatory year) to proceed with as a committed project, the distributor must identify that decision and project in its compliance report for that regulatory year.

(7) Where a distributor decides, in a regulatory year, to proceed with a network option to meet an identified need that it had previously decided to meet by means of a project that was a committed project, the distributor must identify that network option and committed project in its compliance report for that regulatory year.

(8) 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.

2.5 Accruing of project incentives

(1) A project incentive accrues to a distributor when its eligible project becomes a committed project.

(2) The total financial incentive that a distributor can accrue across all committed projects under this scheme in year $t$ is limited to 1.0 per cent of the annual smoothed revenue requirement (AR) for year $t$.

(3) The total financial incentive that a distributor can include in the distributor’s annual revenue requirement in regulatory year $t$ is the total financial incentive
accrued by the distributor in regulatory year \( t-2 \). That is, the total financial incentive that can be included in a distributor’s annual revenue requirement in year \( t \) is calculated as Total financial incentive\(_t\) in equation 2.

**Equation 2: Total financial incentive paid in year \( t \) under the scheme**

\[
\text{Total financial incentive}_t = \sum_{i=1}^{N} \text{incentive}_{i,t-2}
\]

Subject to the constraint:

\[
\text{Total financial incentive}_t \leq AR_{t-2} \times 1\%
\]

Where:
- \( \text{Total financial incentive}_t \) is the total financial incentive paid in year \( t \).
- \( \sum_{i=1}^{N} \text{incentive}_{i,t-2} \) is the summation of the project incentives accrued to \( N \) number of projects, \( i \) in year \( t-2 \).
- \( AR_{t-2} \) is a distributor’s annual smoothed revenue requirement for year \( t-2 \).

**Explanatory box for equation 2:**

Equation 2 calculates the total financial incentive that a distributor can include in its annual revenue requirement for the regulatory year \( t \) (‘incentive paid in year \( t \>').

The incentive paid in year \( t \) to a distributor equals the summation of all project incentives that a distributor accrued in year \( t-2 \) to eligible projects under this scheme.

The incentive paid in year \( t \) to a distributor must not exceed 1.0 per cent of its annual smoothed revenue requirement in year \( t-2 \).

**Example: Calculating the total financial incentive**

(4)

(5)

(6) Table 1 provides an illustrative example of how to apply clauses 2.5(1)–(3). In this example, the constraint in equation 2 does not bind for the committed projects in year 1, but binds for the committed projects in year 2. The numbers in table 1 are real figures and are in year 1 dollars.

(7) In this example, a hypothetical distributor is undertaking three eligible projects. These projects have the following project incentives:

- \( PV \text{ incentive}_1 = $2 \text{ million} \) that accrues when project 1 becomes a committed project in year 1.
- \( PV \text{ incentive}_2 = $3 \text{ million} \) that accrues when project 2 becomes a committed project in year 2.
o $PV$ incentive$_3 = $1.5$ million that accrues when project 3 becomes a committed project in year 2.

### Table 1: Illustrative example of incentive calculation ($ million, year 1$)

<table>
<thead>
<tr>
<th>Time</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incentive accrued to project 1</td>
<td>2.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incentive accrued to project 2</td>
<td></td>
<td>3.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incentive accrued to project 3</td>
<td></td>
<td></td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>Total incentive accrued to projects</td>
<td>2.0</td>
<td>4.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1% AR incentive (assumption)</td>
<td>3.1</td>
<td>3.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total incentive accrued (up to cap)</td>
<td>2.0</td>
<td>3.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incentive paid (total accrued with 2 year lag)</td>
<td></td>
<td></td>
<td>2.0</td>
<td>3.2</td>
</tr>
</tbody>
</table>

#### 2.6 Application of the total financial incentive

1. Within 5 months of receiving the distributor's demand management compliance report as required by clause 2.4(1), the AER will determine, and inform the distributor of, the distributor's total financial incentive for the regulatory year $t - 2$ to be included in the distributor's annual revenue requirement for the regulatory year $t$. The AER will make this determination by either:
   
   (a) Approving the amount of the total financial incentive that the distributor submitted in its compliance report, if the distributor:
      
      i. calculated that total financial incentive in accordance with section 2.5 of this scheme; and
      
      ii. complied with this scheme in accruing project incentives in year $t - 2$; or
   
   (b) If the AER identifies a calculation or compliance error by the distributor, determining a revised total financial incentive.

2. The distributor may include the total financial incentive determined or approved by the AER under clause 2.6(1) for the regulatory year $t - 2$ in the distributor's annual revenue requirement for the regulatory year $t$. 
Figure 2: Process for passing through total financial incentive in regulatory year $t$

$t – 2$ years
Distributor accrues the total financial incentive for year $t – 2$

$t – 8$ months
Distributor submits compliance report to the AER under this scheme for year $t – 2$

$t – 3$ months
The AER determines the total financial incentive for the year $t – 2$.

$t – 3$ months
Distributor submits pricing proposal for year $t$ to AER, which includes, as part of its annual revenue requirement, the total financial incentive approved or determined by AER for year $t – 2$

year $t$
Distributor recovers total financial incentive for year $t – 2$ from consumers in year $t$ via distribution use of system charges
## A Glossary

<table>
<thead>
<tr>
<th>Shortened form or term</th>
<th>Extended form or definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AEMC</td>
<td>Australian Energy Market Commission</td>
</tr>
<tr>
<td>AEMO</td>
<td>Australian Energy Market Operator</td>
</tr>
<tr>
<td>AER</td>
<td>Australian Energy Regulator</td>
</tr>
<tr>
<td>allowance mechanism</td>
<td>Demand Management Innovation Allowance Mechanism</td>
</tr>
<tr>
<td>AR</td>
<td>annual smoothed revenue requirement</td>
</tr>
<tr>
<td>committed project</td>
<td>has the meaning given in clause 2.2.2(1)</td>
</tr>
<tr>
<td>compliance report</td>
<td>the demand management compliance report required under clause 2.4(1)</td>
</tr>
<tr>
<td>confidentiality guidelines</td>
<td>the document published by the AER entitled &quot;Confidentiality Guideline, November 2013&quot;, as amended or replaced by the AER from time to time.</td>
</tr>
<tr>
<td>credible option</td>
<td>has the meaning given in clause 5.15.2(a) of the NER</td>
</tr>
<tr>
<td>demand management</td>
<td>for the purpose of this scheme, this relates to network demand management. This is the act of modifying the drivers of network demand to remove a network constraint.</td>
</tr>
<tr>
<td>demand management contract</td>
<td>has the meaning given in clause 2.2.2(2)</td>
</tr>
<tr>
<td>demand management proposal</td>
<td>has the meaning given in clause 2.2.2(3)</td>
</tr>
<tr>
<td>distributor</td>
<td>Distribution Network Service Provider</td>
</tr>
<tr>
<td>efficient non-network option</td>
<td>has the meaning given in clause 2.2(2)</td>
</tr>
<tr>
<td>eligible project</td>
<td>has the meaning given in clause 2.2(1)</td>
</tr>
<tr>
<td>EBSS</td>
<td>Efficiency Benefit Sharing Scheme</td>
</tr>
<tr>
<td>kVA</td>
<td>A kilovolt -ampere or 1,000 volt-amperes</td>
</tr>
<tr>
<td>minimum project evaluation requirements</td>
<td>has the meaning given in clause 2.2.1</td>
</tr>
<tr>
<td>MWh</td>
<td>Megawatt hour</td>
</tr>
<tr>
<td>NEO</td>
<td>National Electricity Objective</td>
</tr>
<tr>
<td>NER</td>
<td>National Electricity Rules</td>
</tr>
<tr>
<td>non-network option</td>
<td>has the meaning given in chapter 10 of the NER</td>
</tr>
<tr>
<td>NPV</td>
<td>Net present value</td>
</tr>
<tr>
<td>preferred option</td>
<td>the credible option that maximises the present value of the net economic benefit to all those who produce, consume and transport electricity in the relevant market, where the credible option and the relevant market are defined in this glossary</td>
</tr>
<tr>
<td>Shortened form or term</td>
<td>Extended form or definition</td>
</tr>
<tr>
<td>----------------------------------------</td>
<td>---------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>project incentive</td>
<td>the financial incentive that a project can accrue, as determined in accordance with equation 1 with respect to a project, i.</td>
</tr>
<tr>
<td>relevant market</td>
<td>The National Electricity Market, where the distributor is a part of that market. Otherwise, the relevant electricity market in which the distributor transports electricity.</td>
</tr>
<tr>
<td>request for demand management solutions</td>
<td>means a request issued under clause 2.2.1</td>
</tr>
<tr>
<td>RIT-D</td>
<td>Regulatory Investment Test for Distribution</td>
</tr>
<tr>
<td>scheme</td>
<td>Demand Management Incentive Scheme</td>
</tr>
<tr>
<td>total financial incentive</td>
<td>means the sum of all project incentives accrued by a distributor in a particular regulator year, capped (where applicable) at the amount set out in clause 2.5(2)</td>
</tr>
</tbody>
</table>